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29 August 2018 **BY EMAIL AND BY POST**

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

Dear Sirs,

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

INTRODUCTION

On 29 June 2018, the Stock Exchange published a consultation paper entitled *Consultation Paper on Backdoor Listing, Continuing Listing Criteria and Other Rule Amendments* (the "**Consultation Paper**") to seek market's comments on proposals relating to backdoor listing and continuing listing criteria. In an effort to further deter circumvention of new listing requirements by using shell companies to achieve backdoor listing, the Stock Exchange proposed, among others, to codify the existing practices and/or impose additional requirements for reverse takeovers, extreme acquisitions, material disposals, large scale issues of securities and regulatory disclosures. The SFC has already endorsed the Stock Exchange's initiatives to tackle backdoor listings in a press release dated 29 June 2018.

OBJECTIVES OF THE CONSULTATION PAPER

It has come to the attention of market regulators that reverse takeovers are increasingly carried out via shell companies, whose owners can earn a decent premium for trading shell companies to investors, and that shell activities invite speculative trading and can lead to opportunities for market manipulation, insider trading and unnecessary volatility in the market which undermine investors' confidence and overall market quality. There is arguably a need to reduce investors' use of shell companies to achieve backdoor listing and circumvent the new listing requirements. The purpose of the Consultation Paper is to consider whether the RTO Rules should be amended because of these concerns.

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OUR VIEW OF THE KEY PROPOSALS

Key proposals in the Consultation Paper codify in the Listing Rules practices that have already been known to the market through guidance letters and listing decisions previously issued by the Stock Exchange. However, for reasons set out in the following sections, the proposed changes may, in our view, give the Stock Exchange too broad a discretion to deem a transaction as a RTO, which in effect creates unnecessary obstacles for listed issuers to engage in genuine business transactions.

It is well accepted that listed issuers these days would not be able to survive in the long term if they cannot change their business models to keep pace with constantly evolving market demands. If the key proposals arm the Stock Exchange with too much discretion to deem transactions as RTOs, this would result in the regulator replacing the management and shareholders of the listed issuers to decide the issuers' business future. This is because listed issuers would be discouraged from, e.g. entering into new business ventures for development, raising funds from large scale securities issues for future acquisitions, disposing of sunset and unstainable businesses and seeking investors for injection of assets into the companies as such actions may be regarded by the Stock Exchange as a means to circumvent the new listing requirements.

Interests of the issuers' shareholders would suffer from issuers' reluctance to take decisive actions to revive their companies' fortunes. This is because (i) shareholders would be stuck with issuers that have insignificant level of operations with little business development; and (ii) even if they exit the issuers, it is unlikely that they can sell their shares in the market at a good price given the issuers' lack of business prospects. Neither would investors be interested in listing their companies' shares on the Stock Exchange in the long run because under the proposed changes to the Listing Rules, all business transactions intended to be carried out by listed issues are subject to the principle-based test and the six assessment criteria (see reply to A(1) below). Such transactions therefore require the blessing of the Stock Exchange before they can be proceeded with. Investors might regard these kinds of requirements as too strict and create onerous burden on companies seeking continued business evolution and keeping pace of constantly changing business demands.

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Likewise, if the key proposals give the Stock Exchange too much latitude to question and interfere with transactions into which listed issuers propose to enter by, e.g. deeming as RTOs those acquisitions which fail to meet the requirements in Rule 8.05, this may be seen as an attempt by the Stock Exchange to unduly restrict the right of listed issuers to freely run their businesses as they see fit to ensure business survival. This could result in possible contravention of Articles 118 and 119 of the Basic Law, which require that the SAR government provide, among other things, an economic and legal environment for encouraging investments, and formulate appropriate policies to promote the development of commerce, on the part of the Stock Exchange.

Finally, the Stock Exchange has not clarified in the Consultation Paper how it will exercise the wide discretion given to it by the key proposals to determine if a transaction constitutes a RTO, e.g. it is unclear whether the six assessment criteria need to be met at the same time or are balanced against each other in a balancing exercise (see page 7 below). This would cause the market to doubt the certainty of the RTO Rules because the interpretations of such rules are no longer guided by clearly stated and objective principles, but by regulators' own preferences, the basis for the making of which still requires further elaboration by the Stock Exchange.

Without prejudice to our views expressed above, we set out below a summary of the key proposals included in the Consultation Paper and our responses to them. In making the current submission to the Stock Exchange, we have considered all the contents of the Consultation Paper, whether explicitly set out below. All capitalised terms not otherwise defined herein shall have the meanings ascribed to them in the Consultation Paper.

Proposals relating to Backdoor listing (Chapter 2 of the Consultation Paper)

A. Amend the RTO Rules*:*

A(1) Retain the principle-based test in the RTO Rules (proposed Rule 14.06B) and codify in Note 1 to the proposed Rule 14.06B the six assessment criteria currently set out in Guidance Letter GL78-14 with modifications.

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Hong Kong has consistently been ranked as one of the freest trade economies in the world. To preserve this reputation in the context of the Listing Rules, regulators must exercise extreme caution in designing good anti-avoidance provisions which should strike an appropriate balance between allowing listed issuers to freely run their businesses in their shareholders' interests and reducing incidence of circumvention of new listing requirements. For example, good anti-avoidance provisions will not create any artificial obstacle to block listed companies from exploring new business opportunities to ensure business survival and enhance value of their companies in the long term, whereas overly restrictive anti-avoidance provisions cannot provide listed companies with a platform to freely carry on their business and the necessary flexibility to explore new business opportunities to ensure survival and create value for their shareholders.

In our opinion, the proposed Rule 14.06B, armed with the six assessment criteria, is a catch-all provision instead of an anti-avoidance provision because, as will be explained in the following paragraphs, under the proposed assessment criteria for RTO, many types of acquisitions which would not be deemed as RTOs in jurisdictions comparable to Hong Kong such as the UK and Australia would be caught by the six assessment criteria, even without triggering a change of control in the issuer (see below for explanation).

In today's constantly evolving business world in which business cycle is getting shorter and shorter, it is impossible for listed companies to ensure business survival without any modification or change to their business models and continue with their existing businesses indefinitely. The provisions in the proposed Rule 14.06B, however, discourage new business ventures to be entered into by those listed companies which are facing a business downturn or dim business prospects. The proposed Rule 14.06B will also lead to regulators' intervention in business decisions of listed issuers as the provisions therein give regulators a very wide discretion to deem any transaction as RTO. For listed companies which are at their initial stage of development and with little business operations, any decision by the regulators that the new business ventures which they have entered into or intend to enter into represents an attempt to circumvent the new listing

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requirements rather than to promote business development will practically sound the death knell for them because: (i) they are unable to meet the costs associated with a new listing; (ii) regulators may suspend their listing status on account of insufficient business operations under Rule 6.01(3); and (iii) without injections of new business assets, they face eventual extinction.

The above being said, we proceed to consider whether it is appropriate to include the six assessment criteria, namely:

- the size of transaction relative to the size of the issuer;
- the nature and scale of the issuer's business before the acquisition (e.g. whether it is a listed shell);
- any fundamental change in the issuer's principal business (e.g. the existing business would be discontinued or very immaterial to the enlarged group's operations after the acquisition);
- any issue of restricted convertible securities to the vendor which would provide it with de facto control of the issuer (see reply to A(2) below);
- 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;
- 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) (the "**series of arrangements" criterion**"),

as factors for determining whether an acquisition constitutes a RTO.

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By way of comparison, we match the six assessment criteria against their counterparts in the RTO rules in the UK[1] and Australia,[2] whose securities rules provide a model for Hong Kong's own rules. In the UK, backdoor listing occurs when a listed company acquires an unlisted company or assets in which any one of the percentage ratios calculated in accordance with Chapter 10 of the UK Listing Rules is 100% or more or which would result in a fundamental change in the business or a change in the board or voting control of the listed company. In this case, the transaction must be subject to shareholder approval and a circular will be required. The combined group applying for listing will be treated as a new listing applicant.

In Australia, RTO refers to a process where an unlisted entity seeking to have its assets or business listed does so by injecting the assets/business into an existing listed issuer in return for the issuer's shares. If the listed issuer proposes to make a significant change to the nature or scale of its business activities in this manner, it must provide the Australian Securities Exchange (the "**ASX**") with full information regarding the change as soon as practicable, and, if the ASX so requires, the issuer must seek shareholders' approval of the change and ensure the enlarged group can meet new listing requirements upon the change.

As can be seen from the above, the assessment criteria for RTO in the UK and Australia are much simpler than Hong Kong's. For example, the assessment criteria for RTO in the UK are confined to where (i) the acquisition is of the size of a very substantial acquisition (the "**VSA**"); and (ii) there is a fundamental change in issuer's business or change in control in the issuer. The principal assessment criterion for RTO in Australia, on the other hand, is whether the acquisition results in a significant change to the nature and/or scale of the activities of the listed issuer.

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[1] See UK listing rules, rule 5.6.

[2] See ASX listing rules, rules 11.1-11.3.

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In addition to the six assessment criteria, there are three other points in relation to the extent of the Stock Exchange's discretion to deem acquisitions as RTOs which we believe deserve attention. First, under the proposed Rule 14.06B, the Stock Exchange *normally* takes into account the six assessment criteria in deeming acquisitions as RTOs. It follows from this that in addition to the six assessment criteria, the Stock Exchange may consider other factors, which are yet to be elaborated upon by the Stock Exchange, in its determination.

Second, there is no clear indication by the Stock Exchange that the six assessment criteria would be considered by it conjunctively or disjunctively. In other words, the Stock Exchange may weigh the six assessment criteria by using a balancing exercise. Accordingly, even if the acquisition, e.g., would not result in change of control in the issuer, the Stock Exchange may still deem the acquisition as a RTO, provided that the Stock Exchange is satisfied that the other assessment criteria are met.

Finally, the Stock Exchange has the discretion to deem an acquisition below the size of a VSA to be a RTO if there are other specific concerns about circumvention of the RTO Rules (see footnote 13 to paragraph 47 of the Consultation Paper). If follows from this that acquisitions of the size of major transactions and discloseable transactions may be deemed as RTOs if there are concerns over circumvention of new listing requirements in the opinion of the Stock Exchange. Hence, regardless of how large or small the size of the acquisitions is, if the Stock Exchange takes the view that the acquisitions constitute RTOs, listed issuers which propose the RTOs will be treated as if they were new listing applicants under Rule 14.54. Issuers are likely to abort the acquisitions under such circumstances because most, if not all, of the acquisitions cannot meet the requirements in Rule 8.05.

The simpler assessment criteria for RTO in comparable jurisdictions such as the UK and Australia, together with the breadth of the Stock Exchange's discretion to consider the six assessment criteria in a balancing exercise and deem an acquisition as a RTO even if the acquisition is below the size of a VSA reinforce our view that the proposed Rule 14.06B is a catch-all provision instead of an anti-avoidance provision, and provide

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the Stock Exchange with very broad discretion to deem an acquisition as a RTO. This would result in, as explained before, (i) interference in listed issuer's business future; and (ii) banning of acquisition targets non-compliant with Rule 8.05, as well as cause market uncertainty over the Listing Rules.

For the reasons stated above, we do not support the proposal.

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".

Subject to the views expressed in the reply to A(1) above, we agree that a change in control or de facto change in control in the listed issuer is a material factor in the determination of whether the transaction is an attempt to circumvent the new listing requirements. This is because, upon the change of control in the listed issuer, the incoming major shareholder may use the listed issuer as a platform for other business by, e.g. appointing the board of directors to approve embarking on acquisitions that have no relationship to the industry sector in which the issuer operates originally.

However, the Stock Exchange plans to extend the current criterion "issue of restricted convertible securities" to include "any change in control or de facto control of the listed issuer". Indicative factors of a change in de facto control in the issuer will include: (i) substantial change in its board of directors and key management; (ii) change in its single largest substantial shareholder, and (iii) issue of restricted convertible securities to a vendor as consideration for an acquisition (see paragraph 38 of the Consultation Paper).

Given that it has always been very difficult to prove the incoming major shareholder has exercised or will exercise de facto control of the listed issuer, we respectfully invite the Stock Exchange to further set out other factors which it will consider in assessing whether a change in de facto control has occurred in the listed issuer Until this issue is satisfactorily resolved, we do not support the proposal in its current form.

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A(3) Clarify in the "series of arrangements" criterion, i.e. the 4th assessment criterion above:

> ***Transactions and/or arrangements (completed or proposed) may be considered to form a series if they are in reasonable proximity or are otherwise related, and a series of transactions will be treated as if it were one transaction. The Stock Exchange will not normally consider a transaction or arrangement outside a three-year period as part of the series.***

In applying the principle-based test, the Stock Exchange would consider the six assessment criteria set out in GL78-14 (see paragraph 12 of Listing Decision LD113-2017). Although not specifically mentioned in LD113-2017, it is quite clear that, when looking at a series of transactions in the RTO context, the Stock Exchange would aggregate the transactions together and view them as if they formed a single transaction.

Transactions in the series can take different forms: they can be either completed or proposed, and they might include changes in control/de facto control, acquisitions, disposals or termination of the original businesses, greenfield operations or equity fundraisings related to acquisitions or for the development of new business activities (see paragraph 39 of the Consultation Paper).

It is also logical that if transactions are aggregated in a series, the transactions therein should be viewed in totality. If not, it would be unnecessary to aggregate the transactions in a series in the first place. Hence, it is reasonable for the Stock Exchange to assess the effect of all the transactions in a series as if the transactions therein formed one transaction.

However, in order to limit the ambit of the "series of arrangements" criterion, the Stock Exchange proposed in paragraph 42 of the Consultation Paper that it may regard acquisitions and other transactions or arrangements (proposed or completed) as a series if they take place in close proximity to each other (which normally refers to a period of 3 years, i.e. the "**aggregation period**") or are otherwise related.

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In our opinion, the limiting condition proposed by the Stock Exchange above will lead to more questions than answers. For example, (i) what do the terms "reasonable proximity" or "are otherwise related" mean? It seems reasonable to suggest that these terms apply to transactions or arrangements which are entered into by the issuer with the same party or with parties connected or otherwise associated with one another in a defined period. However, for the avoidance of doubt, the Stock Exchange is respectfully invited to further explain and clarify these terms, e.g. by way of examples; and (ii) what are the criteria the Stock Exchange uses to rule that the transactions/arrangements in a series are in reasonable proximity or otherwise related to one another? The Stock Exchange may also need to set out by way of examples how the criteria are applied.

Moreover, it is our view that even with a clear definition of what constitutes "close proximity" and "otherwise related", the proposal in its current form runs the risk of unduly restricting the right of listed issuers to freely enter into certain transactions, thereby contravening the requirements of Articles 118 and 119 of the Basic Law. This is because listed issuers may try to avoid the impression of their being engaged in circumvention of new listing requirements by, e.g., (i) entering into transactions which are not in reasonable proximity or otherwise related to one another, but may not necessarily be in the best interests of their shareholders; and/or (ii) refraining from such transactions, while developing their business activities to ensure future business success, might be considered to be in reasonable proximity or otherwise related to one another, hence subject to the RTO Rules.

As for the length of the aggregation period, the Stock Exchange explained in paragraph 43 of the Consultation Paper that a 3-year aggregation period may result in more disclosure for the issuer's shareholders and members of the public to assess the issuer's business operations and development. The Stock Exchange then cited in footnote 11 to the same paragraph the China Securities Regulatory Commission (the "**CSRC**") rules which provide for a 5-year aggregation period, and the 2-year aggregation period from the ASX listing rules as references for the 3-year aggregation period proposed by it.

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It is noted that in China[3] a backdoor listing will result if a private company's total assets acquired by a listed company account for 50% or more of the ending total assets as specified in the listed company's audited consolidated financial statements for the last fiscal year. In Australia, as mentioned before, RTO occurs where an unlisted entity achieves listing of its assets/business by injecting them into an existing listed issuer in return for the issuer's shares.

Given that the bases of the RTO rules in China and Australia are different from that of Hong Kong, the reference by the Stock Exchange to the aggregation periods in the CSRC rules and the ASX listing rules, with respect, would not seem to advance the Stock Exchange's case for a 3-year aggregation period to a significant extent.

Furthermore, since the market in Hong Kong is used to a 2-year aggregation period (see, e.g., Rule 14.06(b) which states, inter alia, that an acquisition from the incoming shareholders within a 24-month period may constitute RTO, and Rule 14.92, where a listed issuer may not dispose of its existing business for a period of 24 months after a change in control) and there is no evidence to suggest that a 2-year period is insufficient for the public to assess the issuer's business operations, we consider that the reasons given by the Stock Exchange in favour of a 3-year aggregation period (i.e. more disclosure to assess the issuer's business) may not be strong enough to convince the market that a 3-year aggregation period is necessary. Accordingly, the Stock Exchange is respectfully invited to explain with further basis why there is a need to increase the aggregation period from 2 years to 3 years.

For the above reasons, we have reservations on the proposal.

[3] *Measures for the Administration of the Material Asset Restructurings of Listed Companies* (2016 Revision) (上市公司重大资产重组管理办法(2016 修订)), Article 12.

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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 Note 2 to the proposed Rule 14.06B, and extend the aggregation period from 24 months to 36 months.

As mentioned before in the reply to A(1) above, we are of the view that the ambit of the principle-based test is too broad and arms the Stock Exchange with too wide a discretion to deem practically all acquisitions by listed issuer as RTOs, which will hamper business development of the issuers. The better view, it is respectfully submitted, is to rely on the bright line tests to determine if the transaction constitutes a RTO, with the change of control in the listed issuer as the determining factor. The bright line tests, it is noted, is consistent with the approach adopted by other jurisdictions such as the UK, Australia and the PRC in deeming transactions as RTOs.

Turing to the proposal, the market has already been familiar with the bright lines tests as two specific forms of RTO after the Stock Exchange ruled to that effect in a number of listing decisions in the early 2010's. The only revision to the contents of the bright line tests in Note 2 to the proposed Rule 14.06B is that the aggregation period will be extended from 24 months to 36 months.

The Stock Exchange argued that the aggregation period in the bright light tests should be extended from 24 months to 36 months to align with the proposed aggregation period in respect of the "series of arrangements" criterion (see paragraph 54 of the Consultation Paper) for clarity. We have queried in the reply to A(3) above the appropriateness of the choice of a 36-month aggregation period instead of a 24-month period in respect of the "series of arrangements" criterion. For these reasons, we do not support the proposal.

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(b) ***modify current Rules 14.92 and 14.93 as follows. The proposed Rule 14.06E(1) restricts any 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 any other person(s), would meet the requirements under Rule 8.05 (or Rule 8.05A or 8.05B). If a disposal does not meet these requirements, it will result in the listed issuer being treated as a new listing applicant (proposed Rule 14.6E(2)).***

We would like to express our view from the outset that we do not see the need to impose restrictions on any material disposal of an issuer's existing business. This is because if the issuer is unable to meet the requirements in Rule 13.24 after its original business is disposed of, its shares would be suspended for trading under Rule 6.01(3) in any event, thereby achieving what the proposed Rule 14.06E(2) sets out to accomplish.

The above being said, we turn to the proposed Rule 14.06E, which is a modified form of Rules 14.92 and 14.93. Subject to our observations in the paragraph below, we conditionally support the proposed Rule 14.06E.

To our understanding, Rules 14.92 and 14.93 are intended to prevent circumvention of the RTO Rules by restricting 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 any other assets acquired after the change in control can meet the requirements in Rule 8.05.

The proposed Rule 14.06E(1) enhances Rules 14.92 by restricting any *material* disposal of an issuer's existing business (a) *when there is a proposed or intended change in control of the issuer; or (b)* within *36 months* after a change in control, unless (i) the *remaining business*; or (ii) the assets acquired from the new controlling shareholder (and its associates) and any other person(s), would meet the

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requirements under Rule 8.05. As per the proposed 14.06E(2), any disposal which does not meet the requirements under the proposed Rule 14.06E(1) will result in the listed issuer being treated as a new listing applicant.

In relation to the proposed changes to Rules 14.92 and 14.93 as italicised above, our observations are as follows: (i) there is a need for the Stock Exchange to further define what constitutes a "material" disposal of an issuer's existing business; (ii) the restriction period is extended from 24 months to 36 months to align with the proposed 36-month aggregation period. Please refer to our query of the length of the aggregation period in the reply to A(3) above; (iii) we have no issue with the need for the remaining business of the issuer, upon material disposal of the issuer's assets, to meet Rule 8.05 requirements and the proposed extension of the restriction on any material disposal to the time of a proposed or intended change in control of the issuer as they represent additional hurdles against any attempt to circumvent the listing requirements.

(c) provide, by way of a Note to the proposed Rule 14.06E, the Stock Exchange with a discretion to apply proposed Rule 14.06E 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.

The Note intends to extend the reach of the proposed Rule 14.06E(1) to a disposal of an issuer's existing business when there is a proposed or intended change in the single largest substantial shareholder in the 36 months before the disposal.

According to the Stock Exchange (see paragraph 59 of the Consultation Paper), the proposed Note addresses concerns where there is a change in the single largest shareholder of the issuer and the new substantial shareholder acquires de facto control of a listed issuer, and the issuer develops a new business through greenfield operation and then disposes of its original business, which achieves a listing of

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the new business and hence circumventing the new listing requirements.

We believe that the concern expressed in the above paragraph is already fully addressed by the proposed Rule 14.06B(1)(d), where the Stock Exchange will regard any change in control or de facto control of the issuer as part of its consideration of whether the transaction is a possible RTO. The factors considered by the Stock Exchange to determine it include, among others, any change in the single largest substantial shareholder of the issuer (see also the reply to A(2) above). The proposed Note is therefore unnecessary and we do not support the proposal as a result.

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

codify the current "extreme VSA" requirements in Guidance Letter GL78-14 into the Listing Rules, and rename this category of transaction as "extreme transaction", and 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 (collectively the "Additional Requirements").

We conditionally support the proposal to codify the current extreme VSA requirements set out in Guidance Letter GL78-14. The market has become aware of them since the publication of GL78-14 in May 2014. If the market finds the codification of the current "extreme VSA" requirements in the proposed Rule 14.06C acceptable, we would lend support to the proposal introduction of the Additional Requirements.

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According to the Stock Exchange, a transaction would be classified as extreme VSA (i) by reference to the six assessment criteria mentioned in reply to A(1) above; and (ii) the assets to be acquired can meet Rule 8.05 requirements, and circumvention of the new listing requirements would not be a material concern (see paragraph 8 of GL78-14). However, if the assets to be acquired by the issuer are of a significant size when compared to its original business, the issuer's original business may become immaterial after the acquisition and might result in a fundamental change in the issuer's original business. The Stock Exchange might regard this as a means to achieve the listing of the assets to be acquired (see paragraphs 21, 47 and 48 of the Consultation Paper). Accordingly, it is essential that the issuer can meet the Additional Requirements to allay the Stock Exchange's concern expressed above that the existing business are insignificant in size by comparison to the newly acquired assets, thereby triggering circumvention of the new listing requirements.

A(6) Impose additional requirement on transactions classified as RTOs and extreme transactions 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 (the "proposed requirement"). 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.

The Stock Exchange proposed to amend Rule 14.54 (applicable to RTOs) and add Rule 14.06C(2) (applicable to extreme transactions) to require that (i) both the assets to be acquired and the enlarged group must meet Rule 8.04 (i.e. be suitable for listing); (ii) the acquisition targets must meet Rule 8.05, i.e. the track record requirements – currently either the enlarged group or the acquisition targets must meet the track record requirements; and (iii) the enlarged group must meet all the new listing requirements set out in Chapter 8 of the Listing Rules (except Rule 8.05).

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We are of the view that if the acquisition targets can meet the requirements in Rules 8.04 and 8.05, there should not be any question over the enlarged group's capability to meet the same if the listed issuers have been able to maintain a reasonable level of business operations. However, for those listed issuers which have been loss making due to their failure to carry out a sufficient level of business operations and hoping that the acquisitions would help revive their businesses, the proposed requirement is likely to put extra pressure on the resources of the acquisition targets and dash the hope. This is because for the enlarged group to succeed under the proposed requirement, the acquisition targets must be able to meet the track record requirements to such an extent that they can fully absorb all the money lost by the issuers in the past three years (for a new listing on the Main Board). If the acquisition targets are unable to do so, the Stock Exchange may take the view that the enlarged group is not suitable for listing and deem the acquisition as a RTO. This will make the revival of the listed issuer's business practically impossible to achieve, which, in turn, harms the interests of shareholders of those listed issuers.

The above being said, considering those listed issuers are in breach of Rule 13.24 by failing to maintain a sufficient level of business operations, we have no objection to the (i) suspension of shares of those issuers under Rule 6.01(3), and (ii) each of the acquisition target(s) and the enlarged group must meet all the new listing requirements in Chapter 8.

For the above reasons, we support the proposal.

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.

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 by the Stock Exchange, it will not be regarded as suitable for listing and trading in its securities will be suspended under Rule 14.82. As per Rule 14.84, the issuer would be required to comply with all new listing requirements

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and issue a listing document to lift the trading suspension (collectively the "**cash company Rules**").

In paragraph 6 of GL84-15, the Stock Exchange applied the cash company Rules to large scale issues of securities where investors would circumvent the new listing requirements by injecting substantial amounts of cash into the listed issuers through share subscriptions to obtain control of listed issuers, and use the funds raised from such issues in largely green field operations with little or no relation to the issuer's existing principal business.

Because of the share subscriptions, the issuer's assets would consist substantially of cash upon completion. The Stock Exchange would not regard the listed issuer as suitable for listing and trading in its securities would be suspended.

We would like to state from the outset that we disagree with the cash company Rules. This is because listed issuers may wish to conduct fund raising exercises for the legitimate reasons of using the proceeds raised therefrom to fund acquisitions and expand their business activities in the future. After a fund raising, an issuer may hold more than half of its assets in cash in anticipation of and preparation for the best timing to make future acquisitions. The issuer's holding onto the cash is a legitimate business practice in the interests of the issuer's shareholders, and listed issuers should not be penalised for acting in the interests of their shareholders in this manner. Hence, it would not be fair for the Stock Exchange, we respectfully submit, to immediately suspend the issuer's listing status under Rule 14.82 as soon as it becomes aware of the listed issuer's failure to comply with the cash company Rules. When more than 50% of the issuer's total assets are in cash or short dated securities, the Stock Exchange, we further respectfully submit, should allow the issuer a grace period of 6 months so that it can deploy the cash for viable business ventures.

Having said the above, we now turn to the proposed Rule 14.06D. The Stock Exchange stated in paragraph 81 of the Consultation Paper that the proposed Rule 14.06D is intended to apply to a large scale issue of securities for cash proposed by a

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listed issuer hoping to acquire and/or develop a new business through future acquisitions. The new business is expected to be substantially larger than the issuer's existing principal business, with a view to achieving a listing of the new business that would not have otherwise met the listing requirements.

The Stock Exchange has justified the proposed Rule 14.06D by arguing that the new rule will apply to the situation where the funds raised from the large-scale share issue would be used to develop a new business through future acquisitions in addition to the greenfield operations as described above in paragraph 6 of GL84-15 (see paragraph 81 of the Consultation Paper).

We do not agree with the Stock Exchange's basis for the proposed Rule 14.06D because its reliance on paragraph 6 of GL84-15 to justify the new rule is only possible if (i) the large scale share issue would also result in a change of control in the listed issuer; and (ii) the funds raised from the large scale share issue would be used to develop a new business through future acquisitions. However, there are many large scale securities issues proposed by listed issuers which would not result in a change of control. There are also, as mentioned before, many legitimate fund raisings exercises conducted by listed issuers for business expansion and development. In such circumstances, it would not be fair for the Stock Exchange to apply the proposed Rule 14.06D to such share issues. For these reasons, we do not support the proposed Rule 14.06D in its current form, and respectfully invite the Stock Exchange to re-examine the merits of GL84-15 in light of our comments above.

Proposals relating to Continuing Listing Criteria (Chapter 3 of the Consultation Paper)

B. Amend Rule 13.24:

B(1) Amend Rule 13.24 to clarify that a listed issuer must carry out a business with a sufficient operation 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.

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An issuer having a sufficient level of operations or assets of sufficient value to support the issuer's operations to warrant its continued listing are alternative criteria under the current Rule 13.24. The Stock Exchange's proposed amendments to Rule 13.24 is to turn these alternative criteria into a double-limb test, which means that an issuer must satisfy both tests.

We support this proposal. In our view, sufficiency of the issuer's operations (the "**1st limb**") and assets of sufficient value (the "**2nd limb**") should be viewed together in assessing whether the issuer's continued listing is justified. This is because the failure to meet the 1st limb often results in the failure to meet the 2nd limb as well, hence lead to a breach of Rule 13.24. For example, the issuer in Listing Decision LD116-2017 failed to comply with Rule 13.24 because the issuer and its subsidiaries (collectively the "**group**"):

- it had a very low level of operating activities and revenue, e.g. the issuer's business did not generate sufficient revenue to cover its corporate expenses, resulting in net losses and negative operating cash flows;

- its current operation did not represent a temporary downturn, the issuer had been operating at a very small scale and incurring losses for several years; and

- its assets did not generate sufficient revenue and profits to ensure the issuer to operate a viable and sustainable business.

However, if the 1st limb and the 2nd limb are considered alternatively in determining if a possible breach of Rule 13.24 has occurred, there could be cases where the listed issuer has maintained a sufficient level of operations, but its assets are not of sufficient value to generate adequate revenue and profits to ensure that the issuer operates a viable and sustainable business. Nevertheless, since the 2nd limb is not considered together with the 1st limb as a whole, the issuer can still comply with Rule 13.24 because it has been able to meet the 1st limb. As a result, the issuer's shares would not be subject to suspension under Rule 6.01(3). Likewise, issuers that hold significant assets but do not

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carry on sufficient level of business operations would be able to meet the continuing listing criteria by relying on the fact that it can meet the 2nd limb, even though not 1st limb.

The continued listing of issuers that can meet either the 1st limb or 2nd limb but not both would only intensify the Stock Exchange's concerns about the suitability for listing of these businesses, 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. Accordingly, the proposed amendments to Rule 13.24 by requiring issuers' compliance with both 1st limb and 2nd limb is a step in the right direction and is supported.

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.

According to the Stock Exchange, as most of the listed issuers tend not to engage in securities trading and/or investment as their main businesses, it proposed to exclude issuers' trading and/or investment when considering the sufficiency of the listed issuers' operations and assets (see paragraph 115 of the Consultation Paper).

If the trading of securities and investment do not form part of the main business of the issuer, the gains arising from such trading will not be counted towards revenue in the consolidated accounts of the issuer's group, hence the issuer's business operations. Accordingly, we do not see the regulatory rationale of the proposal and have reservations about it.

C. Amend the cash company Rules (Rules 14.82 to 14.83):

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.

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The new definition of short-dated securities is consistent with market practice in Australia and Malaysia. We therefore support the proposal.

C(2) ***Amend Rule 14.83 to exclude assets held on behalf of clients by issuers would not be considered in assessing whether the issuer is a cash company.***

We support the proposal.

Other proposed Rule amendments (Chapter 4 of the Consultation Paper):

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).***

We do not agree with the proposal. If the transactions are genuine, they should not be excluded.

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

We agree with the proposal. The additional disclosure allows investors to know more about the listed issuer's investment portfolio.

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.

We agree with the proposal as it will lead to better protection of investors' interests.

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F. Proposals relating to notifiable or connected transactions

F(1) Require disclosure on any subsequent change and the outcome of any financial performance guarantee of a target acquired by the issuer in a notifiable and connected transaction as set out in paragraph 140 of the Consultation Paper.

We agree with the proposal.

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.

We agree with the proposal, which can provide more information to investors.

F(3) 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 Stock 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.

We agree with the proposal.

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CONCLUSION

According to the Stock Exchange, the key proposals in the Consultation Paper are intended to discourage circumvention of the new listing rules by increasing the transaction costs associated with a backdoor listing of shell companies, which include, among others, the extension of the aggregation period from 2 years to 3 years, the implementation of restrictions on disposals of an issuer's existing business, the cost in maintaining a viable and sustainable business.

We have set out in detail in the above sections that we do not support the majority of the key proposals in the Consultation Paper which, in our view, arm the Stock Exchange with too much discretion in deeming a transaction as a RTO, and significantly interferes with the way in which listed issuers run their businesses. If the key proposals are implemented without amendments, interests of issuers' shareholders would suffer, and investors may not be interested in listing their companies' shares on the Stock Exchange on the ground that listed issuers here have little prospect for business success because they are discouraged from, among others, changing their business models to keep pace with new business demands, and entering into new business ventures for development and expansion. This would make us lose sight of the overriding goal to maintain Hong Kong's reputation and position as one of the world's (i) freest trade economies as well as (ii) leading IPO markets and listing venues of choice. Neither can we afford to let listed issuers stagnate because of potential circumvention of new listing requirements by backdoor listing.

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Yours faithfully,
For and on behalf of
Central China International Capital Limited

[redacted]

Billy C.W. Cheung
General Manager

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