

## 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.

*The proposed changes to the Listing Rules introduce considerable uncertainties and substantially highest costs to many small to medium-sized issuers contemplating quite conventional transactions. The proposal rejects bright line tests alone which can be calculated at the time a transaction is proposed by adding to them much vaguer and subjective measures by giving the Exchange "broad discretion" to deem an acquisition to be a new listing and introducing considerable "flexibility" as to how these rules are to be interpreted in the future. While the consultation paper states that it does not wish to "restrict listed issuers from business expansion or diversification that are part of its business strategies or are consistent with its size and resources" it does not distinguish these transactions from ones which could under its wide and generally worded remit be transactions designed to circumvent new listing requirements. It should be accepted that any acquisition effects a listing of the assets acquired and any takeover can anticipate changes in business strategy. This is the reason why a change of control is required to be accompanied by a takeover offer at a specified price.*

*The problem is exacerbated by including in the aggregation of transactions, transactions which are proposed or intended but not necessarily implemented over a considerable period of time, being three years or in the case of a series of transactions, possibly rather longer. Once a listed issuer has made one acquisition and proposes another, it has opened itself up to being considered a new listing and has no means of reversing the decision. It should be open to the issuer to abandon a proposed transaction if it is likely to trigger an RTO problem. However even abandoning a previously proposed transaction may cause a further problem in that it would restrain an issuer from any other acquisition in the fear of it being deemed an RTO. This must introduce a greater degree of risk and with it speculative trading and unnecessary volatility in the trading of an listed issuer's shares which appears to contradict the stated purpose for the rule changes.*

*The proposed rule changes also bear much more heavily on smaller companies and the risk is increased substantially were a listed issuer to incur losses following the making of an acquisition as the listed issuer as a whole, and not just the business assets acquired, is required to meet the new listing requirements of Rule 8.05. One of our concerns is the impact on a small listed company that announces a loss. Its ability to undertake any acquisition to improve its position has a danger of being treated as an RTO. These risks are further exacerbated by the changes to the delisting procedures which set a much shorter timeframe to avoid delisting for a listed issuer which has had trading in its shares suspended. The expected result of these proposed changes is to make smaller listed companies a riskier investment and to curtail, unnecessarily in our view, corporate activity by these companies. (See remaining response on a separate sheet)<sup>0</sup>*



## **Questionnaire on backdoor listing, continuing listing criteria and other rule amendments**

### **Response from Anglo Chinese Corporate Finance, Limited**

#### **Question 1 (Continued)**

We would also note that, while other proposed changes are common to other exchanges and this is given emphasis in the consultation paper, to our knowledge these proposals are without precedent in any other developed market.

In our view the regulators seem to be unduly concerned about back door listings and shell companies which are a common feature of many markets. By way of example in the US market there is no such prohibition; in fact the listing of special purpose acquisition companies, i.e. cash shells, is permitted. These proposed rule changes do not address the reasons why shell companies have become popular in the Hong Kong market and command absurdly high premia for listing status on either the Main Board or GEM. In our view this anomaly has arisen from the unduly burdensome listing process that developed over the years resulting in monumental prospectuses being produced which may record in detail and often repetitively much information which has little relevance to an investment decision relating to the business and prospects of the listing applicant. Were the process and the information required simplified and the process made less burdensome the uncertainty and expense of listing would be significantly reduced thereby making the listing of a company through the IPO process here the better option. We only need to look at other established stock markets to see how much more helpful and concise are their IPO prospectuses than the documents that are produced here.

Lastly, the application of the proposed rules will require a high level of subjective judgment being exercised by the Exchange of the unstated motivation of a listed issuer's directors in entering in to a transaction. This will result in difficulty for the Exchange to ensure consistency in the application of these rules. Such uncertainty will further reduce the attraction of Hong Kong being a place of choice to list shares.

31<sup>st</sup> August, 2018

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.

***The addition of the concept of defacto control will introduce even greater uncertainty to transactions for listed companies. Code control as a measure has worked well to date and to introduce another form of control is unnecessary.***

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.

***We do not agree for the reasons given in the response to question 1 above.***

- (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.

***For the reasons stated above, the inclusion of prospective transactions over a long period of time introduces an unacceptably high level of risk to many smaller listed companies. The risk is made greater if consideration is given to the new arrangements for delisting companies whose shares have been suspended for a period of twelve months.***

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.

***A two year period should be sufficient.***

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.

***During the 36 months period (which is a fairly lengthy period) after a change in the single largest substantial shareholder, if an issuer legitimately intends to dispose of its existing business which is not performing well and, or its prospects are declining, and it is able to sell the business for a fair and reasonable price, the proposed restriction of any material disposal of an issuer's existing business may conflict with the issuer's board of directors' fiduciary duties to act in the best interest of the company's shareholders as a whole. In other words, the proposed Rule 14.06E should allow material disposals if there are genuine commercial reasons for the disposals. Further, we would not support a restriction on the sale of businesses back to the original management or controlling shareholders as they may be the most logical buyer and the buyer which may pay the highest price.***



(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.

***See response in 5(a) above***

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.

***While we do not think that any comment we make will deflect from the Exchange's determination to maintain and codify this category of transaction, we are not convinced that it is necessary. It obviously complicates, delays and makes more expensive a particular category of substantial transaction which will bear most heavily on smaller listed companies. It is also a departure from what other established exchanges have felt necessary.***

(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.

***Again, we are not convinced that this is necessary. As we have seen with the sponsorship regime, it is likely to increase transaction costs considerably without necessarily providing investors with any tangible benefit.***

(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.

**See above.**

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.

***Under the current Listing Rules, an issuer contemplating an acquisition may be deemed as a RTO or an extreme VSA (to be renamed as an "extreme transaction" under the new RTO rules) even though there is no change in control in the issuer. We believe that the proposed amendments to Rule 14.54 should provide an exemption for issuers that do not undergo an actual change in control (in terms of the Takeovers Code) in order that these issuers may pursue business or asset acquisitions that are commercially sound though falling short of the track record requirements under Rule 8.05. As an example, an issuer operating a business with a substantial size under the same control over a three year period should have the liberty to acquire a related business that has a profitable two year track record provided the enlarged listed group meets all the other basic listing conditions set out in Chapter 8 of the Listing Rules.***

(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.

***See our response to question one 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.

- (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.

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.

***Philosophically we are not supportive of making "cash shell or RTO" transactions increasingly difficult and expensive. Similarly, if investors are prepared to invest in an issue which raises a substantial amount of cash relative to the size of the issuer, we see no reason to prevent this. We note that the largest and most sophisticated exchange on the world, the NYSE, has no difficulty with special purpose acquisition companies and is quite prepared to list what is in effect a cash shell.***

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.

***We consider the existing Rule 13.24 which include the alternative should stay as it must be quite possible for a listed company to have substantial assets but limited operations, for instance, it could own a large commercial building (like a shopping mall or a hotel), the management of which is out-sourced to external professional managers. This is one of many common business models of companies with substantial assets but limited operations. Another example is a ship owning company with its vessels managed by an independent ship's agent. In these situations, we question if it is sensible to suspend trading and threaten the delisting of a listed company which has assets worth billions of dollars, and how that protect public shareholders. The proposed rule amendments relating to continuing listing criteria should not only tackle shell activities, but ought to take into account legitimate business models with substantial assets and limited operations. Further, we believe it will be helpful if the Exchange compares the currently suggested rule changes with those of overseas exchanges.***

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.

***We suggest that the paragraph describing the Exchange's views of a money lending business should be deleted as it unnecessarily particularises this rule. It would be better to be included as a published Listing Division decision, if this has not already been done.***

(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.

***See our response to question 10 above.***

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.

***It would depend if it had been a significant activity over a period.***

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.

***This is another example of the Exchange creating a category of listed issuer which many other exchanges do not find objectionable. The previous definition of a "cash company" was deliberately very narrow. The amendment is vague and subjective. It requires the Exchange to determine what is in the minds of the directors and to determine what 'substantial' means. "Short term investments" can cover a very wide variety of assets, for example, in Hong Kong a wide variety of commodity properties. So it should be possible to circumvent this rule unless the rule is interpreted to cover virtually any investment which is readily marketable: a huge category of potential investments. Further this definition should not penalise a company for selling a major asset when it intends to deploy the proceeds of sale on an asset of a similar kind in the future.***

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.

***However, we note that most, if not all, of the Hong Kong listed securities brokerage houses are also engaged in other core businesses including securities margin financing, IPO or other securities underwriting and money lending. In practice, the exemption under Rule 14.83 and the suggested rule changes seem to be of limited use.***

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.

***The proposal appears to conflate possible actions to maintain a "shell" company and the active management of liquid resources by a listed issuer which often includes securities transactions. As it is, a number of listed issuers are required by the rules to disclose their share trading activity and we think that the use of the "revenue exemption" may be useful, if share trading is a regular activity and the disclosure of it is not particularly meaningful to investors generally.***



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.

***We agree with the proposed rule changes other than the voting arrangements. We consider that only those shareholders (and their close associates) who have a material interest in the transaction are required to abstain from voting, and they do not necessarily include the controlling shareholders all the time. The shareholders who must abstain from voting ought to be determined on a case-by-case basis. This approach is consistent with the voting arrangements applicable for very substantial disposals governed by Chapter 14 of the Listing Rules.***

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.

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 -