ASIAN CAPITAL
卓亞融資有限公司

BY POST AND BY EMAIL (response@hkex.com.hk)

31 August 2018

Hong Kong Exchange and Clearing Limited
12th Floor, 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

1. Reference is made the captioned consultation paper. We have completed and attached herewith the questionnaire as **Appendix I** for your perusal.

2. We have been, in the past 19 years, advising a number of issuers in corporate restructuring and resumptions. We are also licensed by the Securities and Futures Commission to carry out Type 1 (dealing in securities) regulated activity. Our roles as financial adviser to distressed companies and brokers allow us to offer views and suggestions to the captioned Consultation Paper in a perspective vastly different from regulators as below.

3. Our foremost concern is that the proposed amendments to Rule 14.54 (under Consultation Questions #7(a) and (b)) is unreasonably stringent for a rescue situation and is unfairly prejudicial to Rule 13.24 issuers.

4. Further, paragraph 115 of the Consultation Paper suggests that companies that are engaged in securities trading and/or investment are generally listed under Chapters 20 or 21 and thus all other issuers' activities in trading and/or investment in securities should be excluded from consideration for the purpose of assessing their sufficiency of operations under Rule 13.24. In this regard, we beg to differ.

5. The Stock Exchange's view expressed in paragraph 115 of the Consultation Paper faults fundamentally as business does, as a matter of reality, evolve over time. Issuers not listed under Chapters 20 or 21 should not be artificially hindered from growing into any law-abiding businesses (which in this case securities trading or investment businesses). Further, we strongly feel that the Stock Exchange may have overlooked the fact that securities trading and/or investment activities could well be incidental to the issuer's principal business.

6. To further elaborate our view on the Consultation Paper, we have prepared and attached a detailed response to specific consultation questions the Stock Exchange asked in the Consultation Paper as **Appendix II**.

ASIAN CAPITAL LIMITED
Suite 601 | Bank of America Tower
12 Harcourt Road | Central | Hong Kong

T (852) 2869-8861
F (852) 2869-9660
www.asiancapital.com.hk

Should you have any queries, please feel free to contract the undersigned at [redacted].

Yours faithfully
For and on behalf of
Asian Capital Limited

[redacted]

Patrick K.C. Yeung
Chief Executive Officer

Encl.

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.

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 refer to the attached submissions for details.

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.

(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.

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.

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.

(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.

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.

(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.

(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.

Please refer to the attached submissions for details.

(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 attached submissions for details.

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.

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.

Please refer to the attached submissions for details.

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.

Please refer to the attached submissions for details.

(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.

Please refer to the attached submissions for details.

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 attached submissions for details.

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.

Please refer to the attached submissions for details.

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.

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.

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.

Please refer to the attached submissions for details.

- End -

1. Consultation Question #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?

We respectfully disagree. A change in control should be a matter of fact that relates to the voting rights attached to shares of the issuers, a concept that underpins the Takeovers Code and the laws.

This proposal creates potential conflicts between "change in de facto control" under the Listing Rules and "change in control" under the Takeovers Code. While the current Takeovers Code focuses on regulating changes to voting rights, this proposal goes beyond and covers the underlying shares of convertible securities, which the subscriber(s) may choose not to convert, and even if the convertible securities are converted into shares, the shares (thus the voting rights attached to it) may no longer belong to the original subscriber(s) of the convertible securities, making it grossly unfair that the subscriber(s) be so deemed.

2. Consultation Question #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?

We respectfully disagree, as some aspects of the proposed amendments seem purely academic, in particular those relate to public shareholder requirements.

In a RTO situation, existing public shareholders are given an opportunity to consider and approve RTO transactions. Their approval may reasonably be construed as the acquisition target attracted sufficient public interest. If the existing issuer is in compliance with public float requirements prior to the RTO transactions, it is unclear to us as to the reasons for the enlarged group to be required to prove its compliance of public shareholder requirements once again, which is generally assumed to be done by undergoing a share offer to public. The proposed requirement is also unreasonably stringent for a rescue situation and minority shareholders' residual value should take precedence in such circumstances.

3. Consultation Question #7(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?

We respectfully disagree as the proposed amendment is unfairly prejudicial to Rule 13.24 issuers.

The Stock Exchange will consider that an issuer has failed to comply with Rule 13.24 (i.e. a Rule 13.24 issuer) when the issuer is considered not having sufficient operations and assets under the proposed changes to Rule 13.24. Rule 13.24 issuers are typically unable to fulfil the financial requirements under Rule 8.05, and possibly have incurred substantial losses for a prolonged period of time. Under the proposed amendments as described in paragraph 69(ii) of the Consultation Paper, the acquisition target must attain sufficiently high level of profits that can meet the financial requirements under Rule 8.05, and also be able to absorb the losses previously incurred by Rule 13.24 issuer during the entire track record period of the acquisition target. This effectively prohibits Rule 13.24 issuer from conducting self-rescue through

acquisitions, especially when compared with its non-Rule 13.24 counterparts. This is tantamount to delisting all Rule 13.24 issuers.

While such prohibition has serious adverse implications to the issuer and its shareholders, the Stock Exchange offers limited rationale to explain and support this proposed amendments. In the Consultation Paper, the Stock Exchange only cites "isolated instances" (paragraph 71), which merely relate to the requirement of new public shareholders under Chapter 8, in support of the differential treatment against Rule 13.24 issuers.

Further, the Stock Exchange has stated that it would normally disregard the results arising from discontinued operations when assessing Rule 8.05 (paragraph 73 of the Consultation Paper), but such statement is not included in the proposed Rules. In the event the proposed Rule 13.24 (2) is to be adopted in its current form, we suggest the Stock Exchange to include the aforementioned statement in the proposed Rules (or by way of a note to the proposed Rules).

4. **Consultation Question #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? If not, why?

Given the Stock Exchange has stated that Rule 13.24 is a qualitative test, and it would consider the issuers' specific circumstances, we suggest that Rule 13.24 test should focus on the viability and sustainability of the business, rather than emphasizing the level of operation and value of assets that the Stock Exchange has refused to provide a benchmark.

5. **Consultation Question #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?

As set out in our response to Consultation Question #10 above, we consider Rule 13.24 needs further clarification, and thus the note to the proposed Rule 13.24 has to be amended accordingly.

6. **Consultation Question #11(b)**

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

As set out in our response to Consultation Question #10 above, we consider Rule 13.24 needs further clarification, and thus the note to the proposed Rule 13.24 has to be amended accordingly.

7. **Consultation Question #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?

We respectfully disagree. While the Stock Exchange's intention of curbing shell maintenance activities is understandable, we submit that the Listing Rules should focus on issuers' qualitative factors and individual circumstances (which is explicitly stated in the proposed note to Rule 13.4(1)), instead of arbitrarily exclude certain businesses from being regarded as a genuine business. We set out below our concerns and offer suggestions to the Rule amendments that would better achieve the Stock Exchange's target.

(i) Businesses should not be disallowed to organically evolve over time

Paragraph 115 of the Consultation Paper states that "companies that are engaged in securities trading and/or investment are generally listed under Chapter 20 (applicable to authorised collective investment schemes) or Chapter 21 (applicable to non-authorised collective investment schemes)". Yet, we argue that businesses naturally evolve over time, and issuers should have the liberty to organically grow into securities trading or investment businesses after listing.

With the proposed Rule 13.24(2) in place, issuers are practically barred from shifting its business focus towards securities trading and/or investment activities as their principal activity(ies). Otherwise, it would probably be considered as not having sufficient operations and assets under Rule 13.24.

In this regard, we note the Stock Exchange states in the Consultation Paper that Rule 13.24 (Rule 13.24(1) in particular) is a qualitative test, and on application, the Stock Exchange will make an assessment based on specific facts and circumstances of individual issuers. With this in mind, it is hard to comprehend the underlying reason for securities trading and/or investment activities to be specifically denied from being considered as, by itself or a part of, a substantial business in the finance sector, but not being assessed by the Stock Exchange which involves assessing a totality of factors.

(ii) Securities trading and/or investment activities could be incidental to the issuer's principal business

We further submit that securities trading and/or investment activities could be incidental to the issuers' principal business and are integral part of issuers' business.

To illustrate our view, we invite the Stock Exchange to consider a licensed corporation who acts as an underwriter for an IPO. As an underwriter, the licensed corporation generally has three kinds of income/revenue:-

(1) Underwriting commission, which is derived from being the underwriter of the offering;
(2) Investment gain, which is derived from taking propriety position in the offering (or in other investment activities); and
(3) Trading income, which is derived from being the stabilising manager of the offering.

While it is obvious all three types of incomes are generated from an integrated business activity, there is a danger that only the first kind of income would be considered in assessing the sufficiency of operations under the proposed Rule 13.24. We consider it plainly absurd and it is not necessary to do so.

(iii) Requirements in other markets

In the Consultation Paper, the Stock Exchange makes reference to comparable rules in other major financial markets in respect of sufficiency of operations (paragraphs 98 and 99) and suitability of listing (paragraph 100). Yet, in respect of this particular consultation question, the Consultation Paper sheds no light on any comparable legislation or rules in other major financial markets that specifically exclude certain businesses in assessing issuers' sufficiency of operations and suitability of listing.

We are not aware that major overseas markets have any comparable rules having similar effect of the proposed Rule 13.24(2) that exclude certain types of business when assessing issuers' sufficiency of operations.

(iv) Proposed Rule 13.24(2) should be removed in its entirety

After considering the above factors, we suggest removing the proposed Rule 13.24(2) in its entirety and allowing the Stock Exchange to exercise its discretion under Rule 13.24(1) to assess whether securities trading and/or investment activities conducted by the issuer in concern are "shell maintenance activities" under which only a small number of issuers are engaging in (paragraph 114 of the Consultation Paper), or genuine business that the issuers should have the liberty to engage in.

Alternatively, the Stock Exchange may give exemptions to issuers being regulated by other prudent regulatory bodies from Rule 13.24(2).

8. **Consultation Question #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?

We respectfully disagree, as this proposal will adversely affect listed financial institutions' underwriting capabilities.

The Securities and Futures (Financial Resources) Rules (Chapter 571N of the laws of Hong Kong) (the **"FRR"**) require licensed corporations to maintain prescribed level of issued share capital and liquid capital. Essentially, the liquid capital is the entity's liquid assets (excluding clients' assets), net of its ranking liabilities (including its net underwriting commitments).

To cater for underwriting opportunities and to comply with the FRR's liquid capital requirements, it is a common practise among institutional underwriters to maintain substantial portion of their assets in the form of cash or assets easily convertible into cash.

Should the proposal be implemented, only clients' assets, which are not regarded as liquid assets under the FRRs, are exempted under Rule 14.83. In this circumstance, listed financial institutions will face a dilemma: they either (i) continue their business practises and risk themselves of being regarded as cash companies; or (ii) trim down their liquid capital but as a result forgo large-scale underwriting opportunities due to liquid capital shortage. In the case of the latter, listed financial institutions are unnecessarily placed in a disadvantageous competitive position vis-a-vis their non-Hong Kong listed competitors.

Further, we note that Rule 8.05C, which generally forbids issuers whose assets consist wholly or substantially cash or short-dated securities from listing, give exemptions to issuers solely or mainly engaged in the securities brokerage business. We are of the view that Rule 8.05C and the proposed Rule 14.83 contradict with each other in principle.

9. **Consultation Question #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?

In principle, the Stock Exchange's initiatives in respect of the application of alternative size test are welcomed, yet there are a few suggestions on the relevant proposed Rule amendments.

Under the proposed Rule 14.20, the Stock Exchange "may also require the issuer to apply other size test(s) that the Exchange considers appropriate". We submits that this create regulatory uncertainty to issuers and advisers. To maintain regulatory certainty, we suggest the Stock Exchange considering the following two measures in respect of the administrative operations of this proposal:-

(i) Provide guidance on conditions stipulating the application of alternative size test

The Stock Exchange should set out factors and circumstances it normally considers appropriate to apply alternative size.

(ii) Notify the issuer in advance of its intention to apply alternative size test

As we expect the Stock Exchange would generally consider issuers' historical financial information before exercising its discretion under the proposed Rule 14.20, the Stock Exchange should notify the issuer in advance of its intention to apply alternative size test. This would give the issuer sufficient time to collate relevant information for computing alternative size test, and can avoid the situation that a transaction may need to be re-classified due to the adoption of an alternative size test following the transaction being announced.