香港董事學會
The Hong Kong Institute of Directors
FOUNDED 1997

4 September 2018

Hong Kong Exchanges and Clearing Limited
10th 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

The Hong Kong Institute of Directors ("HKIoD") is pleased to forward our response to the captioned paper.

HKIoD is Hong Kong's premier body representing directors to foster the long-term success of companies through advocacy and standards-setting in corporate governance and professional development for directors. We are committed to contributing towards the formulation of public policies that are conducive to the advancement of Hong Kong's international status.

In developing the response, we have consulted our members.

Should you require further information regarding our response, please do not hesitate to contact me on tel no. [redacted]

Thank you very much for your kind attention.

Yours sincerely
THE HONG KONG INSTITUTE OF DIRECTORS

[redacted]

Dr Carlye Tsui
Chief Executive Officer

Enc

cc: Mr Henry Lai, Chairman, HKIoD

香港董事學會
The Hong Kong Institute of Directors
FOUNDED 1997

Issued on: 4 September 2018

The Exchange's Consultation Paper on
Backdoor Listing, Continuing Listing Criteria and other Rule Amendments (June 2018)

In relation to the captioned Consultation Paper, we at The Hong Kong Institute of Directors present our views and comments.

General Comments

We at HKIoD appreciate the Exchange's effort at maintaining the reputation of the Hong Kong market and the quality of listed companies. While we can readily see the merits of the proposals, we are also mindful that measures to redress circumvention of listing rules should not be made too restrictive.

Amending the RTO Rules

We agree in principle with many of the proposals but have reservations in certain parts.

In clarifying the "series of arrangements" criterion, we agree with the notion of including transactions and arrangements that take place in reasonable proximity or are otherwise related, but we believe a three-year aggregation period is too long; 24 months is sufficient.

In the Rule amendment to restrict any material disposal (or a disposal by way of distribution in specie that amounts to a material disposal), there will be the stipulation of a restriction on "material disposal" rather than a blanket prohibition on issuers to dispose of its existing business. Such should add some flexibility, but we do not believe there is a need to extend the aggregation period to 36 months; to maintain the current 24-month restriction period is sufficient.

The Consultation Paper has the premise that the RTO Rules are to redress circumvention of new listing requirements but not to unduly restrict business expansion or diversification by issuers over a reasonable period. That reasonable period is said to be "usually three or more years". See Consultation Paper para 43, for instance. In this fast-changing world, however, three years can be a long time. To so extend the aggregation/restriction period can amount to be an undue restriction.

The proposed RTO Rules amendment will require issuers undertaking RTO transactions to be treated as if it were a new listing applicant. The proposed amendments to continuing listing criteria will require issuers to have and maintain substantial operations to maintain listing status. If an issuer can otherwise meet those requirements, we do not believe it should matter that the issuer has undertaken RTO transactions in quick succession. To lengthen the aggregation/restriction period from 24 to 36 months does not add much more in terms of enhancing quality but will have the effect of hampering issuers from capturing opportunities and implementing a successful strategy. The effect could be that investors are not protected that much more but may be denied the gain in shareholder value that could be had.

About the proposal to impose requirements to the effect that, in RTOs and extreme transactions, each of the acquisition targets and the enlarged group must essentially meet all the new listing requirements in Chapter 8, we believe that the operation of the RTO Rules should not exclude companies that are otherwise permitted for listing under the Listing Rules that may be in force now or in future. The Listing Rules now permit certain companies that do not meet Chapter 8 requirements to become listed (e.g., biotech companies per Chapter 18A). The Listing Rules

may in the future have other provisions to permit more types of companies that do not quite meet Chapter 8 requirements. The operation of RTO Rules need not exclude businesses that are otherwise seen fit for listing.

We also believe the operation of the RTO Rules should not stand in the way of good faith efforts to resurrect a business in distress. Issuers that have been suspended or are under de-listing procedures could find it difficult to meet the requirements as proposed. A business combination by way of an RTO could be the solution, but it is conceivable that the acquisition target can itself meet the track record requirements yet the combined pro forma cannot. We believe there could be some mechanism to give exception to situations where an RTO type transaction is contemplated as part of the restructuring effort. To deny this possibility outright can take away opportunities for the shareholders in those distressed issuers to regain value in their holdings.

Continuing Listing Criteria
We generally agree with the proposal relating to the continuing listing criteria, but we believe better guidance is needed in certain areas.

We agree with the notion of requiring 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. One part of the proposals, as described in Consultation Paper para 107-109, is to add a Note to what would become Rule 13.24(1) to stipulate that the test will be "qualitative". The proposed Note as stated, however, may have the effect of granting the Exchange too wide a discretion. The onus is said to be on the issuer to demonstrate to the Exchange's satisfaction that it is operating a business of substance, but issuers have little certainty over what would make the cut. The text of the proposed Note gives an example of assessing an issuer's "money lending business", but issuers may have the occasion to get into vast different kinds of businesses. It may not be appropriate to rely all on strict quantitative tests, but we think further guidance on the criteria and approach that the Exchange will use to assess compliance of Rule 13.24(1) will be more useful to issuers.

* * *

<u>Consultation Questions</u>
Subject to our general comments above, we state our responses to specific questions as set out in the Consultation Paper as follows:

Amend the RTO Rules – Proposal A(1)-A(3)
Question 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?

HKIoD response:
- AGREE in principle but have reservations in certain parts.

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?

HKIoD response:
- AGREE, subject to our comments in response to Question 7.

- The original criteria among the six to be codified considers "any issue of Restricted Convertible Securities to the vendor which would provide it with de facto control of the issuer" as important consideration of whether there is an RTO. The proposal is to extend the criteria to consider "any change in control (as defined in the Takeover Code) or de facto control" as material factor. This will have the effect of capturing more transactions under the realm of RTOs. Subject to our comments in response to Question 7, we can support this treatment.

Question 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?

(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?

HKIoD response:

- As to 3(a), AGREE in part and DISAGREE in part.
  - We agree with the proposal to include transactions and arrangements that take place in reasonable proximity or are otherwise related, but we disagree with the aggregation period of three years. Two years/24 months is sufficient.
- As to 3(b), AGREE.

Amend the RTO Rules – Proposal A(4)

Question 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?

(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)?

HKIoD response:

- As to 4(a), AGREE in principle to retain the bright line tests for reverse takeovers.
- As to 4(b), DISAGREE.
  - It is sufficient to maintain the current aggregation period of 24 months.

Question 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?

(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?

HKIoD response:

- As to 5(a), AGREE in part and DISAGREE in part.
  - We agree in principle with the Rule amendment to restrict ***material disposal*** (or a disposal by way of distribution in specie that amounts to a ***material disposal***) of an issuer's existing business but we disagree with the restriction period. It is sufficient to maintain the current restriction period of 24 months.
- As to 5(b), AGREE in part and DISAGREE in part.
  - We agree in principle with the proposal to leave the Exchange with some discretion to apply proposed Rule 14.06E to a ***material disposal*** of an issuer's

existing business where there is a change in the single largest substantial shareholder, but we disagree with the restriction period. It is sufficient to maintain the current restriction period of 24 months.

Amend the RTO Rules – Proposal A(5)

Question 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?

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

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

HKIoD response:

- As to 6(a), AGREE.
- As to 6(b), AGREE.
- As to 6(c), AGREE.

Amend the RTO Rules – Proposal A(6)

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?

(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?

HKIoD response:

- As to 7(a), AGREE in principle, but we believe the proposal is too restrictive.
  - The proposal would require, for both RTOs and extreme transactions, that both the acquisition targets and the enlarged groups to meet Rule 8.04 (i.e. be suitable for listing), that the acquisition targets must meet the "track record requirements", and that the enlarged group must essentially meet all the new listing requirements as set out in Chapter 8.
    - The Listing Rules now permit certain companies that do not meet Chapter 8 requirements to become listed (e.g., biotech companies per Chapter 18A). The Listing Rules may in the future have other provisions to permit more types of companies that do not quite meet Chapter 8 requirements. We believe the operation of the RTO Rules should not exclude companies that are otherwise permitted for listing under the Listing Rules.
- As to 7(b), AGREE in principle, but we believe the proposal is too restrictive.
  - The proposal would require that, where an issuer who has failed to comply with Rule 13.24 (for not carrying on a sufficient level of operations or have sufficient assets to maintain its listing) and who requests a RTO, each of the acquisition target and the enlarged group must meet all the new listing requirements set out in Chapter 8 of the Rules.
    - Issuers that have been suspended or are under de-listing procedures could find it difficult to meet the requirements as proposed. A business combination by way of an RTO could resurrect the issuer in distress, but it is conceivable that the acquisition target can itself meet the track

record requirements yet the combined pro forma cannot. We believe there could be some mechanism to give exception to situations where an RTO type transaction is contemplated as part of the restructuring effort. To deny this possibility outright can take away opportunities for the shareholders in those distressed issuers/companies to regain value in their holdings.

- See also our response to Question 7(a)

Question 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?

(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?

HKIoD response:

- As to 8(a), AGREE with the proposal to clarify the three-year track record requirement.
- As to 8(b), AGREE with the proposed pro forma income statement requirement.

Amend the RTO Rules – Proposal A(7)

Question 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?

HKIoD response:

- AGREE.
  - We believe the codification of the practice set out in GL84-15 is not too restrictive, as there would still be proper fund-raising options available to issuers.

Continuing Listing Criteria - Proposal B(1)

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?

HKIoD response:

- AGREE, subject to our response to Question 11

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?

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

HKIoD response:

- As to 11(a), AGREE as to the concept of a Note to what would become Rule 13.24(1) but DISAGREE as to the specifics in the proposal.
  - The proposal as described in Consultation Paper para 107-109 may have the effect of granting the Exchange too wide a discretion. The onus is said to be on

the issuer to demonstrate to the Exchange's satisfaction that it is operating a business of substance, but issuers have little certainty over what would make the cut. The text of the proposed Note gives an example of assessing an issuer's "money lending business", but issuers may have the occasion to get into vast different kinds of businesses. It may not be appropriate to rely all on strict quantitative tests, but we think further guidance on the criteria and approach that the Exchange will use to assess compliance of what would become Rule 13.24(1) will be more useful to issuers.

- As to 11(b), subject to our response to 11(a), we do not object to removing the existing Note to Rule 13.24 (and replacing such with another form of appropriate guidance.)

Continuing Listing Criteria – Proposal B(2)

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?

HKIoD response:

- AGREE

Continuing Listing Criteria – Proposal C(1)

Question 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")?

HKIoD response:

- AGREE

Continuing Listing Criteria – Proposal C(2)

Question14 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?

HKIoD response:

- AGREE

Continuing Listing Criteria – Proposal D(1)

Question 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?

HKIoD response:

- AGREE

Continuing Listing Criteria – Proposal D(2)

Question 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)?

HKIoD response:

- AGREE

Continuing Listing Criteria – Proposal E

Question 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?

HKIoD response:

- AGREE

Continuing Listing Criteria – Proposal F(1)

Question 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?

HKIoD response:

- AGREE

Continuing Listing Criteria – Proposal F(2)

Question 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?

(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?

HKIoD response:

- As to 19(a), AGREE in principle
  - We believe there will be circumstances that should warrant the granting of a waiver to such disclosure.
- As to 19(b), AGREE in principle
  - We believe there will be circumstances that should warrant the granting of a waiver to such disclosure.

Continuing Listing Criteria – Proposal F(3)

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?

HKIoD response:

- AGREE

<ENDS>