Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please reply to the questions below that are raised in the Consultation Paper downloadable from the HKEX website at:
http://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/June-2018-Backdoor-and-Continuing-Listing/Consultation-Paper/cp201806.pdf

Where there is insufficient space provided for your comments, please attach additional pages.

1. 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?

   ☐ Yes

   ☑ No

   If your answer is "No", please give reasons for your views.

   Please see enclosed the reasons and basis titled "Reasons to the reply - Question 1".

2. 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?

   ☐ Yes

   ☑ No

   If your answer is "No", please give reasons for your views.

   Please see enclosed the reasons and basis titled "Reasons to the reply - Question 2".

3. (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?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

Please see enclosed the reasons and basis titled "Reasons to the reply - Question 3(a)".

(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?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

Please see enclosed the reasons and basis titled "Reasons to the reply - Question 3(b)".

4. (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?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

(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)?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

As explained in the "Reasons to the reply - Question 3(a)", there is no meaningful basis insofar given by the Exchange in determining the length of such period.

5. (a) Do you agree with the proposed changes to Rule 14.92 (proposed Rule 14.06E) as described in paragraph 56 of the Consultation Paper?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

In the absence of clear definition of "material disposal", such proposed change creates difficulties for listed issuers to comply with. There are cases of disposals with an objective to stop further loss of non-performing assets/businesses, whereas they are certainly beneficial to shareholders if the cut-loss actions are taken at an early stage. Nevertheless, distribution in specie to be deemed as disposal does make sense.

(b) Do you agree with the proposal to add a Note to proposed Rule 14.06E as described in paragraph 59 of the Consultation Paper?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

Please refer to the replies to question 2, 3(a) and 4(b), and the reasons given in "Reasons to the reply - Question 2" and "Reasons to the reply - Question 3(a)".

6. (a) Do you agree with the proposal to add a new Rule 14.06C for "extreme transactions" as described in paragraph 62 of the Consultation Paper?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

The wordings in codifying the "extreme" transactions are vague and create difficulties for listed issuers to comply. There is no reference as what constitutes a business with substantial size or a large business enterprise. The insertion of these wordings further restricts the ability of listed issuers to take appropriate actions in business or economy downturns. Please also refer to the "Reasons to the reply - Question 1".

(b) Do you agree with the disclosure requirements for circulars of extreme transactions set out in proposed Rules 14.53A(1) and 14.69?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

The extension to historical transactions and/or arrangements that have been completed would imply "infinite" disclosures, whereas the disclosures of historical transactions could be looked up from listed issuers' announcements, interim and annual reports. "Enhanced disclosure" in circular is agreeable and fair enough.

(c) Do you agree with the due diligence requirements for extreme transactions under proposed Rule 14.53A(2)?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

7. (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) of the Consultation Paper?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

A downturn in existing business due to political and fast-changing business environment that leaded to failure in satisfying new listing requirements should not be considered as one of the factors for an acquisition, furthermore, there are risks and other reasons affecting the financial performance of the listed issuers. The reasons for listed issuers to acquire an entity do not only limit to the financial performance of the acquisition targets, but also include other factors such as business synergies and strategical business plans. There would not be any direct correlation between the new business to be acquired and the existing business of the listed issuers apart from compliance issue without considering the business needs of listed issuers.

(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) of the Consultation Paper?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

Please refer to the replies to question 7(a) above.

8. (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?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

Please refer to the replies to question 7(a) above.

(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?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

Pro forma financial statements are forward looking information provided to shareholders for their reference. In the absence of clear guidance to what forms "the entire series of acquisitions", it would confuse the shareholders the financial impacts brought by the subject acquisition, and the historical financial performance of previous acquisitions should have already published in listed issuers' annual reports.

9. 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 of the Consultation Paper?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

The existing rules governing fundraising exercise are indeed extensive enough. In view of the "cumulative value dilution" introduced, further entrenchment of the relevant rules would not be necessary but affect listed issuers to raise fundings for business needs, which is not the aim for listing a company.

10. 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?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

Assets of sufficient value may not have a direct correlation with a listed issuer's financial performace, especially for asset light business. Existing Listing Rules have already required listed issuers to have sufficient level of operations to sustain their listing status.

11. (a) Do you agree with the proposal to add a Note to the proposed Rule 13.24(1) as described in paragraphs 107 to 109 of the Consultation Paper?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

(b) Do you agree with the proposal to remove the Note to Rule 13.24 as described in paragraph 112 of the Consultation Paper?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

12. 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?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

Please refer to the reply to question 10 above.

13. 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")?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

14. 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?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

Exemption shall also be given to listed issuers of businesses with the nature of higher cash position or cash equivalents assets, such as assets management companies.

15. 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?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

Purchases and sales of securities also form the principal activity of asset management companies.

16. 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 of the Consultation Paper)?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

17. Do you agree with the proposal to codify the requirements set out in Listing Decision LD75-4 (as described in paragraph 137 of the Consultation Paper) for significant distribution in specie of unlisted assets into the Rules?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

18. 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 of the Consultation Paper?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

19. (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?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

(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?

☐ Yes

☑ No

If your answer is "No", please give reasons for your views.

The disclosures should be limited to only the relevant information related to the subject transaction, listed issuers do not have the rights to force the counter parties to fully disclose their activities not related to the transaction. There is no way that a listed issuer should invade counter parties' privacy for the purpose of a transaction.

20. 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?

☑ Yes

☐ No

If your answer is "No", please give reasons for your views.

- End -

Date: 31 August 2018

To: Hong Kong Exchanges and Clearing Limited

Re: Consultation Paper on Backdoor Listing, Continuing Listing Criteria and Other Rule Amendments - attachments

Reasons to the reply – Question 1

1. The "six assessment criteria" proposed to be added appear to be too generic and cover a wide variety of ordinary corporate actions of listed issuers. The addition of which would rather create confusions and difficulties to listed issuers in complying with the Listing Rules in practice, not only in case of transactions but also some normal corporate actions of the listed issuers from time to time. The existing regulatory regime under Chapter 14 of the Listing Rules and guidance letters have provided a clear regulatory framework that could be clearly defined, while the Exchange has already given the authorities and discretions in concluding an RTO, the addition of the "six assessment criteria" might complicate the existing regulatory regime.

2. Further to the above, in order to grow listed issuers and create values to its shareholders, it is inevitable to involve certain acquisitions for business diversifications and disposals of non-performing assets/businesses. The upshots of favourable acquisitions are well accepted by the investor community and conducted by all listed companies globally. On the other hand, divestments of non-performing assets/businesses also enable listed issuers to preserve its resources for other good business opportunities. The inclusion of the "six assessment criteria" effectively causes any transaction of any size open to the subjective assessment of the Exchange. The regulatory function of the Exchange is a "two-bladed sword", it could improve the stock market by monitoring the quality of assets/businesses listed, but at the same time it should not create burdens to listed issuers and discourage activities of bringing potential growth.

3. In view of the current fast-changing business and political environment all over the world, business cycles among different sectors are shortened than before, it becomes harder for management of listed issuers to foresee incidents (such as trade wars) that will adversely affect their existing businesses. Reasonable degree of flexibility on acquisitions/disposals should be aligned with listed issuers for them to cope with the fasting changing environment, with an aim to protect the interests of shareholders and investors. Rather than defining what constitutes an RTO, more attentions should be paid on the quality of underlying assets/business to be acquired by listed issuers, nevertheless, quality of listed assets/businesses should not be concluded only from technical point of view or fulfilling to the new listing requirements.

4. There are numerous small cap listed issuers in the Hong Kong stock market. The proposed addition of the "six assessment criteria" appear to be discriminatory to small cap listed issuers, if that would be the case, it would basically mean to disapprove any transactions of meaningful size or allow only small transactions which is not meaningful to listed issuers' business developments. In other words, it would lead to disastrous consequences of massive delisting of small cap listed issuers and possibly cause market crash of the entire Hong Kong stock market as a chain effect.

Reasons to the reply – Question 2

1. The current regulatory regime has clearly defined the characteristics of "change in control" including the Takeovers Code. Unlike Hong Kong market, there are numerous listed companies in the United States that their founders are only interested in small stakes (say less than 20%) but retained with the management rights, especially technology-based companies. Such arrangement has become more common for listed companies worldwide nowadays. The "change in de facto control" then would not be applicable to all listed issuers effectively, and may not be possibly defined in a concise manner, especially when it applies to a small threshold level of 10%.

2. The generally accepted definition of control threshold of 30% voting rights under the Takeovers Code had already provided a very clear meaning to "change in de facto control". Excessive restrictions to the change of single largest substantial shareholder would in turn cause more burdens for listed issuers to conduct fundraisings and strengthen their shareholders bases, and create hesitations to international institutional investors to invest in the Hong Kong Stock market as a matter of compliance issue.

3. From business and management point of views, the substantial change in the listed issuers' board and key management should not be related directly to the "change in de facto control", the spirit of change of board members and key management is considered to be more about improving the performance of businesses and sometimes triggered by ad-hoc incidents. A mistaken perception on the change of board members and key management would remove listed issuers' agility to identify appropriate personnel to timely resolve their business issues and affairs. Furthermore, it is also the usual practice of board members change upon acquisitions or disposals, in order to have the right managerial persons to run and overseeing the new business.

Reasons to the reply – Question 3(a)

1. Regarding the existing 24-month period, there has been no meaningful basis in determining the length of period provided by the Exchange insofar. In view of recent market activities in relation to the transactions considered to be in the substance of "backdoor listing", the effect of barely extending to 36 months would be doubtful in avoiding "backdoor listing". From commercial perspective, it is impractical for listed issuers to foresee when a good business opportunity will arise, therefore, restrictions on growth potential for a prolonged period is not appropriate in the absence of a meaningful basis and reasons to extend the length of the period.

2. Furthermore, the existing regulatory regime of 24-month period as well as other reporting and disclosure requirements, are considered to be sufficient for the Exchange and the public to assess whether a listed issuer has adhered to its business objectives and managed the company in the interests of shareholders, the practical benefits for the extension to 36-month period are therefore ambiguous.

Reasons to the reply – Question 3(b)

1. The proposed change to "clarify that series of acquisitions may include proposed and/or completed acquisitions" creates a vague picture for the basis of aggregation which is unjustifiable. There is no reason why a proposed (or aborted) but not completed transaction should be counted and being aggregated in order to arrive the conclusion of an RTO. Besides, such proposed change would also create prejudice on other acquisitions of a listed issuer. It should not be the case that the listed issuers will be required to prove the contrary of an RTO in the course of business integrations or diversifications via acquisitions. As there are always discrepancies between the compliance view of the Exchange and commercial view of listed issuers' management, an ambiguous or biased basis of aggregation is undoubtedly improper.