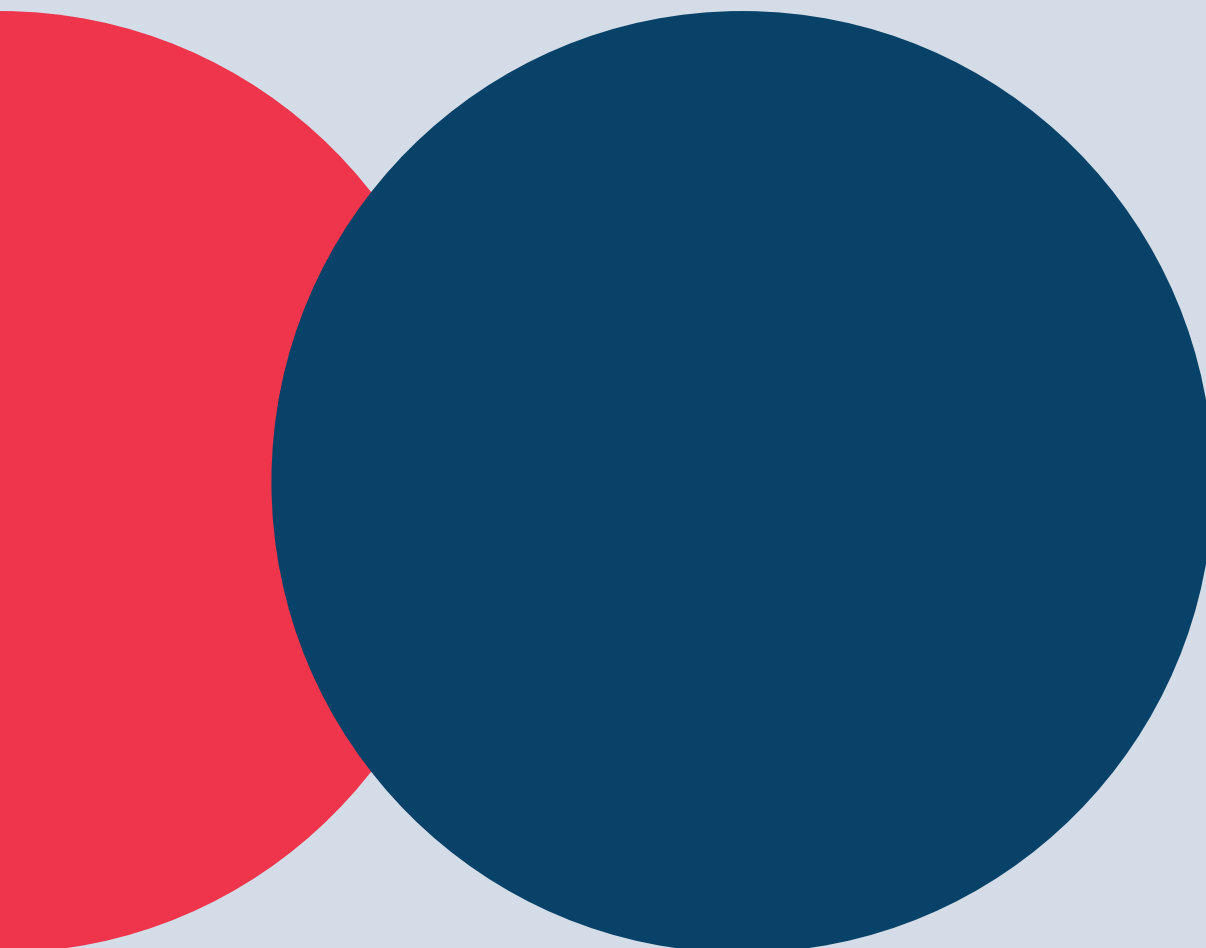


June 2018

CONSULTATION PAPER

BACKDOOR LISTING, CONTINUING LISTING CRITERIA  
AND OTHER RULE AMENDMENTS



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## CONTENTS

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	<b>Page No.</b>
<b>EXECUTIVE SUMMARY</b>	1
<b>CHAPTER 1: INTRODUCTION</b>	6
<b>CHAPTER 2: BACKDOOR LISTING AND PROPOSED RULE AMENDMENTS</b>	9
Proposal A(1)	15
Proposal A(2)	15
Proposal A(3)	16
Proposal A(4)	21
Proposal A(5)	23
Proposal A(6)	26
Proposal A(7)	30
<b>CHAPTER 3: CONTINUING LISTING CRITERIA AND PROPOSED RULE AMENDMENTS</b>	32
Proposal B(1)	37
Proposal B(2)	39
Proposal C(1)	41
Proposal C(2)	42
<b>CHAPTER 4: OTHER PROPOSED RULE AMENDMENTS</b>	43
Proposal D(1)	43
Proposal D(2)	44
Proposal E	45
Proposal F(1)	46
Proposal F(2)	47
Proposal F(3)	48
<b>APPENDICES</b>	
Appendix I:	Draft amendments to the Listing Rules
Appendix II:	Examples of application of “series of arrangements” criterion under the principle based test
Appendix III:	Personal information collection and privacy policy

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10th Floor, One International Finance Centre  
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Hong Kong  
**Re: Consultation Paper on Backdoor Listing,  
Continuing Listing Criteria and Other Rule  
Amendments**

By fax to: (852) 2524-0149

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**Re: Consultation Paper on Backdoor Listing,  
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Amendments**

Our submission enquiry number is (852) 2840-3844.

Respondents are reminded that the Exchange will publish responses on a named basis. If you do not wish your name to be disclosed to members of the public, please state so when responding to this paper. Our policy on handling personal data is set out in Appendix III.

Submissions received during the consultation period by **31 August 2018** will be taken into account before the Exchange decides upon any appropriate further action and a consultation conclusions paper will be published in due course.

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## EXECUTIVE SUMMARY

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1. The Exchange and the SFC have noted market concerns about patterns of problematic corporate behaviours of some listed issuers. In light of these concerns, the Exchange has been conducting an holistic review of its regulation of listed issuers. This Consultation Paper discusses issues and proposals relating to backdoor listing, continuing listing criteria and other Rule amendments.
2. The purpose of this consultation is to consider whether the Rules on backdoor listing and continuing listing criteria should be amended. In recent years, the Exchange has noted an increase in market activities related to the trading of, and the creation of, shell companies. While shell activities are limited to a small segment of the market, these activities invite speculative trading and can lead to opportunities for market manipulation, insider trading and unnecessary volatility in the market which are not in the interest of the investing public. Our proposals are intended to address specific concerns with a view towards maintaining the reputation of our market and quality of listed companies.
3. Separately, we are conducting a review on specific requirements applicable to issuers publishing audited financial statements with disclaimer or adverse audit opinions, with a view to enhancing the quality and reliability of financial information disclosed by issuers.

### Summary of Proposals

4. Our proposals include the following Rule amendments:

### Proposals relating to Backdoor Listing (Chapter 2)

#### 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 criteria 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 criterion “issue of restricted convertible securities” in the principle based test to include any change in control or de facto control of the issuer;

A(3) clarify in the “series of arrangements” criterion:

- (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 three-year period as part of the series; and
- (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. Examples of how this “series of arrangements” criterion would apply under the principle based test are set out in **Appendix II**;

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
- (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;

- 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: (a) the issuer has been operating a principal business with substantial size which will continue after the transaction; 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;
- 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;
  - (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
- 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.

### **Proposals relating to Continuing Listing Criteria (Chapter 3)**

#### *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 to amend the Note to Rule 13.24 to provide guidance on the operation of the Rule; and
- 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.

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

We propose to provide a transitional period of 12-month from the effective date of the Rule amendments for **Proposals B and C** in relation to Rule 13.24 requiring issuers to maintain a sufficient level of operations and assets, and Rules 14.82 to 14.84 on cash companies respectively.

## Other proposed Rule amendments (Chapter 4)

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

D(1) Confine the revenue exemption from the notifiable transaction requirements to purchases and sales of securities only if they are conducted by members of the issuer group that are subject to the supervision of prudential regulators (i.e. banking companies, insurance companies, or securities houses); and

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.

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 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.



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## CHAPTER 1: INTRODUCTION

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5. The Exchange and the SFC have been working together on a number of initiatives with a view to maintaining the quality and reputation of the Hong Kong market. Over the last year, the Exchange announced Rules amendments to address abuses related to large scale deeply discounted capital raising activities, prolonged suspension of trading in some issuers' listed securities, and tightening of the GEM and Main Board new listing requirements<sup>1</sup>. Our review of the Rules relating to backdoor listing and continuing listing criteria forms part of this ongoing holistic review of the Listing Rules.

### **Background**

6. In recent years, the Exchange has noted extensive market commentaries about the creation and trading of listed companies that carry on small scale of operations, and whose market capitalizations are disproportionate to the sizes and prospects of their businesses. The media reported that the significant demand for shell companies for backdoor listings has led to a substantial increase in the value of the listing status, and consequently, some investors acquired control of these issuers for the perceived premium attached to the listing status, rather than the underlying businesses or assets.
7. Shell creation activities involve the listing of new applicants whose sizes and prospects do not appear to justify the cost or purpose associated with a public listing, and listed issuers taking corporate actions to substantially scale down their original businesses, leaving behind very small operations for the purpose of meeting the continuing listing obligations. The Exchange noted that in some cases, listed issuers with failed businesses would attempt to maintain their listing status by establishing new businesses that have a very low barrier of entry and/or can be easily established and discontinued without significant costs. Such actions leave listed issuers with minimal operations, raising concerns about the suitability for listing of these businesses. The Exchange believes that these activities invite speculative trading and can lead to opportunities for market manipulation, insider trading and unnecessary volatility in the market which are not in the interest of the investing public. These activities undermine investors' confidence and overall market quality.

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<sup>1</sup> The Exchange published its consultation conclusions on i) The Review of The Growth Enterprise Market (GEM) and Changes to the GEM and Main Board Listing Rules in December 2017, ii) Capital Raisings by Listed Issuers in May 2018 and iii) Delisting and other Rule Amendments in May 2018.

8. In recent years, the Exchange has conducted a number of reviews of its Rules and adopted practices with a view to improving the regulation of backdoor listings and shell activities. For example, with the increase in backdoor activities in recent years, the Exchange issued Guidance Letter [GL78-14](#) in May 2014 to apply a principle based approach to regulate backdoor listing activities; and Guidance Letter [GL84-15](#) in December 2015 to address circumvention of new listing requirements through the injection of cash into listed shells for the purpose of establishing new businesses.
9. The Exchange has also adopted practices to regulate shell creation activities through new listings. In June 2016, the Exchange issued Guidance Letter [GL68-13A](#) about the suitability for listings of new applicants whose sizes and prospects do not appear to justify the cost or purpose associated with a public listing. In January 2017, the SFC and the Exchange issued a Joint Statement regarding the price volatility of GEM stocks and practices in GEM IPO placings that resulted in high concentrations of shareholdings. In December 2017, the Exchange released its consultation conclusions on the review of the GEM market and announced GEM and Main Board Rule amendments to tighten the new listing requirements<sup>2</sup>.
10. Similarly, the Exchange has taken a robust approach in regulating listed issuers engaging in shell activities, and in the delisting of issuers that are no longer suitable for listing. For example, the Exchange has considered listed issuers with the following characteristics not to meet the continuing listing requirement under Rule 13.24: (i) listed issuers engaged in shell creation activities by disposing of their original businesses and retaining very small operations; (ii) listed issuers that have ceased their original businesses and sought to commence a number of new businesses for the purpose of maintaining the listing status; and (iii) listed issuers whose low level of operations did not warrant their continued listing. Today, the Exchange published Guidance Letter [GL96-18](#) on circumstances where suitability for continued listing under Rule 6.01(4)<sup>3</sup> would be a concern, including circumstances where listed issuers may exhibit “shell” characteristics.

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<sup>2</sup> For details, please refer to the [consultation conclusions](#).

<sup>3</sup> The Rules require that an issuer and its business must be, in the opinion of the Exchange, suitable for listing.

11. The purpose of this consultation is to consider whether the Rules on backdoor listing and continuing listing criteria should be amended. We note that while shell activities are limited to a small segment of the market, these activities undermine investors' confidence and overall market quality. The RTO Rules are anti-avoidance provisions to prevent circumvention of the new listing requirements and as such, should be principle based and provide sufficient flexibility to address changing structures and practices. Our proposals are intended to address specific concerns with a view towards maintaining the reputation of our market and quality of listed companies.
12. Separately, we are conducting a review on specific requirements applicable to issuers publishing audited financial statements with disclaimer or adverse audit opinions, with a view to enhancing the quality and reliability of financial information disclosed by issuers.

### **Purpose of this Paper**

13. Chapter 2 discusses the current RTO Rules, together with our findings and issues concerning backdoor listing. It proposes amendments to the RTO Rules to address specific concerns about circumvention of the new listing requirements.
14. Chapter 3 discusses the continuing listing criteria under the current Rules, our findings and issues concerning shell companies and shell activities. It proposes Rule amendments to enhance the continuing listing criteria and address the issues identified.
15. Chapter 4 proposes other Rule amendments to enhance the requirements in various areas, including (a) securities trading and/or investments by listed issuers; (b) significant distributions in specie; and (c) matters relating to notifiable or connected transactions.
16. Unless otherwise specified, the Rules cited in this Paper refer to the Main Board Rules. The issues and proposals apply equally to the GEM Rules, unless otherwise stated. Drafts of the proposed amendments to the Main Board Rules and the GEM Rules are set out in **Appendix I**.

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## CHAPTER 2: BACKDOOR LISTING AND PROPOSED RULE AMENDMENTS

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17. In this Chapter, we review the current RTO Rules and discuss our findings and issues concerning backdoor listing. We propose Rule amendments to address specific concerns about circumvention of the new listing requirements.

### Current Rules and Practice

18. Rule 14.06(6) applies to treat as a reverse takeover (**RTO**) an acquisition or a series of acquisitions of assets (the **target**) which, in the opinion of the Exchange, constitutes (or is part of a series of transactions or arrangements which constitutes) an attempt to achieve a listing of the assets to be acquired and a means to circumvent the requirements for new applicants under the Rules (the **principle based test**).
19. Rules 14.06(6)(a) and (b) refer to two specific forms of RTOs: (a) an acquisition or a series of acquisitions<sup>4</sup> 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); or (b) very substantial acquisition(s) of assets (individually or in aggregate) from the new controlling shareholder and its associates within 24 months following a change in control (as defined in the Takeovers Code) (the **bright line tests**).
20. The RTO Rules are principle based, anti-avoidance provisions designed to prevent the circumvention of new listing requirements. In May 2014, we issued Guidance Letter [GL78-14](#) to provide guidance on our application of the RTO Rules and particularly, the principle based test. Under the principle based test, the Exchange would take into account six assessment criteria in deciding whether, taking together all the criteria, the transaction would be considered an attempt by the issuer to achieve a listing of the assets to be acquired and to circumvent the new listing requirements. The six criteria include:

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<sup>4</sup> Aggregated under Rules 14.22 and 14.23, which require 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. Factors for consideration include whether the transactions (1) are entered into by the issuer with the same party or with parties connected or otherwise associated with one another; (2) involve the acquisition or disposal of securities or an interest in one particular company or group of companies; (3) involve the acquisition or disposal of parts of one asset; or (4) together lead to substantial involvement by the listed issuer in a business activity which did not previously form part of the listed issuer's principal business activities.

- (a) the size of transaction relative to the size of the issuer;
  - (b) the quality of the business to be acquired—whether it can meet the trading record requirements for listings, or whether it is unsuitable for listing (e.g. an early stage exploration company);
  - (c) the nature and scale of the issuer's business before the acquisition (e.g. whether it is a listed shell);
  - (d) any fundamental change in the issuer's principal business (e.g. the existing business would be discontinued or become very immaterial to the enlarged group's operations after the acquisition);
  - (e) other events and transactions (historical, proposed or intended) which, together with the acquisition, form a series of arrangements to circumvent the RTO Rules (e.g. a disposal of the issuer's original business simultaneously with a very substantial acquisition); and
  - (f) any issue of restricted convertible securities<sup>5</sup> to the vendor which would provide it with de facto control of the issuer.
21. Since then, the Exchange has issued a number of Listing Decisions on the application of the assessment criteria in particular circumstances. In March 2016, it published three Listing Decisions on circumstances where the quality of the target assets was not considered suitable for listing and consequently, these acquisitions were RTOs<sup>6</sup>. These included circumstances where the target assets were newly set up without track record, had reliance issues or were passive investments to the listed issuer. In these cases, given the significant size of the transactions, the acquisitions if completed would result in a fundamental change in the issuers' principal businesses.

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<sup>5</sup> Restricted convertible securities are highly dilutive convertible securities with a conversion restriction mechanism (e.g. restriction from conversion that would cause the securities holder to hold a 30% or larger interest) to avoid triggering a change of control under the Takeovers Code.

<sup>6</sup> See [LD96-2016](#), [LD95-2016](#), and [LD94-2016](#).

22. The Exchange also issued Listing Decision [LD109-2017](#) in June 2017 on the application of the “series of arrangements” criterion to aggregate a proposed acquisition with an acquisition completed by the issuer which together, would lead to the issuer’s substantial involvement in a new business. While the two acquisitions were announced over a 20-month period, it was noted that there was no prescribed fixed time period when assessing arrangements or transactions that would constitute a series. The acquisitions, together with the proposed disposal of the issuer’s original business, would have resulted in a complete change of the issuer’s business.
23. A listed issuer proposing a RTO will be treated as if it were a new listing applicant. Under Rule 14.54 the enlarged group or the assets to be acquired must meet the requirements for new applicants under Rule 8.05 and the enlarged group must meet all other new listing requirements under Chapter 8 of the Rules.

## **Issues and findings**

### *Large scale issue of securities*

24. Following the issue of Guidance Letter [GL78-14](#), the Exchange noted a reduction in the number of very significant acquisitions. However, at the same time, there was a change in the structure of RTO transactions, in part in response to our Guidance Letter. For example, some issuers conducted large scale share subscriptions that resulted in the introduction of new controlling shareholders, they would cause the companies to use the injected funds to start greenfield operations unrelated to the issuers’ original businesses. This is in effect a circumvention of the new listing requirements. The RTO Rules would not apply to the new businesses as there were no acquisitions, but the practical effect was that the new controllers obtained a listed shell to operate a new business.
25. In December 2015 the Exchange issued Guidance Letter [GL84-15](#) on the application of the cash company Rules<sup>7</sup> to large scale issues of securities. Where the Exchange considers that the proposed fundraising would involve investors injecting substantial amounts of cash into an issuer and result in the issuer’s assets consisting substantially of cash upon completion, the cash company Rules (Rules 14.82 to 14.84) would apply and under Rule 14.82, the issuer would not be regarded as suitable for listing and trading in its securities would be suspended. Rule 14.84 would require the issuer to comply with all new listing requirements and issue a listing document to lift the trading suspension.

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<sup>7</sup> Under Rule 14.82, a cash company is a company whose assets consist wholly or substantially of cash or short-dated securities. Once a company is found to be a cash company for any reason, it will not be regarded as suitable for listing and trading in its securities will be suspended.

*Series of transactions and/or arrangements*

26. We noted arrangements whereby listed issuers attempt to circumvent the new listing requirements by building up a new business through a series of smaller acquisitions, or acquiring a new business and then disposing of its original business (**resequencing transactions**). These transactions and/or arrangements, taken together, have the effect of fundamentally changing the nature of the issuer's principal business.
27. The Exchange also noted investors acquiring control of listed issuers and using these issuers as a listing platform to acquire new businesses. The new business or businesses would bear no relationship with the issuer's original business. In some cases, the original business of the issuer would be disposed, terminated or diminished over time, resulting in a complete change of the principal business of the listed issuer. In other cases, the listed issuer would, through a series of acquisitions and greenfield operations, operate multiple new businesses in different sectors. These new businesses may have a very low barrier to entry; can be easily established and discontinued without significant costs; be asset-light or the assets may be highly liquid or marketable. Market commentators commented that these issuers and their major shareholders may be engaged in "shell creation" or "shell maintenance" activities and the new businesses are operated by the issuers for purpose of maintaining their listing status, given the demand for listed "shells".
28. The Exchange has applied the "series of arrangements" criterion under the RTO principle based test to aggregate acquisitions made within a short period and which, together, would lead to a substantial involvement by the listed issuer in a new business completely different from its principal business<sup>8</sup>. In practice, there are ambiguities in the current Rules. For example, as an issuer acquires assets over a period of time to build up its new business, there is a lack of clarity on how to assess the materiality of the new business, as the size of the issuer would progressively get larger over time as a result of the acquisitions.
29. Further, where the issuer acquired a new business before disposing of its original businesses, the current RTO Rules would not apply retrospectively to the completed acquisition. In one case (see Listing Decision [LD113-2017](#)), the Exchange applied Rule 2.04<sup>9</sup> to a proposed disposal by the listed issuer which, was part of its resequencing transactions to avoid the application of the RTO Rules to an earlier acquisition.

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<sup>8</sup> See Listing Decision [LD109-2017](#) published in June 2017.

<sup>9</sup> Under Rule 2.04, "...the Exchange may impose additional requirements or make listing subject to special conditions whenever it considers it appropriate...".

## Proposals

### A. Amend the RTO Rules

30. We propose to amend the RTO Rules as follows:

- (1) retain the principle based test in the RTO Rules (proposed Rule 14.06B) and codify the six assessment criteria currently set out in Guidance Letter [GL78-14](#) (with modifications, see **Proposals A(2) and A(3)** below);
- (2) extend the current criterion “issue of restricted convertible securities” in the principle based test to include any change in control or de facto control of the issuer;
- (3) clarify the “series of arrangements” criterion:
  - (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 three-year period as part of the series; and
  - (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;
- (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



- (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;
- (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;
- (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;
  - (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
- (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.

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

31. The current RTO Rules are anti-avoidance provisions which may be applied to acquisition(s) which, in the opinion of the Exchange, constitutes an attempt to achieve a listing of the assets to be acquired and a means to circumvent the new listing requirements. These provisions give the Exchange broad discretion to deem an acquisition to be a new listing.
32. We consider it important that the RTO Rules should be principle based and not bright line, and believe the current RTO Rules, together with the assessment criteria set out in Guidance Letter [GL78-14](#) (subject to modifications described below), provide a framework for addressing backdoor listing and sufficient flexibility to address changing RTO structures without imposing undue restrictions on legitimate business activities of issuers.
33. We consider that the RTO Rules should not restrict listed issuers from business expansion or diversification that are part of the issuer's business strategies, or are consistent with the issuer's size and resources. The RTO Rules should be targeted towards transactions that represent an attempt to circumvent the new listing requirements, particularly those involving companies engaging in "shell" activities.
34. Accordingly, we propose to codify the six assessment criteria under the principle based test set out in Guidance Letter [GL78-14](#) as a Note to the proposed Rule 14.06B (subject to modifications set out in **Proposals A(2) and A(3)** below).

**Q1 Do you agree with the proposal to codify the assessment criteria under the principle based test in a Note to the proposed Rule 14.06B? If not, why?**

**(2) Extend the current criterion "issue of restricted convertible securities" to include any change in control or de facto control of the issuer**

35. Currently, one of the six assessment criteria involves "any issue of restricted convertible securities to the vendor which would provide it with de facto control of the issuer". We propose to extend this criterion to include any change in control or de facto control of the issuer. We would assess whether there is a change in control or de facto control of the issuer that forms part of a series of arrangements to list a new business.

36. We consider a change in control or de facto control to be a material factor as the major shareholder can appoint the board of directors which oversees the operations and directions of the company. We have noted circumstances where investors acquired control of a listed issuer and subsequently, embarked on acquisitions of businesses that had no relationship to the industry sector in which the issuer operated originally. This is indicative of backdoor listing where the investor would use the listed issuer as a listing platform for other businesses.
37. However, those situations would be distinguished from commercial transactions where an investor acquired control of a listed issuer with a view to developing the underlying business and upon acquiring control, the listed issuer makes further acquisitions as part of its business expansion strategy.
38. In assessing whether there is a change in de facto control of the issuer, the Exchange would consider the influence the new major shareholder may have over the issuer, taking 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 (i.e. convertible securities with a conversion restriction mechanism to avoid triggering a change in control under the Takeovers Code) to a vendor as consideration for an acquisition.

**Q2** *Do you agree with the proposal to extend the current criterion “issue of restricted convertible securities” in the principle based test to include any change in control or de facto control of issuers? If not, why?*

- (3) Clarify the “series of arrangements” criterion to refer to transactions or arrangements that are in reasonable proximity or are otherwise related and normally within a three-year period, and that the RTO Rules may apply to transactions that were previously completed**
39. As noted in paragraph 26 above, some issuers attempt to circumvent the new listing requirements by building up a new business through a series of smaller acquisitions, or acquiring a new business and then disposing of its original business. Assessing these transactions and/or arrangements in totality provides an important safeguard against circumvention of the RTO Rules. These transactions and/or arrangements may include changes in control/de facto control, acquisitions, disposals or termination of the original businesses, and in some circumstances (see paragraphs 44 to 46 below), greenfield operations or equity fundraisings related to, or for the development of, newly acquired businesses.

40. As the current RTO Rules apply to acquisitions only, they may not apply to a proposed disposal of an issuer's original business following an acquisition of a new business, the effect of which would be to list the acquired business<sup>10</sup>. Further, the current Rules and guidance materials do not give guidance on the duration of the period applicable in assessing a series of arrangements, or how the size of the new business would be assessed for the purpose of considering the criterion "size of the target's business relative to the size of the listed issuer's existing business".
41. The "series of arrangements" criterion should address concerns about major shareholders and their issuers conducting a series of smaller transactions and/or arrangements over time to achieve a listing of new businesses. This criterion normally operates with other criteria such as fundamental change in the issuer's principal business; the relative size of the target to the listed issuer; and any change in control or de facto control of the issuer.
- (a) Series of transactions and/or arrangements that are in reasonable proximity or are otherwise related within a three-year period*
42. We propose 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 to each other, or are otherwise related.
43. This criterion is not intended to unduly restrict business expansion or diversification 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. The Exchange will not normally consider a transaction or arrangement outside the three-year period<sup>11</sup> as part of the series, unless there are specific concerns about circumvention of the RTO Rules (for example, proposing a transaction shortly after three years and which accordingly is likely to have been in contemplation inside the three-year period).

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<sup>10</sup> See paragraph 29 where the Exchange applied Rule 2.04 in a case involving a disposal following an acquisition of new businesses by the listed issuer.

<sup>11</sup> For reference, the China Securities Regulatory Commission rules provide for an aggregation period of five years when there is a change in control of the listed company. The Australian Securities Exchange (**ASX**) listing rules provide that generally, the ASX will aggregate a series of acquisitions of similar businesses within 24 months for the purpose of the shareholders' approval requirement. However, if the proposed transaction is, in the opinion of the ASX, a backdoor listing, the ASX will require shareholders' approval and re-compliance with the admission requirements regardless of any prior acquisitions that the issuer may have made, whether in the preceding 24 months or otherwise.

44. As issuers may venture into new businesses over time, the Exchange would not normally include greenfield operations as part of the series unless the issuer operates a business model that involves a combination of acquisitions leading to a new principal business and greenfield operations in that same business. An example involves a change in control and board of directors of the listed issuer (originally engaged in manufacturing), following which the issuer commenced a new business in money lending through greenfield operation, and also acquired companies engaging in money lending business.
45. Similarly, an equity fundraising may be considered as part of the series where there is a clear nexus between the equity fundraising and the acquisition of a new business or greenfield operation in that same business. An example involves equity fundraising as part of the acquisition of a new business, where the issuer intends to apply the funds toward further expansion of the new business<sup>12</sup>.
46. While the RTO Rules normally apply to a listing of a new business, the Exchange may apply the Rules to multiple new businesses in different sectors acquired and/or developed over the three-year period where there is a concern about “shell” activities. This addresses issues cited in paragraph 27 above. For example, this would be the case where the control of the listed issuer changed and subsequently, it commenced to operate a number of new businesses and wound down its original business.
47. Where a series of acquisitions is of a significant size, the issuer’s original business(es) may become immaterial after the acquisitions. The Exchange will consider whether the size of the acquisition is very substantial<sup>13</sup>. When calculating the percentage ratios for acquisitions in a series of transactions, the denominator would be the lower of (i) the issuer’s published financial figure for the immediate past financial period (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. The numerator would be calculated by aggregating the financial figures of the targets acquired and/or to be acquired or the considerations for the acquisitions applicable at the time of the respective acquisitions. This is in line with the approach adopted under the current Rule 14.06(6)(b).

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<sup>12</sup> The Exchange would not double count the effect of the equity fundraising and the acquisition (for example, where the proceeds are to be applied towards the consideration of the acquisition, the equity fundraising would not be aggregated).

<sup>13</sup> It should be noted that under the RTO 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.

48. The Exchange may consider that there is a fundamental change in principal business if the issuer's new businesses are material in size when compared to its original business (i.e. the business it operated before the first transaction/event in the series). When making the assessment, the Exchange would compare the size of the issuer's new businesses in aggregate (the **new businesses**) with that of its original business 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<sup>14</sup>.
- (b) For the purpose of the RTO Rules, the series of transactions and/or arrangements would be treated as if it were one transaction, consequently, it is no longer required for a proposed transaction to be an acquisition to trigger the RTO Rules*
49. In assessing the series of transactions and/or arrangements, the Exchange would consider the effect of all the transactions and/or arrangements in the series as a whole. Consequently, while the 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 may apply to that completed acquisition. For example, a proposed disposal that is a part of a series of arrangements that constitutes a RTO could result in an earlier acquisition being subject to the RTO Rules.
50. We will amend the definition in the RTO Rule 14.06B to clarify that a series of acquisitions of assets by a listed issuer should refer to a series of acquisitions of assets by a listed issuer proposed and/or completed. The entire series would be assessed in considering whether the new business(es) would meet the new listing requirements. See **Proposal A(6)** below on the track record calculation where the series of transactions and/or arrangements falls within the definition of a RTO.
51. Where the proposed (last) transaction in the series involves a disposal or termination of the issuer's original business, both the RTO Rules and the continuing listing requirements (Rule 13.24) may apply. The issuer's remaining business (after the proposed disposal) must meet the continuing listing requirement under proposed Rule 13.24, failing which the issuer may be subject to the delisting procedures under Rule 6.01(3). Additionally, the RTO Rules may apply where the issuer's remaining business was previously acquired and formed part of the series of arrangements in question.

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<sup>14</sup> Where segmental financial information of the new businesses acquired or the original business is not available in the issuers' financial results, issuers should provide appropriate financial figures and other relevant information for the Exchange to assess whether there is any fundamental change in the issuer's principal business(es).

52. The Exchange may impose additional requirements if the issuer attempts to circumvent the RTO Rules through a series of transactions and/or arrangements, and subsequently aborts the latest proposed transaction in the series (e.g. after the Exchange makes a RTO ruling on the series). Where 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, the Exchange 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. In addition, the SFC may, when appropriate, take separate regulatory action (including trading suspension) under the Securities and Futures Ordinance (the **SFO**) and/or the Securities and Futures (Stock Market Listing) Rules.
53. **Appendix II** provides examples that illustrate the operation of the proposal. They include: (1) a series of acquisitions leading to the operation of a new business; (2) acquisitions and funds raised to develop the newly acquired business that together led to the operation of a new business; (3) acquisitions of multiple lines of businesses after a change in control/ de facto control of the issuer that would fundamentally change the issuer's principal business(es); (4) disposal of original business after acquisitions; (5) change in control after acquisition of new business; and (6) a series of arrangements involving disposal, change in control and acquisition.

**Q3 (a) As regards the “series of arrangements” criterion, do you agree with the proposal to include transactions and arrangements that take place in reasonable proximity or are otherwise related and normally within a three-year period? If not, why?**

**(b) Do you agree with the proposal to amend the RTO Rule 14.06B to clarify that a series of acquisitions may include proposed and/or completed acquisitions? If not, why?**

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

**(a) Rule 14.06(6) (proposed Rule 14.06B) - Acquisitions as RTOs**

54. As described in paragraph 19, Rules 14.06(6)(a) and (b) set out the bright line tests and refers to two specific forms of RTO involving a change in control and an acquisition (or a series of acquisitions of assets) from the incoming shareholder within a 24-month period after the change in control (as defined by the Takeovers Code). For clarity, we propose to i) retain these definitions in a Note to the RTO Rules, and ii) extend the period from 24 months to 36 months. The 36-month period aligns with our proposal under the principle based test (see **Proposal A(3)**).

**(b) Rules 14.92 and 14.93 (proposed Rule 14.06E) - Restriction from disposal**

55. Rules 14.92 and 14.93<sup>15</sup> restrict a listed issuer from disposing of its existing business for a 24-month period after a change in control, unless the assets acquired from the new controlling shareholder (and its associates) and any other assets acquired after the change in control can meet the requirements under Rule 8.05 (or Rule 8.05A or 8.05B). These Rules complement the 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 transactions.
56. We propose to amend Rule 14.92 to restrict any material disposal (or a disposal by way of distribution in specie that amounts to a material disposal) of its existing business at the time of or within 36 months after a change in control, unless (i) its remaining business or (ii) the assets injection(s) 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).
57. The proposals will:
- (i) extend the restriction period from 24 months to 36 months to align with our proposal under the principle based test (see **Proposal A(3)**);

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<sup>15</sup> Rules 14.92 and 14.93 address circumvention of the RTO Rules in situations where the new controlling shareholder may structure a RTO as a series of transactions by deferring the disposal of the issuer's existing business until after an injection of assets to the issuer shortly after a change in control.



- (ii) apply the restriction to any material disposal (rather than a disposal) of existing business at the time of, or within the 36-month period after the change of control; and
  - (iii) disapply this restriction if the remaining business of the issuers (and not only any assets acquired after the change in control under the current Rules) can meet the requirements under Rule 8.05 (or Rule 8.05A or 8.05B).
58. Our proposal will align the disposal restrictions under Rule 14.92 with the RTO principle based test (see **Proposal A(3)**). It will apply to the disposal of a principal business of the issuer or a material part of the business. Further, extending the restriction to also apply at the time of the change in control (see paragraph 57(ii) above) would capture shell creation structures where a controlling shareholder of a listed issuer 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.
- (c) Provide the Exchange with a discretion to apply proposed Rule 14.06E to a material disposal of an issuer's existing business within 36 months after a change in the single largest substantial shareholder**
59. We also propose 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 distribution in specie that amounts to a material disposal) of an issuer's existing business where there is a change in the single largest substantial shareholder in the last 36 months before the disposal or distribution. This is to address concerns where a new substantial shareholder acquires de facto control of an issuer and it develops a new business through greenfield operation, and subsequently, disposes of its original business. The series of arrangements and transactions would effectively circumvent the new listing requirements, but not be caught by the proposed RTO Rules as they apply to acquisitions.

**Q4 (a) Do you agree with the proposal to retain the bright line tests under Rules 14.06(6)(a) and (b) in a Note to the proposed Rule 14.06B? If not, why?**

**(b) Do you agree with the proposal to extend the aggregation period from 24 months to 36 months under the bright line test currently set out in Rule 14.06(6)(b)? If not, why?**

**Q5 (a) Do you agree with the proposed changes to Rule 14.92 (proposed Rule 14.06E) as described in paragraph 56? If not, why?**

**(b) Do you agree with the proposal to add a Note to proposed Rule 14.06E as described in paragraph 59? If not, why?**

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

**Guidance Letter**

60. The current 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<sup>16</sup> of the Rules. Where the issuer can demonstrate that the target business meets the eligibility and suitability for listing requirements under Chapter 8, circumvention of the new listing requirements would not be a material concern<sup>17</sup>, Guidance Letter [GL78-14](#) provides that the proposed acquisition may be classified as an extreme VSA.
61. Under Guidance Letter [GL78-14](#), the issuer would be required to prepare a transaction circular under an enhanced disclosure and vetting approach, and to appoint a financial adviser to conduct due diligence with reference to Practice Note 21 of the Rules. The financial adviser is required to provide a declaration to the Exchange in respect of its due diligence on the transaction in the form set out in Attachment 2 of the Guidance Letter.

**Proposal**

62. We propose to codify the extreme VSA requirements under Guidance Letter [GL78-14](#) into the Rules and rename this category of transaction as “extreme transaction”. In assessing whether a transaction would qualify as an extreme transaction, we propose the following additional requirements:

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<sup>16</sup> For GEM issuers, the positive cash flow requirement under GEM Rule 11.12A.

<sup>17</sup> For a transaction to be classified as an extreme VSA, the issuer has to demonstrate that circumvention of the new listing requirements would not be of a material concern. In Listing Decision [LD108-2017](#) published in June 2017, the proposed acquisition was ruled as RTO given concerns about the Target’s ability to satisfy the new listing requirements. In particular, there were concerns about the target’s historical financial information not being representative of its future performance due to significant changes in its business model.

- (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.
63. The Exchange would normally classify an acquisition (or a series of acquisitions) as an “extreme transaction (extreme transactions)” where an issuer conducts very significant business expansions and/or diversifications and the issuer has been operating a business of substantial size, or where the acquisitions arise from group reorganizations. 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.
64. Accordingly, 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 e.g. any significant investments or surplus cash of the issuer, and any revenue or assets attributed to a newly acquired or developed business. The Exchange would also take into account the issuer’s financial position (e.g. whether the issuer has a very small net asset value or in a net liabilities position), the nature and operating model of the issuer’s business and its future business plans in assessing whether its principal business is of substantial size.
65. Under the proposed Rule 14.53A, issuers proposing an extreme transaction must comply with the following requirements:
- (i) comply with the disclosure requirements applicable to a new applicant, and
  - (ii) appoint a financial adviser<sup>18</sup> to perform due diligence on the assets subject to the acquisitions (and any assets and businesses subject to a series of transactions and/or arrangements, if any). The financial adviser is required to submit a declaration regarding the due diligence conducted.

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<sup>18</sup> 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.

66. Where the Exchange considers that an acquisition may fall under the “extreme transaction” category, the transaction would be presented to the Listing Committee for its determination on whether the transaction should be an “extreme transaction” or a RTO. 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 announcement and any additional information requested by the Exchange. 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 target business is able to meet the new listing requirements. Failure to provide sufficient information for the Exchange to make a determination may result in a RTO ruling. Where there is additional information indicating that the target business is not eligible or suitable for listing, or there are any other concerns about circumvention of the new listing requirements, the Exchange will require the issuer to reclassify the acquisition as a RTO.
67. The compliance requirements set out in paragraph 65 above are consistent with those currently required for an “extreme VSA” under Guidance Letter [GL78-14](#).

- Q6** (a) *Do you agree with the proposal to add a new Rule 14.06C for “extreme transactions” as described in paragraph 62? If not, why?*
- (b) *Do you agree with the disclosure requirements for circulars of extreme transactions set out in proposed Rules 14.53A(1) and 14.69? If not, why?*
- (c) *Do you agree with the due diligence requirements for extreme transactions under proposed Rule 14.53A(2)? If not, why?*

**(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 transactions under Rule 14.06C**

**Current Rules**

68. Under current Rule 14.54, the Exchange will treat a listed issuer proposing a RTO as if it were a new listing applicant. The enlarged group or the assets to be acquired (the **acquisition targets**) must be able to meet the track record requirements (Rule 8.05) and the enlarged group must be able to meet all the other basic listing conditions set out in Chapter 8 of the Rules. This requirement also applies to extreme VSAs currently.

**Proposal**

69. We propose to:
- (i) amend Rule 14.54 (applicable to RTOs) and add Rule 14.06C(2) (applicable to extreme transactions) to require that i) both the acquisition targets and the enlarged group must meet Rule 8.04 (i.e. be suitable for listing); and ii) 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).
  - (ii) amend Rule 14.54 to require that where an issuer that has failed to comply with Rule 13.24<sup>19</sup> (**Rule 13.24 issuer**) proposes a RTO, each of the acquisition targets and the enlarged group must meet all the new listing requirements set out in Chapter 8 of the Rules.

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<sup>19</sup> Rule 13.24 requires issuers to carry on a sufficient level of operations or have sufficient assets to maintain its listing. An issuer that does not meet this requirement is normally suspended.

70. The proposal imposes additional requirements that the acquisition targets must meet Rules 8.05 (or Rule 8.05A or 8.05B) and 8.04. This requirement would ensure that where an issuer conducts a RTO or an extreme transaction, the assets acquired would meet the new listing requirements.
71. The Exchange has noted isolated instances where investors would acquire a “listed shell” and conduct a RTO, instead of conducting an initial public offer, due to concerns that the acquisition target might not meet the new listing requirements in Chapter 8. For example, the acquisition targets might not be able to attract a minimum of 300 public shareholders under Rule 8.08(2), or it might not meet Rule 8.07 which requires sufficient public interest in the business of the issuers and the securities for which listing is sought. Accordingly, the proposal also requires a Rule 13.24 issuer to demonstrate that each of the acquisition targets and the enlarged group would meet all the new listing requirements in Chapter 8 of the Rules.
72. For other issuers, the requirements set out in paragraph 69(i) apply. However, where the Exchange is aware of information suggesting that the purpose of the RTO is to circumvent the new listing requirements, we would require the acquisition targets to meet all the new listing requirements.
73. In assessing Rule 8.05 compliance by the enlarged group of a Rule 13.24 issuer, the combined track record of the acquisition targets and the “listed shell” must meet the requirements under Rule 8.05 (or Rule 8.05A or 8.05B). The Exchange would normally disregard the results arising from discontinued operations when assessing Rule 8.05.

**Q7 (a) Do you agree with the proposal to amend Rule 14.54 and to add Rule 14.06C(2) as described in paragraph 69(i)? If not, why?**

**(b) Do you agree with the proposal to amend Rule 14.54 to impose additional requirements on RTOs proposed by Rule 13.24 issuers as described in paragraph 69(ii)? If not, why?**

- (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**

### **Current Rules and Practices**

74. Rule 14.57 requires an issuer proposing a RTO to comply with the procedures and requirements for new listing applications as set out in Chapter 9 of the Rules. Where the RTO involves a series of acquisitions, both the completed acquisition(s) and the proposed acquisition forming part of the RTO are subject to documentary requirements, including the production of accountants' reports and pro forma financial information. As these acquisitions may have taken place over a few years, the current Rules do not provide guidance on how the track record of the acquisitions would be determined and the financial information to be presented.

### **Proposal**

75. We propose to add Rule 14.57A to clarify:
- (i) 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, and
  - (ii) to demonstrate that the series of transactions and/or arrangements as a whole would meet the requirements of Rule 8.05 (or Rule 8.05A or 8.05B), the circular must contain the pro forma income statement<sup>20</sup> of all the acquisition targets in the series of acquisitions. Where applicable, the pro forma income statement may also include new businesses developed by the issuer that form part of the series (see paragraphs 44 to 46 above).

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<sup>20</sup> For a GEM issuer, the circular must contain the pro forma cash flow statement of all the acquisition targets in the series of acquisitions to demonstrate compliance with GEM Rule 11.12A. Where applicable, the pro forma cash flow statement may include new businesses developed by the issuer that form part of the series.

76. For example, if an issuer completed an acquisition of Target A in FY2015 and proposed an acquisition of Target B in FY2017 forming a series of acquisitions, the track record period would be determined with reference to the proposed acquisition (i.e. FY2014 to FY2016). Where the series comprise the FY2015 acquisition and a proposed disposal in FY2017, the track record period for the acquisition would also be determined with reference to the 2017 proposed disposal (i.e. FY2014 to FY2016).
77. Under the proposed Rule 4.30, the pro forma income statement will be presented by combining the historical income statements 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) as if they had been operated as a single group on an aggregated basis since the commencement of the track record period. To demonstrate their compliance with the requirements of Rule 8.05, pro forma income statement must be published for each of the three financial years of the track record period.
78. The proposed Rule 4.30 would also require that the unadjusted information must be derived from the acquisition targets' accountants' reports, and the pro forma financial information must be reported on by the auditors or reporting accountants. These requirements are to provide assurance on the pro forma financial information and are in line with the current Rule 4.29<sup>21</sup>. Accordingly, the issuer must also produce accountants' reports for each of the acquisition targets for the track record period. Applying this to the example in paragraph 76, the circular or listing document must contain the accountants' report of Target A and the accountants' report of Target B for the track record period (i.e. FY2014 to FY2016) and the pro forma income statement of Target A and Target B.

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<sup>21</sup> Rule 4.29 sets out the requirements for pro form financial information to illustrate the impact of a transaction on the issuer's financial position. The pro forma financial information may only be published in respect of (a) the current financial period; (b) the most recently completed financial period; and/or (c) the most recent interim period. Rule 4.29 would not apply to pro forma financial information required under the proposed Rule 14.57A.



79. For the avoidance of doubt, for extreme transactions or RTOs involving a series of transactions and/or arrangements, only the proposed transaction is subject to shareholders' approval.

**Q8 (a) Do you agree with the proposed Rule 14.57A to clarify the track record requirements for extreme transactions and RTOs that involve a series of transactions and/or arrangements? If not, why?**

**(b) Do you agree with the proposed Rule 4.30 that sets out the requirements for preparing 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? If not, why?**

- (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**

80. As described in paragraphs 24 to 25 above, the Exchange has applied the cash company Rules to disallow large scale issues of securities where the funds 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. Guidance Letter [GL84-15](#) explains the circumstances under which the Exchange would apply the restriction.

81. We propose to codify this practice into the RTO Rules. The proposal is intended to apply to a large scale issuance of shares for cash proposed by a listed 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. With the modification, the proposed Rule would apply where the funds raised are to be used to develop a new business through future acquisitions, in addition to greenfield operations as described in Guidance Letter [GL84-15](#).

82. The proposal is not intended to unduly restrict fundraising activities of issuers generally. It will not normally apply to an issue of securities if, taking into account the proceeds from the issue, less than half of the issuer's assets would consist of cash as a result of the fundraising, unless there are specific concerns about circumvention of the Rule.

83. As the proposed Rule is an anti-avoidance provision to prevent circumvention of the new listing requirements, we will retain Guidance Letter [GL84-15](#) which explains its intent and operation.

**Q9** *Do you agree with the proposal to add a new Rule 14.06D to codify, with modification, the practice under Guidance Letter GL84-15 as described in paragraph 81? If not, why?*

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## CHAPTER 3: CONTINUING LISTING CRITERIA AND PROPOSED RULE AMENDMENTS

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84. In this Chapter, we review the continuing listing criteria under the current Rules and propose Rule amendments to address market activities involving listed shells.

### I. Continuing Listing Criteria

#### i) Current Rule on sufficiency of operations

85. Rule 13.24 requires that an issuer must carry out a sufficient level of 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.

86. The Rule itself does not provide guidance on what constitutes "sufficient operations or assets"<sup>22</sup>. In practice, to comply with the Rule, an issuer must demonstrate that it has a **viable and sustainable** business<sup>23</sup>. This is a qualitative test and is assessed based on the specific facts and circumstances of individual issuers.

#### *Application of Rule 13.24*

87. Listing Decision [LD35-2012](#) describes the purpose of Rule 13.24 and provides guidance on its application. Rule 13.24 is intended to maintain overall market quality. Issuers that fail to meet this Rule are "blue sky companies" where public investors have no information about their business plans and prospects. This leaves much room for the market to speculate their possible acquisitions in the future. To allow these issuers' shares to continue to trade and list may have an adverse impact on investor confidence.

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<sup>22</sup> Practice Note 17 (or the Note to Rule 13.24 (effective 1 August 2018) sets out the characteristics of issuers that do not comply with Rule 13.24. 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; or (ii) issuers which have net liabilities as at their balance sheet date.

<sup>23</sup> See Guidance Letter [GL95-18](#) and Listing Decisions [LD97-2016](#), [LD98-2016](#), [LD99-2016](#), [LD88-2015](#) and [LD35-2012](#). Guidance Letter [GL95-18](#) issued in May 2018 requires a company suspended due to insufficient business operations and/or assets to demonstrate to the Exchange's satisfaction that it has a business of substance and is viable and sustainable in the longer term to re-comply with Rule 13.24.

88. Where the continuing listing requirement under Rule 13.24 is not met, the Exchange would suspend trading in the issuer's securities under Rule 6.01(3) for the protection of investors and the maintenance of an orderly market. 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.

*a) Issuers taking corporate actions*

89. In recent years, the significant demand for shell companies has led to an increase in "shell cleansing" activities where issuers dispose of their main businesses and leave very small operations for the purpose of meeting the continuing listing obligations. In some cases the business is disposed of to the existing major shareholders, who would also have sold down their interests in the listed issuer. These activities attract speculative trading in the listed issuers and raise concerns about trading of securities in an orderly manner. Where the issuer cannot demonstrate that the remaining business would be viable and sustainable, the issuer would not meet Rule 13.24 if it continues with the disposal. The Exchange has issued a number of Listing Decisions<sup>24</sup> describing these circumstances.

*b) Issuers involved in shell maintenance*

90. In recent period, the Exchange has taken a robust approach in applying Rule 13.24 to cases where the issuers maintain very low levels of operations. In our view, an issuer should operate a business of sufficient size to justify a listing, as the value of shareholders' investment should correlate with the value and prospects of the business of the listed issuer and not merely or solely on the premium attached to a listing status.

91. In April 2017, the Exchange published Listing Decision [LD105-2017](#) which involves an issuer that ceased its principal business activities, and immediately thereafter, sought to commence a number of new businesses that in aggregate, had very low level of operations. These new businesses had no relation with the issuer's original principal activities, they were mostly trading businesses that were asset-light and with low entry barriers, and relying on a few customers and suppliers. These actions brought into question whether the issuer, operating these businesses, warranted a continued listing.

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<sup>24</sup> See Listing Decisions [LD97-2016](#), [LD98-2016](#), [LD99-2016](#), [LD88-2015](#) and [LD35-2012](#).

92. In November 2017, the Exchange published two Listing Decisions [LD115-2017](#) and [LD116-2017](#) which involve issuers that did not meet Rule 13.24. They have the following characteristics: (i) a very low level of operating activities and revenue; for example the issuer's business does not generate sufficient revenue to cover its corporate expenses, resulting in net losses and negative operating cash flows; (ii) the current operation does not represent a temporary downturn, the issuer had been operating at a very small scale and incurring losses for years; and (iii) the assets do not generate sufficient revenue and profits to support a continued listing.

*c) Issuers failing to carry on business of substance*

93. Concerns about whether a business has substance would also give rise to questions about the viability and sustainability of the issuer's business and its ability to meet Rule 13.24. Circumstances include (i) track record that could not support future performance; (ii) heavy reliance on connected person(s) or particular employee to generate business; and (iii) questions about the basis for substantial fees/ revenue and the substance of those transactions giving rise to the revenue. In October 2017, the Exchange published Listing Decision [LD112-2017](#) about an issuer with these concerns where it was found not to meet Rule 13.24.

**ii) Current Rules on suitability for continued listing**

94. Rules 8.04 and 6.01(4) set out a continuing listing criterion that both an issuer (including a new applicant for listing and a listed issuer) and its business must be, in the opinion of the Exchange, suitable for listing.
95. The suitability criterion provides the Exchange with the discretion to meet its regulatory objectives and its obligations to act in the best interest of the market as a whole and in the public interest. The Exchange may cancel a listing where the suitability issues are fundamental to the general principles for listing and are beyond remedy, or the listed issuer fails to demonstrate a reasonable prospect of addressing the issues and resuming trading within a reasonable period.

96. Issues relating to false accounting, management integrity, illegal operations, and excessive reliance on key customer / supplier or controlling / substantial shareholders may give rise to concerns about an issuer's suitability for listing<sup>25</sup>. As described in the Consultation Paper on Delisting and other Rule Amendments published in September 2017, the Exchange has considered it necessary to adopt a more robust delisting approach towards issuers that are not suitable for listing in the interest of maintaining the reputation of the market.
97. The Exchange has issued Guidance Letter [GL96-18](#) today on listed issuers' suitability for continued listing, citing examples of circumstances where it may raise concerns about the suitability for listing of an issuer or its business. One example involves issuers that have ceased or disposed of their original business and are operating new businesses, where the business models exhibit shell like characteristics and give rise to concerns whether they are operated to maintain a listing status and are suitable for listing. The Exchange noted that certain types of businesses, such as proprietary securities trading, money lending and indent trading may be employed in these circumstances as they can be operated with an asset-light model or with highly liquid assets, are highly dependent on parent or has a high concentration of customers.

## **Requirements in other markets**

### **i) Rule on sufficiency of operations**

98. Our Rule 13.24 is similar to those in other markets such as the UK and Australia. In the UK a company must operate an independent business in order to meet its continuing obligations. In Australia a company must maintain a level of operations which is sufficient to the satisfaction of the Australian Securities Exchange. Those rules provide a principle based approach for regulators to assess if a company has a substantive business.
99. In contrast, some Asian markets such as Shanghai and Singapore have quantitative continuing listing requirements and may delist an issuer if it continues to incur losses for a number of consecutive years, or its assets are below a minimum level. For example, Singapore listed companies failing the quantitative continuing listing requirements are placed on a watch list and required to remedy the situation. Shanghai imposes a delisting risk warning (\*ST) and requires companies that have three years of continued losses to rectify their deficiencies before the prescribed deadline.

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<sup>25</sup> For example, see Listing Decision [LD114-2017](#) issued in October 2017 which concluded that a long suspended issuer with material accounting or corporate governance irregularities would not be considered to be suitable for listing under Rule 6.01(4).

## **ii) Rule on suitability of listing**

100. Our Rule is in line with other markets. For example: The UK Financial Conduct Authority may cancel a listing if it is satisfied that there are special circumstances that preclude normal regular dealings in the securities of a UK listed issuer; the New York Stock Exchange sets out a number of criteria, including any other event or condition which may exist or occur that makes further dealings or listing of the securities on the exchange inadvisable or unwarranted in the opinion of the exchange, or engagement by the issuer or its management in operations contrary to the public interest; and the Toronto Stock Exchange may delist a company on the ground that dealings in the securities may be prejudicial to the public interest.

## **Issues and findings**

101. The Exchange notes that the increase in demand for shell companies has led to an increase in shell creation and maintenance activities, including disposals or termination of an issuer's main business, and carrying on businesses with a very low level of operations to meet the continuing listing obligations. Such actions leave listed companies with minimal operations, raising concerns about the suitability for listing of these businesses. These activities invite speculative trading, and can lead to opportunities for market manipulation, insider trading and unnecessary volatility in the market which are not in the interest of the investing public. These activities undermine investors' confidence and overall market quality.
102. In response, the Exchange has applied the current Rules on continuing listing requirements to address these regulatory concerns. We consider that these Rules are largely adequate. In particular, the Rules are principle based and provide the Exchange the ability to delist issuers based on currently acceptable standards in the market, and to address current regulatory concerns. It is also broadly in line with those in other major markets.
103. We have also considered, but do not propose to introduce quantitative continuing listing requirements (see paragraph 99 above) separate from the current "sufficiency of operations / assets" test. Imposing a quantitative continuing listing requirement is an arbitrary measure of the "quality" of listed issuers and is likely to have a wide implication on issuers. At the same time, it would not address current issues about quality of companies as bright line criteria can be easily circumvented.

104. In light of our experience, we would like to amend the Rules to clarify their application and address some specific circumstances; including where issuers conduct securities trading on a proprietary basis with a view to maintaining the listing status, or where issuers hold significant assets for the purpose of maintaining a listing status.

## **Proposals**

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

105. We propose to amend the Rules on continuing listing criteria as follows:

- (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 to amend the Note to Rule 13.24 to provide guidance on the operation of the Rule; and
- (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 an issuer's operations and assets under 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**

106. We propose to 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.

107. We also propose to add a Note to Rule 13.24 to make it clear that this 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. For example, when assessing whether the money lending business of a particular issuer is a business of substance, the Exchange may take into account, among other factors, the business model, operating scale and history, source of funding, size and diversity of customer base, loan portfolio and internal control systems of the money lending business of that particular issuer.



108. The Note would also specify that the Exchange will make an assessment 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.
109. For the avoidance of doubt, if the Exchange considers that an issuer is not operating a business of substance, the Exchange may also question the issuer's suitability for continued listing under Rule 6.01(4).
110. We consider that the proposal will make it clear that issuers that hold significant assets but do not carry on a business of sufficient size would not meet the continuing listing criteria. The proposed Note to the Rule reflects current practice and interpretation, as described in paragraphs 90 to 92 above.
111. For the avoidance of doubt, issuers holding substantial operating assets and experiencing a temporary reduction or suspension of operations due to market conditions or from business strategies would not be considered to fail Rule 13.24 solely by virtue of its temporary circumstances.
112. We intend to remove the Note to Rule 13.24, which sets out the characteristics of issuers which are unable to comply with Rule 13.24<sup>26</sup>. Following our proposed amendments to Rule 13.24, these characteristics do not adequately describe all situations where an issuer is considered to have failed to comply with the proposed Rule 13.24 and as such, may mislead readers in the interpretation of the Rule.

**Q10 Do you agree with the proposal 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? If not, why?**

**Q11 Do you agree with (a) the proposal to add a Note to the proposed Rule 13.24(1) as described in paragraphs 107 to 109; and (b) the proposal to remove the Note to Rule 13.24 as described in paragraph 112? If not, why?**

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<sup>26</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 (which are currently set out in Paragraph 2.2 of Practice Note 17). The Note to Rule 13.24 setting out these characteristics will be effective from 1 August 2018 as a consequential amendment to the removal of Practice Note 17.

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

113. We propose to exclude an issuer's trading and/or investment in securities (other than an investment company listed under Chapter 21) when considering the sufficiency of an issuer's operations and assets under Rule 13.24.
114. As part of shell maintenance activities, we have noted a small number of issuers engaging in proprietary securities trading or investment. The underlying investments are highly liquid, the investment portfolio is most often limited and not managed by persons with relevant experience, and the business lacks the systems and controls customary for regulating risks and other matters relating to securities investment businesses<sup>27</sup>. Market commentators suggest that these arrangements are established for the purpose of maintaining the listing status rather than operating any businesses of substance, as these investments could be easily liquidated in the event an investor acquires control of the issuer.
115. Under the Rules, companies that are engaged in securities trading and/or investment are generally listed under Chapter 20 (applicable to authorized collective investment schemes) or Chapter 21 (applicable to non-authorized collective investment schemes). These issuers are governed by a different set of regulations<sup>28</sup> that protects investors in those circumstances. While listed issuers (for example, banks, insurance companies or brokerage house) may hold listed securities ancillary to their main businesses either as part of their investments or treasury activities, we do not envisage listed issuers to be primarily engaged in securities trading and/or investment as their main business, except those issuers listed under Chapter 20 or 21 and subject to regulations applicable to collective investment schemes or investment companies<sup>29</sup>.

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<sup>27</sup> See Listing Decision [LD117-2017](#) published in November 2017. The issuer proposed a spin-off and its remaining business was primarily a securities business that invested in one company during the track record period. There was a question whether the issuer was carrying on a business of substance, despite meeting the track record requirement.

<sup>28</sup> Listed collective investment schemes authorized by the SFC are regulated by the SFC and subject to the SFO and the Code on Real Estate Investment Trusts. These schemes are listed under Chapter 20 of the Rules. An unauthorized scheme may be listed under Chapter 21 of the Rules.

<sup>29</sup> The proposal is not intended to affect issuers in the financial services industry such as banks, insurance companies or brokerage houses that carry out securities trading and/or investment activities incidental to their principal businesses.

**Q12 Do you agree with the proposal to 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? If not, why?**

## II. Cash companies

### Current Rules

116. Under the cash company Rules (Rules 14.82 to 14.84), where for any reason the assets of a listed issuer consist wholly or substantially of cash or short-dated securities, it will not be regarded as suitable for listing<sup>30</sup>. Short-dated securities mean securities such as bonds, bills or notes that have less than one year to maturity. The cash company Rules do not apply to an investment company listed under Chapter 21 of the Rules or an issuer solely or mainly engaged in the securities brokerage business.
117. The purpose of the cash company Rules is to discourage speculative trading in the securities of cash companies as they are blue sky companies with no substantive business. Public investors have no information about their business plans and prospects.
118. The cash company Rules are not intended to prohibit issuers from retaining cash for legitimate business purposes. Whilst there is no prescribed threshold on the level of cash for purpose of the Rule, normally this is expected to be much higher than half of the issuer's total assets. When making the assessment, the Exchange would also consider the nature of the issuer's business and its business model.
119. Currently, the cash company Rules have been applied to address transactions involving substantial cash injection into listed issuers to operate new businesses and circumvent the new listing requirements, as these new businesses lack a track record and would not have otherwise met the new listing requirements. This is set out in Guidance Letter [GL84-15](#). We propose to codify these requirements into the RTO Rules. Please refer to **Proposal A(7)** above.

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<sup>30</sup> Trading in the issuer's securities will be suspended and its application to lift the suspension will be treated as if it were an application for listing from a new applicant.

## Issue

120. We have noted some issuers disposed of their main businesses and converted a substantial amount of the cash proceeds into highly liquid assets, such as listed securities or short-term loans, to reduce its cash level and avoid being treated as cash companies. While these assets do not fall within the definition of short-dated securities under the current Rules, they nevertheless share the characteristics that they are highly liquid and easily convertible into cash.

## Proposals

### C. (1) Amend Rule 14.82

121. We propose to extend the definition of short-dated securities<sup>31</sup> in the cash company Rules to cover investments that are easily convertible into cash (**short-term investments**).
122. Under the proposal, in determining whether an issuer's assets are "short-term investments", the Exchange will apply a principle based approach and consider the intention of the issuer 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 readily realizable 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).
123. In assessing whether an issuer is a cash company under Rule 14.82, the Exchange will take into account the value of the issuer's cash and short-term investments relative to its total assets, the nature of the issuer's business and its level of operations and financial position. The Exchange may include assets of the issuer if the holding of the assets are, in the opinion of the Exchange, a means to circumvent the cash company Rules. Equally, we do not envisage short-term investments to include near cash assets used in the ordinary and usual course of business.
124. Our proposal is consistent with other markets: in Australia, the cash company rule applies to cash or assets readily convertible into cash; in Malaysia, the cash company rule applies to short-term investments that include equities which are readily realizable and intended to be held for less than 12 months.

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<sup>31</sup> "Short-dated securities" is defined under Rule 14.82 to mean securities such as bonds, bills or notes which have less than 1 year to maturity.

**Q13** *Do you agree with the proposal to extend the definition of short-dated securities in the cash company Rules to cover investments that are easily convertible into cash (“short-term investments”)? If not, why?*

**(2) Amend Rule 14.83**

125. 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. We propose to amend Rule 14.83 to confine the exemption to clients’ assets relating to the issuer’s securities brokerage business.
126. The proposal is not intended to impose an undue restriction on the operations of securities brokerage companies. As explained in paragraph 123 above, the Exchange would take into account the nature of the issuer’s business and its cash needs in its ordinary and usual course of business when applying the cash company Rules.

**Q14** *Do you agree with the proposal that the exemption under Rule 14.83 shall only be confined to clients’ assets relating to the issuer’s securities brokerage business? If not, why?*

**III. Transitional arrangements for proposals relating to Continuing Listing Criteria**

127. We propose to provide a transitional period of 12-month from the effective date of the Rule amendments for **Proposals B and C** in relation to Rule 13.24 requiring issuers to maintain a sufficient level of operations and assets, and Rules 14.82 to 14.84 on cash companies respectively.
128. The transitional arrangement would minimize the impact of the Rule amendments on such issuers by allowing them a 12-month period to comply with the Rules as amended. The Exchange is minded to allow these issuers to bring themselves into compliance with the new Rules. Where the proposals involve corporate actions that may be subject to a RTO assessment, the Exchange will evaluate each case individually and take into account the underlying purpose of the proposals in our RTO assessment, with the objective of facilitating these companies to comply with the new Rules.

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## CHAPTER 4: OTHER PROPOSED RULE AMENDMENTS

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129. This Chapter discusses proposed Rule amendments relating to (a) securities transactions; (b) significant distribution in specie of unlisted assets; and (c) notifiable or connected transactions.

### D. Proposals relating to securities transactions

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

130. Under Rule 14.04(1)(g), transactions that are of a revenue nature in the issuer's ordinary and usual course of business are fully exempt from the notifiable transaction requirements under Chapter 14 of the Rules, including the requirements for disclosure and/or shareholders' approval when conducting these transactions (the **revenue exemption**).

131. In recent years, some issuers have reported securities trading / investment as one of their principal business activities and claimed revenue exemption for their securities trading activities. While securities investment businesses are generally subject to regulations (e.g. under the supervision of prudential regulators), the securities investment activities conducted by these issuers are not regulated. These activities are also commonly employed by issuers involved in shell maintenance activities to demonstrate that they have assets or operations to maintain a listing status.

132. To enhance investor protection and address shell activities, we propose to confine the revenue exemption to purchases and sales of securities only if they are conducted by members of the issuer group that are subject to the supervision of prudential regulators (i.e. banking companies, insurance companies, or securities houses). Securities transactions by other issuers would not be exempted.

**Q15 Do you agree with the proposal to confine the revenue exemption to purchases and sales of securities only if they are conducted by banking companies, insurance companies and securities houses within the listed issuers' group? If not, why?**

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

133. Paragraph 32(4) of Appendix 16 to the Rules requires issuers to disclose significant investments held, their performance during the financial year, and future prospects.
134. We propose to 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, including:
- (i) the name and principal business of the underlying company, the number or percentage of shares held and the investment costs;
  - (ii) the fair value of each investment as at the year end date and its size relative to the issuer's total assets;
  - (iii) the performance of each investment during the year, including any realized and unrealized gain or loss and any dividend received; and
  - (iv) a discussion of the issuer's strategy for the significant investments.
135. The proposal would clarify the nature and extent of disclosure required of significant investments held by issuers. The proposed disclosure items are in line with the guidance given in our review of issuers' annual reports<sup>32</sup>.

**Q16** *Do you agree with the proposal to 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 above)? If not, why?*

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<sup>32</sup> Review of Disclosure in Issuers' Annual Reports to Monitor Rule Compliance – Report 2017 (published on 26 January 2018).

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

136. As set out in Listing Decision [LD75-4](#), under Rule 2.04, the Exchange requires issuers who intend to conduct significant distributions in specie of unlisted assets (which amounts to a very substantial disposal) to obtain prior approval of the distribution from independent shareholders in a general meeting. The approval should 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 must not be 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. Further, the issuers' 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.
137. As explained in Listing Decision [LD75-4](#), a significant distribution in specie is tantamount to a delisting of the business by the listed issuer. Accordingly, this corporate action should be subject to similar levels of protection offered to shareholders as in the case of a delisting of the issuer's securities. We propose to codify these additional requirements for significant distribution in specie of unlisted assets currently under Listing Decision [LD75-4](#) in proposed Rule 14.94:
- (i) the distribution in specie must be approved by independent shareholders with at least 75% of the votes for and not more than 10% of the votes against the resolution. 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
  - (ii) 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.

**Q17 Do you agree with the proposal to codify the requirements set out in Listing Decision [LD75-4](#) (as described in paragraph 137 above) for significant distribution in specie of unlisted assets into the Rules? If not, why?**



## **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**

138. Rule 14A.63 sets out the information required to be disclosed in an announcement and the next annual report in relation to any financial performance guarantee given by a connected person where the actual financial performance fails to meet the guarantee. A common example involves a profit guarantee given by the vendor in relation to an acquisition of a company or business by the issuer. Where an independent party provides a financial performance guarantee, the current Rules do not provide any specific disclosure requirements in this regard.
139. In the Review of Disclosures in Issuers' Annual Reports to Monitor Rule Compliance Report<sup>33</sup>, we recommended that as a matter of accountability and transparency, issuers should follow the disclosure requirements under Rule 14A.63 even where the counterparty is independent. Further, issuers should make these disclosures in all circumstances involving financial performance guarantees (including where the financial performance guaranteed was met).
140. We propose to amend the Rules to require (i) disclosures 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 (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 (or the guarantee as amended) (currently required for a connected transaction only).

**Q18 Do you agree with the proposal to 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? If not, why?**

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<sup>33</sup> Review of Disclosure in Issuers' Annual Reports to Monitor Rule Compliance – Report 2017 (published on 26 January 2018).

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

141. Rules 14.58 and 14A.68 set out the disclosure required in notifiable transactions and connected transactions announcements. In particular, issuers are required to disclose in the announcement a general description of the principal business activities of the parties to the transaction (if the counterparty is a company or entity).
142. We propose to require disclosure of the identities of the parties to a transaction in the announcements and circulars of notifiable transactions. This serves to enhance the transparency of material transactions, and is in line with the disclosure requirements in the UK and Australian listing rules.
143. Issuers are reminded that under Rule 14.58(3), the announcement of a notifiable transaction must contain the directors' confirmation that, to the best of their knowledge, information and belief having made all reasonable enquiry, the counterparty and the ultimate beneficial owner of the counterparty to the transaction are third parties independent of the issuer and its connected persons. The directors are expected to provide such confirmation after making reasonable due diligence enquiries.
144. In respect of connected transactions, the current Rule requires issuers to disclose the identity and activities of the parties to the transaction and of their ultimate beneficial owners in the circulars<sup>34</sup>. We propose to extend this requirement to announcements of connected transactions, including those that are exempt from the circular and shareholder's approval requirements. This would facilitate investors in understanding the connected relationship between the parties to the transactions.

**Q19 (a) Do you agree with the proposal to require disclosure on the identity of the parties to a transaction in the announcements and circulars of notifiable transactions? If not, why?**

**(b) Do you agree with the proposal to require the disclosure on the identities and activities of the parties to the transaction and of their ultimate beneficial owners in the announcements of connected transactions? If not, why?**

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<sup>34</sup> Rule 14A.70.

### (3) Alternative size tests requirements

145. Under the current Rules<sup>35</sup>, issuers are required to classify the size of a notifiable or connected transaction using the five percentage ratios set out in Rule 14.07. The percentage ratios measure the materiality of a transaction to the issuer for the purpose of determining the applicable compliance requirements (i.e. disclosure and/ or shareholders' approval, as the case may be).
146. As the percentage ratios are generally based on the latest published financial positions of the issuers (subject to adjustments in some cases), it may not reflect the current financial position of the issuer. For example, where the issuer makes a material disposal shortly before an acquisition, when calculating the percentage ratios of the acquisition, the latest published financial position may overstate the level of operations of the issuer.
147. Rule 14.20 provides an exception to the classification rules where the Exchange may exercise its discretion to disregard the prescribed percentage ratios if any of them produces an anomalous result or is inappropriate to the sphere of activities of the issuer. Listed issuers must provide alternative size tests for the Exchange's consideration in this regard.
148. We propose to amend the Rules to make it 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.

**Q20** *Do you agree with the proposal 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? If not, why?*

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<sup>35</sup> Rules 14.05 and 14.06.

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## APPENDIX I: DRAFT AMENDMENTS TO THE LISTING RULES

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### A. Proposed Amendments to the Main Board Rules

#### Chapter 4

##### 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 14.06C), 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).

Proposal  
A(5)

...

##### Pro Forma Financial information

...

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 rule 14.69(4)(a)(i) 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 the enlarged group.

Proposal  
A(5)

...

4.29 Where an issuer includes pro forma financial information in any document (whether or not such disclosure of pro forma financial information is required under the Exchange Listing Rules), other than the pro forma financial information described in rule 4.30, that information must comply with rules 4.29(1) to (6) and a report in the terms of rule 4.29(7) must be included in the relevant document.

Proposal  
A(6)

...

4.30 In the case of an extreme transaction or reverse takeover that involves a series of transactions and/or arrangements, the circular or listing document must contain pro forma income statement of all the acquisition targets in the series of acquisitions (where applicable, would include any new businesses developed by the issuer that form part of the series) for the track record period.

- (1) The purpose of the pro forma income statement is for the listed issuer to demonstrate that the acquisition targets that form the series of acquisitions can meet the requirements of rule 8.05 (or rule 8.05A or 8.05B). The pro forma income statement is presented by combining the historical income statements of the acquisition targets as if they had been operated as a single group on an aggregated basis since the commencement of the track record period.
- (2) The pro forma financial information must be published in respect of each of the financial years/periods of the track record period.
- (3) The unadjusted information must be derived from the acquisition targets' accountants' reports for the track record period.
- (4) The pro forma financial information must comply with the requirements as set out in rules 4.29(2), (3) and (6).
- (5) The pro forma financial information must be reported on in the circular or listing document by the auditors or reporting accountants who must report that, in their opinion:
  - (a) the pro forma financial information has been properly compiled on the basis stated;
  - (b) such basis is consistent with the accounting policies of the issuer; and
  - (c) the adjustments are appropriate for the purposes of the pro forma financial information as disclosed pursuant to rule 4.30(1).

...

## **Chapter 6**

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 13

...

- 13.24 (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 ~~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.~~

Proposal  
B(1)

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 onus is on the issuer to demonstrate to the satisfaction of the Exchange its compliance with the rule.

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 take into account, among other factors, the business model, operating scale and history, source of funding, size and diversity of customer base, loan portfolio and internal control systems of the money lending business of that particular issuer.

For the avoidance of doubt, if the Exchange considers that an issuer is not operating a business of substance, the Exchange may also question the issuer's suitability for continued listing under rule 6.01(4).

- (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).

Proposal  
B(2)

\*Notes (i) and (ii) to Rule 13.24 will take effect from 1 August 2018.

...

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

Proposal  
A(5)

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 subject to the acquisition(s) and any businesses subject to a series of transactions and/or arrangements 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 Securities and Futures Ordinance 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**

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 purpose 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 of a 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 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 by a member of the listed issuer group that is a banking company, insurance company or securities house as one of the principal activities and in the ordinary and usual course of business of the listed issuer.*

Proposal D(1)
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3. ...

4. ...

...



(5A) an “insurance company” means a company which is authorized to carry out insurance business under the Insurance Companies Ordinance or appropriate overseas legislation or authority;

(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 depository 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;

Proposal  
A(5)

...

(10E) 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 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 (the “acquisition targets”) by a listed issuer (proposed and/or completed) which, in the opinion of the Exchange, constitutes, or is part of a transaction or arrangement or series of transactions and/or arrangements which constitute, an attempt to achieve a listing of the assets acquired and/or 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” refers to:

#### Notes:

1. In making its determination, the Exchange will normally take into account the following factors:

- (a) the size of the acquisition targets relative to that of the issuer;
- (b) the nature and scale of the issuer’s business before the acquisition(s);
- (c) any fundamental change in the issuer’s principal business(es);
- (d) any 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).

The Exchange considers a change in control or de facto control a material factor in its determination of whether a transaction constitutes a reverse takeover, as the major shareholder may oversee the operations and business direction of the listed issuer through appointing the board of directors. In assessing whether there is a change in de facto control of the listed issuer (other than at the level of its subsidiaries), the Exchange will consider the influence the new major shareholder may have over the listed issuer, taking into account indicative factors including (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 (i.e. convertible securities with a conversion restriction mechanism to avoid triggering a change in control under the Takeovers Code) to a vendor as the consideration for an acquisition;

Proposal  
A(1)

Proposal  
A(2)

(e) the quality of the acquisition targets.

In general, an acquisition of a target business that is not eligible or suitable for listing will more likely be considered a circumvention of the new listing requirements; and/or

(f) other transactions or arrangements (historical, proposed or intended) which, together with the acquisition(s), form a series of arrangements to list the acquisition targets.

Proposal  
A(3)

These transactions or arrangements may include changes in control/de facto control, acquisitions, disposals or termination of the original business and, in some circumstances, greenfield operations or equity fundraisings related to, or for the development of, newly acquired businesses. 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 3 years or less) or are otherwise related.

2. Without limiting the generality of rule 14.06B, the following transactions are normally reverse takeovers:

Proposal  
A(4)

(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:

Proposal  
A(4)

- (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 (the “acquisition targets”) by a listed issuer (proposed and/or completed), 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 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 Exchange Listing Rules and that:

Proposal A(5)
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- (1) (a) the issuer has been operating a principal business of a substantial size, which will continue after the transaction; or
  - (b) the issuer has been under the control of a large business enterprise for a long period (normally not less than 3 years), and the transaction forms part of a business restructuring of the issuer and would not result in a change in control (as defined in the Takeovers Code) of the listed issuer (other than at the level of its subsidiaries); and
- (2) the acquisition targets and the enlarged group must meet the requirements of rule 8.04. In addition, the acquisition targets must meet the requirements of rule 8.05 (or rule 8.05A or 8.05B) and the enlarged group must meet all the new listing requirements set out in Chapter 8 of the Listing Rules (except rule 8.05).

Note: Where 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 shares (including any 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 new shares.

Proposal  
A(7)

Notes:

1. 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 shares for cash proposed by a listed issuer with the intention of acquiring and/or developing 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.
2. This rule is not intended to unduly restrict fundraising activities of listed issuers generally. It will not normally apply to an issue of securities if, taking into account the proceeds from the issue, less than half (50%) of the issuer's assets would consist of cash as a result of the fundraising, unless there are specific concerns about circumvention of the rule.

**Restriction on disposals**

14.9214.06E (1) A listed issuer may not carry out a material disposal (or distribution in specie) dispose of its existing business (a) when there is a proposed or intended 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 24-months after 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 trading record requirements of rule 8.05 (or rule 8.05A or 8.05B).

Proposal  
A(4)

- 14.93 (2) A disposal or distribution in specie by a listed issuer which does not meet the above requirement under rule 14.92 will result in the listed issuer being treated as a new listing applicant.

Note: The Exchange may apply this rule to a material disposal (or distribution in specie) by a listed issuer of its existing business (a) when there is a proposed or intended change in the single largest substantial shareholder of the issuer; or (b) for a period of 36 months from such change, if the Exchange considers that the disposal (or distribution 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 ratios produces an anomalous result or is inappropriate to the sphere of activity of the listed issuer, the Exchange may, where any of the calculation 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 provide alternative test(s) which it considers appropriate to the Exchange for consideration. The Exchange may also require the issuer to apply other size test(s) that the Exchange considers appropriate. The listed issuer must seek prior consent of the Exchange if it wishes to apply this rule.

Proposal  
F(3)

...

#### *Aggregation of transactions*

- 14.22 In addition to the aggregation requirements under rules 14.06B and 14.06C 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**

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

Proposal  
A(5)

...

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

...

Guaranteed profits or net assets

Proposal  
F(1)

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 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:

Proposal  
A(5)

- (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 rule 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 assets subject to the acquisition (and any assets and businesses subject to a series of transactions and/or arrangements, if any) 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.

Proposal  
A(6)

- (1) The assets ~~acquired and/or~~ to be acquired (the acquisition targets) and the enlarged group must meet the requirements of rule 8.04. In addition, the acquisition targets ~~must be able to~~ meet the requirements of rule 8.05 (or rule 8.05A or 8.05B) and 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).

*Note: 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.*

- (2) Where the reverse takeover is proposed by a listed issuer that has failed to comply with rule 13.24, each of the acquisition targets and the enlarged group must meet all the new listing requirements set out in Chapter 8 of the Listing Rules.

- (3) The listed issuer must comply with the requirements for all transactions set out in rule 14.34 to 14.37.



Notes:

1. See also rule 14.57A if the reverse takeover involves a series of transactions and/or arrangements.
2. Where 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 In the case of an extreme transaction or reverse takeover that involves a series of transactions and/or arrangements:

Proposal  
A(6)

- (1) the listed issuer must ensure that the circular or listing document contains pro forma income statement of all the acquisition targets in the series of acquisitions (where applicable, would include any new businesses developed by the issuer that form part of the series) for the track record period to demonstrate that the requirements under rule 8.05 (or rule 8.05A or 8.05B) can be met (see rule 14.06C(2) or 14.54); and
- (2) the track record period normally covers the three financial years immediately prior to the issue of the circular or listing document for seeking shareholders' approval for the latest transaction of the series.

**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:

Proposal  
A(5)

...

- (2) a description of the principal business activities carried out by the listed issuer and the identities and a description of the principal business activities of the parties to the transaction ~~a general description of the principal business activities of the counterparty, if the counterparty is a company or entity;~~

Proposal  
F(2)

...

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:

Proposal  
A(5)

...

14.66 A circular relating to a major transaction must contain:-

...

(4) information which is required to be included in the announcement under rule 14.60;

...

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

Proposal  
A(5)

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 rule 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] where the reverse takeover or the extreme transaction involves a series of transactions and/or arrangements, the information required under rule 14.57A; and
- (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;
- (ii) for an extreme transaction, the information required under Chapter 5 on the property interests acquired and/or to be acquired by the issuer; and

Proposal  
A(6)

...

*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 ...

Proposal  
A(5)

...

**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 has less than 1 year to maturity.

Proposal  
C(1)

Notes:

1. In determining whether an issuer's assets are short-term investments for the purpose of rule 14.82, the Exchange will consider the intention of the issuer in holding the assets, and the marketability or liquidity of the assets.

Examples of short term investments are (a) bonds, bills or notes which have less than 1 year to maturity or which are intended to be held for less than 1 year; (b) securities listed on the Exchange or other stock exchanges that are available for sale; (c) investments that are readily realisable or convertible to cash; and (d) advances to third parties which are repayable within 1 year (excluding trade receivables arising from the issuer's ordinary and usual course of business).

2. In assessing whether an issuer's assets consist wholly or substantially of cash and short-term investments, the Exchange will normally take into account the value of the issuer's cash and short-term investments relative to its total assets, the nature of the issuer's business and its level of operations and financial position.

14.83 Where aA listed issuer which is solely or mainly engaged in the securities brokerage business, assets held on behalf of its clients relating to such business will not be taken into account in assessing whether the issuer is a cash company under subject to rule 14.82.

Proposal  
C(2)

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 1 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.

...

#### **Distribution of assets in specie to shareholders**

14.94 Where a listed issuer proposes a distribution of assets (which are not listed securities) and the disposal of such assets would amount to a very substantial disposal based on the percentage ratio calculations:

Proposal E

(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 should be a liquid market for the shareholders to readily realize a value from those securities and the issuer will make arrangements to facilitate the shareholders to hold or sell those securities.

## **Chapter 14A**

...

### *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.

Proposal  
F(1)

(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 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(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.

...

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;

Proposal  
F(2)

...

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);

Proposal  
F(2)

...

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 Exchange may disregard the ~~ratio calculation~~ and/or apply other relevant indicators of size, including industry specific tests. The listed issuer must provide consider alternative test(s) which it considers appropriate to the Exchange for consideration provided by the listed issuer. The Exchange may also require the listed issuer to apply other size test(s) that the Exchange considers appropriate. The listed issuer must seek prior consent of the Exchange if it wishes to apply this rule.

Proposal  
F(3)

...

## Appendix 16

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;~~

Proposal  
F(1)

...

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. The issuer should disclose a breakdown of its significant investments (including any investment with a value of 5 per cent. or more of the issuer's total assets):

Proposal  
D(2)

- (a) details of each investment, including the name and principal businesses 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 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**

Proposal  
A(5)

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

To: The Listing Department  
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) by The Stock Exchange of Hong Kong Limited (the "Exchange") ~~for the purpose~~ of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "~~Exchange Listing Rules~~") and have offices located at .....

Under Rules 13.87A and 14.53A(2), we ~~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 assets acquired and/or to be acquired under the Transaction (together, the Acquisition Targets) (and where applicable, together with any businesses subject to a series of transactions and/or arrangements (the Businesses)) and the enlarged group are able to meet the requirements of rule 8.04. In addition, the Acquisition Targets (and where applicable, together with the Businesses) are is able to meet the minimum profit requirements under Exchange Listing rule 8.05 (or rule 8.05A or 8.05B) and the enlarged group is able to meet all the new listing requirements other conditions in Chapter 8 of the Exchange Listing 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, the financial condition and profitability of the Acquisition Targets and, where applicable, the Businesses ~~assets to be acquired under the Transaction~~ 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 ~~assets to be acquired~~ 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 Department  
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: .....

## **B. Proposed Amendments to the GEM Rules**

### **Chapter 7**

#### **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 (see rule 19.06C) or a reverse takeover (see rules 19.67 and 19.69) unless the company being acquired is itself a company on GEM or the Main Board.

Proposal  
A(5)

...

#### **Pro Forma Financial information**

...

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 rule 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 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 the enlarged group.

Proposal  
A(5)

...

7.31 Where an issuer includes pro forma financial information in any document (whether or not such disclosure of pro forma financial information is required under the GEM Listing Rules), other than the pro forma financial information described in rule 7.32, that information must comply with rules 7.31(1) to (6) and a report in the terms of rule 7.31(7) must be included in the relevant document.

Proposal  
A(6)

7.32 In the case of an extreme transaction or reverse takeover that involves a series of transactions and/or arrangements, the circular or listing document must contain pro forma cash flow statement of all the acquisition targets in the series of acquisitions (where applicable, would include any new businesses developed by the issuer that form part of the series) for the track record period.

- (1) The purpose of the pro forma cash flow statement is for the listed issuer to demonstrate that the acquisition targets that form the series of acquisitions can meet the requirements of rule 11.12A (or rule 11.14). The pro forma cash flow statement is presented by combining the historical cash flow statements of the acquisition targets as if they had been operated as a single group on an aggregated basis since the commencement of the track record period.
- (2) The pro forma financial information must be published in respect of each of the financial years/periods of the track record period.
- (3) The unadjusted information must be derived from the acquisition targets' accountants' reports for the track record period.
- (4) The pro forma financial information must comply with the requirements as set out in rules 7.31(2), (3) and (6).
- (5) The pro forma financial information must be reported on in the circular or listing document by the auditors or reporting accountants who must report that, in their opinion:
  - (a) the pro forma financial information has been properly compiled on the basis stated;
  - (b) such basis is consistent with the accounting policies of the issuer; and
  - (c) the adjustments are appropriate for the purposes of the pro forma financial information as disclosed pursuant to rule 7.32(1).

...

## Chapter 9

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 17

...

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.~~

Proposal  
B(1)

*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 onus is on the issuer to demonstrate to the satisfaction of the Exchange its compliance with the rule.*

*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 take into account, among other factors, the business model, operating scale and history, source of funding, size and diversity of customer base, loan portfolio and internal control systems of the money lending business of that particular issuer.*

For the avoidance of doubt, if the Exchange considers that an issuer is not operating a business of substance, the Exchange may also question the issuer's suitability for continued listing under rule 9.04(4).

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

Proposal  
B(2)

\*Notes (i) and (ii) to GEM Rule 17.26 will take effect from 1 August 2018.

...

### **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 subject to the acquisition(s) and any businesses subject to a series of transactions and/or arrangements 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.

Proposal  
A(5)

17.99B The financial adviser must be a person licensed or registered under the Securities and Futures Ordinance 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

...

18.07 A 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 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;~~

Proposal  
F(1)

...

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. The issuer should disclose a breakdown of its significant investments (including any investment with a value of 5 per cent. or more of the issuer's total assets):

Proposal  
D(2)

(a) details of each investment, including the name and principal businesses 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 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**

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 purpose 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 by a member of the listed issuer group that is a banking company, insurance company or securities house as one of the principal activities and in the ordinary and usual course of business of the listed issuer.*

Proposal  
D(1)

*3. ...*

*4. ...*

...

(5A) an “insurance company” means a company which is authorized to carry out insurance business under the Insurance Companies Ordinance or appropriate overseas legislation or authority;

(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;

Proposal  
A(5)

...

(10E) 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 issuer must determine whether or not to consult its Compliance Advisers 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 (the “acquisition targets”) by a listed issuer (proposed and/or completed) which, in the opinion of the Exchange, constitutes, or is part of a transaction or arrangement or series of transactions and/or arrangements which constitute, an attempt to achieve a listing of the assets acquired and/or 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. In making its determination, the Exchange will normally take into account the following factors:

- (a) the size of the acquisition targets relative to that of the issuer;
- (b) the nature and scale of the issuer’s business before the acquisition(s);
- (c) any fundamental change in the issuer’s principal business(es);
- (d) any 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).

The Exchange considers a change in control or de facto control a material factor in its determination of whether a transaction constitutes a reverse takeover, as the major shareholder may oversee the operations and business direction of the listed issuer through appointing the board of directors. In assessing whether there is a change in de facto control of the listed issuer (other than at the level of its subsidiaries), the Exchange will consider the influence the new major shareholder may have over the listed issuer, taking into account indicative factors including (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 (i.e. convertible securities with a conversion restriction mechanism to avoid triggering a change in control under the Takeovers Code) to a vendor as the consideration for an acquisition;

Proposal  
A(1)

Proposal  
A(2)

(e) the quality of the acquisition targets.

In general, an acquisition of a target business that is not eligible or suitable for listing will more likely be considered a circumvention of the new listing requirements; and/or

(f) other transactions or arrangements (historical, proposed or intended) which, together with the acquisition(s), form a series of arrangements to list the acquisition targets.

Proposal  
A(3)

These transactions or arrangements may include changes in control/de facto control, acquisitions, disposals or termination of the original business and, in some circumstances, greenfield operations or equity fundraisings related to, or for the development of, newly acquired businesses. 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 3 years or less) or are otherwise related.

2. Without limiting the generality of rule 19.06B, the following transactions are normally reverse takeovers:

Proposal  
A(4)

(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:

Proposal  
A(4)

(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 (the “acquisition targets”) by a listed issuer (proposed and/or completed), 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 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:

Proposal  
A(5)

- (1) (a) the issuer has been operating a principal business of a substantial size, which will continue after the transaction; or
- (b) the issuer has been under the control of a large business enterprise for a long period (normally not less than 3 years), and the transaction forms part of a business restructuring of the issuer and would not result in a change in control (as defined in the Takeovers Code) of the listed issuer (other than at the level of its subsidiaries); and
- (2) the acquisition targets and the enlarged group must meet the requirements of rule 11.06. In addition, the acquisition targets must meet the requirements of rule 11.12A (or rule 11.14), and the enlarged group must meet all the new listing requirements in Chapter 11 of the GEM Listing Rules (except rule 11.12A).

Note: Where 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 shares (including any 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 new shares.

Proposal  
A(7)

Notes:

1. 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 shares for cash proposed by a listed issuer with the intention of acquiring and/or developing 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.
2. This rule is not intended to unduly restrict fundraising activities of listed issuers generally. It will not normally apply to an issue of securities if, taking into account the proceeds from the issue, less than half (50%) of the issuer's assets would consist of cash as a result of the fundraising, unless there are specific concerns about circumvention of the rule.

**Restriction on disposals**

~~19.94~~19.06E (1) A listed issuer may not carry out a material disposal (or distribution in specie) ~~dispose of~~ its existing business (a) when there is a proposed or intended 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 ~~after~~ 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 requirement of rule 11.12A (or rule 11.14).

Proposal  
A(4)

~~19.92~~ (2) A disposal or distribution in specie by a listed issuer which does not meet the above requirement ~~under rule 19.94~~ will result in the listed issuer being treated as a new listing applicant.

Note: The Exchange may apply this rule to a material disposal (or distribution in specie) by a listed issuer of its existing business (a) when there is a proposed or intended change in the single largest substantial shareholder of the issuer; or (b) for a period of 36 months from such change, if the Exchange considers that the disposal (or distribution 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 ratios produces an anomalous result or is in appropriate to the sphere of activity of the listed issuer, the Exchange may, where any of the calculations of 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 provide alternative test(s) which it considers appropriate to the Exchange for consideration. The Exchange may also require the issuer to apply other size test(s) that the Exchange considers appropriate. The listed issuer must seek prior consent of the Exchange if it wishes to apply this rule.

Proposal  
F(3)

...

*Aggregation of transactions*

- 19.22 In addition to the aggregation requirements under rules 19.06B and 19.06C ~~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, disclosable transaction, major transaction, very substantial disposal, very substantial acquisition, extreme transaction or reverse takeover have been finalized, the listed issuer must in each case :-

Proposal  
A(5)

...

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

...

Guaranteed profits or net assets

Proposal  
F(1)

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 therefore, 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:

Proposal  
A(5)

- (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 rule 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 assets subject to the acquisition (and any assets and businesses subject to a series of transactions and/or arrangements, if any) 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.

Proposal  
A(6)

- (1) The ~~enlarged group~~, or the assets acquired and/or to be acquired (the acquisition targets) and the enlarged group must meet the requirements of rule 11.06. In addition, the acquisition targets must ~~be able to~~ meet the requirements of rule 11.12A (or rule 11.14) and 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).

Note: 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 11 of the GEM Listing Rules.

(2) Where the reverse takeover is proposed by a listed issuer that has failed to comply with rule 17.26, each of the acquisition targets and the enlarged group must meet all the new listing requirements set out in Chapter 11.

(3) The listed issuer must comply with the requirements for all transactions set out in rule 19.34 to 19.37.

Notes:

1. See also rule 19.57A if the reverse takeover involves a series of transactions and/or arrangements.

2. Where the acquisition targets cannot meet rule 11.12A(2) and/or (3) due to a change in control 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 In the case of an extreme transaction or reverse takeover that involves a series of transactions and/or arrangements:

(1) the listed issuer must ensure that the circular or listing document contains pro forma cash flow statement of all the acquisition targets in the series of acquisitions (where applicable, would include any new businesses developed by the issuer that form part of the series) for the track record period to demonstrate that the requirements under rule 11.12A (or rule 11.14) can be met (see rule 19.06C(2) or 19.54); and

(2) the track record period normally covers the two financial years immediately prior to the issue of the circular or listing document for seeking shareholders' approval for the latest transaction of the series.

Proposal  
A(6)

## 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:

Proposal  
A(5)

...

(3) a description of the principal business activities carried out by the listed issuer and the identities and a description of the principal business activities of the parties to the transaction ~~a general description of the principal business activities of the counterparty, if the counterparty is a company or entity;~~

Proposal  
F(2)

...

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:

Proposal  
A(5)

...

19.66 A circular relating to a major transaction must contain:-

...

(5) information which is required to be included in the announcement under rule 19.60;

...

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

Proposal  
A(5)

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 rule 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]~~ where the reverse takeover or the extreme transaction involves a series of transactions and/or arrangements, the information required under rule 19.57A; and
  - (d) (i) for a reverse takeover, information on the enlarged group's property interests under rules 8.01A and 8.01B;  
(ii) for an extreme transaction, the information required under Chapter 8 on the property interests acquired and/or to be acquired by the issuer; and

Proposal  
A(6)

...

*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 ...

Proposal  
A(5)

...

## 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 has less than 1 year to maturity.~~

Proposal  
C(1)

### Notes:

1. In determining whether an issuer’s assets are short-term investments for the purpose of rule 19.82, the Exchange will consider the intention of the issuer in holding the assets, and the marketability or liquidity of the assets.

Examples of short term investments are (a) bonds, bills or notes which have less than 1 year to maturity or which are intended to be held for less than 1 year; (b) securities listed on the Exchange or other stock exchanges that are available for sale; (c) investments that are readily realisable or convertible to cash; and (d) advances to third parties which are repayable within 1 year (excluding trade receivables arising from the issuer’s ordinary and usual course of business).

2. In assessing whether an issuer’s assets consist wholly or substantially of cash and short-term investments, the Exchange will normally take into account the value of the issuer’s cash and short-term investments relative to its total assets, the nature of the issuer’s business and its level of operations and financial position.

- 19.83 ~~Where a~~ A listed issuer is which is solely or mainly engaged in the securities brokerage business, assets held on behalf of its clients relating to such business will not be taken into account in assessing whether the issuer is a cash company under subject to-rule 19.82.

Proposal  
C(2)

- 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 1 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.

...

### Distribution of assets in specie to shareholders

19.93 Where a listed issuer proposes a distribution of assets (which are not listed securities) and the disposal of such assets would amount to a very substantial disposal based on the percentage ratio calculations:

Proposal E

- (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 should be a liquid market for the shareholders to readily realize a value from those securities and the issuer will make arrangements to facilitate the shareholders to hold or sell those securities.

## Chapter 20

### *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.

Proposal  
F(1)

(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~~:

- (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 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.

...

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;

Proposal F(2)
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...

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);

Proposal F(2)
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...

20.78 –If any of the calculation of the percentage ratios produces an anomalous result or is in appropriate to the sphere of activity of the listed issuer, the Exchange 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 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. The listed issuer must seek prior consent of the Exchange if it wishes to apply this rule.

Proposal  
F(3)



**Appendix 21**

Proposal  
A(5)

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

To: The Listing Department  
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) by The Stock Exchange of Hong Kong Limited (the "Exchange") for the purpose of the Rules Governing the Listing of Securities on GEM the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (the "GEM Listing Rules") and have offices located at .....

Under GEM Rules 17.99A and 19.53A(2), we ~~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 assets acquired and/or to be acquired under the Transaction (together, the Acquisition Targets) (and where applicable, together with any businesses subject to a series of transactions and/or arrangements (the Businesses)) and the enlarged group are able to meet the requirements of GEM Listing Rule 11.06. In addition, the Acquisition Targets (and where applicable, together with the Businesses) are ~~is~~ able to meet the positive cash flow requirement under GEM Listing Rule 11.12A (or GEM Listing Rule 11.14) and the enlarged group is able to meet all the other conditions new listing requirements in Chapter 11 of the GEM 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, the financial condition and profitability of the Acquisition Targets and, where applicable, the Businesses ~~assets to be acquired under the Transaction~~;

- (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 ~~assets to be acquired~~ 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 Department  
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 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 II: EXAMPLES OF APPLICATION OF “SERIES OF ARRANGEMENTS” CRITERION UNDER THE PRINCIPLE BASED TEST**

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This Appendix sets out non-exhaustive examples of RTO transactions through a series of transactions and/or arrangements.

### **Example 1 – Series of acquisitions leading to the operation of a new business**

Company A had been principally engaged in software development business since 2010. In 2015 and 2016, it made two acquisitions of businesses engaged in the construction of power plants in various locations. In June 2017, it proposed to acquire another company engaging in the power plant business.

Under the proposed RTO Rules, the completed acquisitions in 2015 and 2016 and the 2017 proposed acquisition would be treated as a series of transactions. For purpose of assessing whether there is any fundamental change in Company A's principal business, the Exchange would aggregate the revenues / profits / asset values of the power plants acquired in 2015 and 2016 based on the issuer's accounts (or its subsidiaries' accounts) for the most recent financial year, together with the accounts of the 2017 proposed acquisition target. These would be compared with the revenue / profit / asset value of the software business in the issuer's published accounts for the most recent financial year.

In this example, the aggregated revenue of the power plant business would be about HK\$250 million by taking into account (i) the revenue of HK\$20 million and HK\$30 million for two power plant businesses acquired by Company A in 2015 and 2016 based on its subsidiaries' accounts for the year ended 31 December 2016 and (ii) the revenue of HK\$200 million for the 2017 proposed acquisition target based on its accounts for the same financial year. Such amount would be compared to the revenue of HK\$50 million for the software business segment as disclosed in Company A's 2016 accounts. The same approach would apply when assessing the extent of change in terms of assets and profits.

In addition, the Exchange would assess the size of the series of acquisitions in accordance with paragraph 47 above.

**Example 2 – Acquisitions and funds raised to develop the newly acquired business that together led to the operation of a new business**

Company B had been principally engaged in the foundation construction business since 2012. In May 2015, it acquired some properties for investment purpose. In June 2017, it proposed to acquire a property development project and conducted equity fundraising to finance the development costs of the project.

For purpose of assessing whether there is any fundamental change in Company B's principal business, the Exchange would aggregate the revenues / profits / asset values of the 2015 acquisition with the 2017 acquisition. When comparing the asset value, the Exchange would also require aggregation of the funds raised by Company B to develop the 2017 acquisition (if the impact was not yet reflected in the target's accounts). Such total amount would be compared with the revenue / profit / asset value of the foundation construction business as reported in the issuer's published accounts for the most recent financial year.

In this example, the aggregated asset value of the property business would be HK\$1,800 million, taking into account (i) the asset value of HK\$300 million for the property business acquired in 2015 based on the relevant segment results disclosed in Company B's accounts for the year ended 31 December 2016; (ii) the asset value of HK\$1,000 million for the 2017 proposed acquisition target as disclosed in its accounts for the same financial year; and (iii) the amount of HK\$500 million from the proposed equity fundraising. This would be compared to the segment assets of HK\$300 million for the foundation business segment as disclosed in Company B's accounts. The same approach would apply when assessing the extent of change in terms of revenue and profits.

In addition, the Exchange would assess the size of the series of acquisitions in accordance with paragraph 47 above.

**Example 3 – Acquisitions of multiple lines of businesses after a change in control/ de facto control of the issuer that would fundamentally change the issuer’s principal business(es)**

Company C had been principally engaged in sourcing and subcontracting of garment products since 2010. After an investor acquired a controlling stake in Company C and made a general offer in January 2014, Company C appointed new directors to the board (none of the new directors had expertise in the garment industry). During 2015 and 2016, Company C acquired and established a number of new businesses, including property investment, provision of consultancy services and trading business. In June 2017, it proposed to acquire a renewable energy business.

Where the listed issuer has fundamentally changed its principal business(es) and commenced operating a number of new businesses that have no or little correlation with its original business, these new businesses would be subject to the new listing requirements under the proposed RTO Rules.

In this example, Company C commenced a number of new businesses after the change in control. At the time of the proposed acquisition in June 2017, the aggregation requirements would apply to the series of acquisitions of new businesses and greenfield operations that took place in 2015 and 2016 including property investment, provision of consultancy services and trading business. For purpose of assessing whether there is any fundamental change in Company C’s principal business, the Exchange would aggregate the revenues / profits / asset values of the new businesses, based on the accounts of the issuer (or its subsidiaries’ accounts) together with the accounts of the 2017 acquisition targets. This would be compared with the revenue / profit / total asset value of the garment business as reported in the issuer’s accounts for the most recent financial year.

In addition, the Exchange would assess the size of the series of acquisitions in accordance with paragraph 47 above.

#### **Example 4 – Disposal of original business after acquisitions**

Company D had been principally engaged in the manufacturing and sale of consumer goods since 2010. In 2015, Company D commenced a new business in money lending and acquired some target companies engaged in securities brokerage and margin financing businesses. In June 2017, it proposed to dispose of its consumer goods business.

After the disposal, Company D would be left with the businesses in financing and securities brokerage that had been operated by it for less than 3 years. Company D must demonstrate that these remaining businesses could meet the continuing listing requirements under the proposed Rule 13.24, or otherwise it would be subject to the delisting procedures upon completion of the disposal.

If the money lending, securities brokerage and margin financing businesses could meet the proposed Rule 13.24 requirements, the RTO Rules would apply to these businesses and require Company D to file a new listing application. These activities, coupled with the disposal, formed a series of transactions that would result in a complete change in Company D's principal business.

#### **Example 5 – Change in control after acquisition of new business**

Company E had been principally engaged in travel agency business since 2011. In June 2017, it completed an acquisition of a new property development business from a third party vendor Mr. X, which was classified as a very substantial acquisition.

In August 2017 (i.e. two months after the acquisition), Company E's controlling shareholder proposed to sell its entire 40% interest in Company E to Mr. X, which would result in a change in control of Company E. The close nexus between the change in control and the completed acquisition raised concern about circumvention of the new listing requirements. These activities would be treated as a series of arrangements and the RTO Rules would apply to the completed acquisition.



**Example 6 – Series of arrangements involving disposal, change in control and acquisition**

Company F had been principally engaged in property business since 2008. In the first half of 2016, it sold a material part of its property portfolio to its then controlling shareholder. In October 2016, an investor acquired a controlling stake in Company F and became the new controlling shareholder of Company F. In June 2017, Company F proposed to expand into a business segment by acquiring a film production and distribution business from a third party.

In this example, Company F must, at the time of the 2016 disposal, demonstrate that its remaining business could meet Rule 13.24 after the 2016 disposal.

The 2016 disposal that took place shortly before the change in control could be a means to cleanse the listed shell. In assessing the acquisition of the film production and distribution business, the Exchange would consider the series of arrangements commencing from the 2016 disposal. The RTO Rules would apply if the series of arrangements would result in a fundamental change in the nature and business of Company F.

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## APPENDIX III: PERSONAL INFORMATION COLLECTION AND PRIVACY POLICY

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Hong Kong Exchanges and Clearing Limited, and from time to time, its subsidiaries (together the "**Group**") (and each being "**HKEX**", "**we**", "**us**" or "**member of the Group**" for the purposes of this Privacy Policy Statement as appropriate) recognise their responsibilities in relation to the collection, holding, processing, use and/or transfer of personal data under the Personal Data (Privacy) Ordinance (Cap. 486) ("**PDPO**"). Personal data will be collected only for lawful and relevant purposes and all practicable steps will be taken to ensure that personal data held by us is accurate. We will use your personal data which we may from time to time collect in accordance with this Privacy Policy Statement.

We regularly review this Privacy Policy Statement and may from time to time revise it or add specific instructions, policies and terms. Where any changes to this Privacy Policy Statement are material, we will notify you using the contact details you have provided us with and, where required by the PDPO, give you the opportunity to opt out of these changes by means notified to you at that time. Otherwise, in relation to personal data supplied to us through the HKEX website or otherwise, continued use by you of the HKEX website or your continued relationship with us shall be deemed to be your acceptance of and consent to this Privacy Policy Statement, as amended from time to time.

If you have any questions about this Privacy Policy Statement or how we use your personal data, please contact us through one of the communication channels set out in the "Contact Us" section below.

We will take all practicable steps to ensure the security of the personal data and to avoid unauthorised or accidental access, erasure or other use. This includes physical, technical and procedural security methods, where appropriate, to ensure that the personal data may only be accessed by authorised personnel.

Please note that if you do not provide us with your personal data (or relevant personal data relating to persons appointed by you to act on your behalf) we may not be able to provide the information, products or services you have asked for or process your requests, applications, subscriptions or registrations, and may not be able to perform or discharge the Regulatory Functions (defined below).

## **Purpose**

From time to time we may collect your personal data including but not limited to your name, mailing address, telephone number, email address, date of birth and login name for the following purposes:

1. to process your applications, subscriptions and registration for our products and services;
2. to perform or discharge the functions of HKEX and any company of which HKEX is the recognised exchange controller (as defined in the Securities and Futures Ordinance (Cap. 571)) ("Regulatory Functions");
3. to provide you with our products and services and administer your account in relation to such products and services;
4. to conduct research and statistical analysis;
5. to process your application for employment or engagement within HKEX to assess your suitability as a candidate for such position and to conduct reference checks with your previous employers; and
6. other purposes directly relating to any of the above.

## **Direct marketing**

Where you have given your consent and have not subsequently opted out, we may also use your name, mailing address, telephone number and email address to send promotional materials to you and conduct direct marketing activities in relation to HKEX financial services and information services, and financial services and information services offered by other members of the Group.

If you do not wish to receive any promotional and direct marketing materials from us or do not wish to receive particular types of promotional and direct marketing materials or do not wish to receive such materials through any particular means of communication, please contact us through one of the communication channels set out in the "Contact Us" section below. To ensure that your request can be processed quickly please provide your full name, email address, log in name and details of the product and/or service you have subscribed.

## **Identity Card Number**

We may also collect your identity card number and process this as required under applicable law or regulation, as required by any regulator having authority over us and, subject to the PDPO, for the purpose of identifying you where it is reasonable for your identity card number to be used for this purpose.

## **Transfers of personal data for direct marketing purposes**

Except to the extent you have already opted out we may transfer your name, mailing address, telephone number and email address to other members of the Group for the purpose of enabling those members of the Group to send promotional materials to you and conduct direct marketing activities in relation to their financial services and information services.

## **Other transfers of your personal data**

For one or more of the purposes specified above, your personal data may be:

1. transferred to other members of the Group and made available to appropriate persons in the Group, in Hong Kong or elsewhere and in this regard you consent to the transfer of your data outside of Hong Kong;
2. supplied to any agent, contractor or third party who provides administrative, telecommunications, computer, payment, debt collection, data processing or other services to HKEX and/or any of other member of the Group in Hong Kong or elsewhere; and
3. other parties as notified to you at the time of collection.

## **How we use cookies**

If you access our information or services through the HKEX website, you should be aware that cookies are used. Cookies are data files stored on your browser. The HKEX website automatically installs and uses cookies on your browser when you access it. Two kinds of cookies are used on the HKEX website:

**Session Cookies:** temporary cookies that only remain in your browser until the time you leave the HKEX website, which are used to obtain and store configuration information and administer the HKEX website, including carrying information from one page to another as you browse the site so as to, for example, avoid you having to re-enter information on each page that you visit. Session cookies are also used to compile anonymous statistics about the use of the HKEX website.

**Persistent Cookies:** cookies that remain in your browser for a longer period of time for the purpose of compiling anonymous statistics about the use of the HKEX website or to track and record user preferences.

The cookies used in connection with the HKEX website do not contain personal data. You may refuse to accept cookies on your browser by modifying the settings in your browser or internet security software. However, if you do so you may not be able to utilise or activate certain functions available on the HKEX website.

## **Compliance with laws and regulations**

HKEX and other members of the Group may be required to retain, process and/or disclose your personal data in order to comply with applicable laws and regulations or in order to comply with a court order, subpoena or other legal process (whether in Hong Kong or elsewhere), or to comply with a request by a government authority, law enforcement agency or similar body (whether situated in Hong Kong or elsewhere) or to perform or discharge the Regulatory Functions. HKEX and other members of the Group may need to disclose your personal data in order to enforce any agreement with you, protect our rights, property or safety, or the rights, property or safety of our employees, or to perform or discharge the Regulatory Functions.

## **Corporate reorganisation**

As we continue to develop our business, we may reorganise our group structure, undergo a change of control or business combination. In these circumstances it may be the case that your personal data is transferred to a third party who will continue to operate our business or a similar service under either this Privacy Policy Statement or a different privacy policy statement which will be notified to you. Such a third party may be located, and use of your personal data may be made, outside of Hong Kong in connection with such acquisition or reorganisation.

## **Access and correction of personal data**

Under the PDPO, you have the right to ascertain whether we hold your personal data, to obtain a copy of the data, and to correct any data that is inaccurate. You may also request us to inform you of the type of personal data held by us. All data access requests shall be made using the form prescribed by the Privacy Commissioner for Personal Data ("Privacy Commissioner") which may be found on the official website of the Office of the Privacy Commissioner or via this link <https://www.pcpd.org.hk/english/publications/files/Dforme.pdf>

Requests for access and correction of personal data or for information regarding policies and practices and kinds of data held by us should be addressed in writing and sent by post to us (see the "Contact Us" section below).

A reasonable fee may be charged to offset our administrative and actual costs incurred in complying with your data access requests.

## **Termination or cancellation**

Should your account or relationship with us be cancelled or terminated at any time, we shall cease processing your personal data as soon as reasonably practicable following such cancellation or termination, provided that we may keep copies of your data as is reasonably required for archival purposes, for use in relation to any actual or potential dispute, for the purpose of compliance with applicable laws and regulations and for the purpose of enforcing any agreement we have with you, for protecting our rights, property or safety, or the rights, property or safety of our employees, and for performing or discharging our functions, obligations and responsibilities.

## **General**

If there is any inconsistency or conflict between the English and Chinese versions of this Privacy Policy Statement, the English version shall prevail.

## **Contact us**

By Post:

Personal Data Privacy Officer  
Hong Kong Exchanges and Clearing Limited  
50/F., One Exchange Square  
8 Connaught Place  
Central  
Hong Kong

By Email:

[DataPrivacy@HKEX.COM.HK](mailto:DataPrivacy@HKEX.COM.HK)

Hong Kong Exchanges and Clearing Limited  
10/F, One International Finance Centre  
1 Harbour View Street, Central, Hong Kong

[info@hkex.com.hk](mailto:info@hkex.com.hk)  
t: +852 2522 1122 f: +852 2295 3106  
[hkexgroup.com](http://hkexgroup.com) | [hkex.com.hk](http://hkex.com.hk)