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Key Regulatory Developments for Q1 2014 – Topical Highlights

Topics

- Revised connected transaction rules to be effective on 1 July 2014
- Alignment to the definitions of 'connected person' and 'associate'
- Guidance on pricing policies for continuing connected transactions and their disclosures
- Listing Decisions on Connected Transactions
- Frequently Asked Questions ("FAQs") relating to the new Companies Ordinance ("New CO") and its impact on listed issuers by the Exchange
- Results of the Exchange's review of listed issuers' financial reports
- Results of the Exchange's review of disclosure in listed issuers' annual reports

I. Revised connected transaction rules to be effective on 1 July 2014

In March 2014, The Stock Exchange of Hong Kong Limited ("the Exchange") published two consultation conclusions on proposals to amend the connected transaction rules which will take effect on 1 July 2014. The amendments include changes to the rules on connected transactions in Chapter 14A of the Main Board Listing Rules¹ ("MB Rule"), details of which will be discussed in this section.

The amendments also include revisions to the definitions of 'connected persons' and 'associate' in Chapter 1 of the MB Rule to distinguish them from those used in Chapter 14A and alignment of the definitions of connected person and associate in other parts of the MB Rule with those used in Chapter 14A. The amendments will be discussed in more details in Section II below.

The following provides a summary of the key changes to the rules on connected transactions:

1. Plain language amendments

The language of the connected transaction rules has been simplified by replacing the current Chapter 14A of the MB Rule with the Guide on Connected Transaction Rules issued by the Exchange in April 2012 with modifications to take into account the comments received from the respondents to the consultations.

2. Amendments to the definition of connected person

Connected persons at the subsidiary level

The current definition of 'connected person' includes persons connected at the subsidiary level (i.e. a director, chief executive or substantial shareholder of any subsidiary of the listed issuer, or an associate of any of them).

¹ All references to Main Board Listing Rules in this publication should be taken to also refer to the equivalent GEM Listing Rules.

The definition of 'connected person' will be revised to exempt the requirement from independent shareholder approval for transactions with persons connected only at the subsidiary level subject to:

- approval of the transactions by the board of directors of the issuer; and
- the independent non-executive directors' (INEDs) confirmation that the terms of the transactions are fair and reasonable, on normal commercial terms, and in the interest of the listed issuer and its shareholders as a whole.

As a consequential amendment, the current rules on shareholder approval exemption for qualified property acquisitions with connected persons at the subsidiary level will be removed.

Insignificant subsidiary

The current connected transaction rules exempt transactions between the listed issuer group and persons connected with the listed issuer's insignificant subsidiaries, subject to a 10% restriction on the consideration test for any capital transaction between an insignificant subsidiary and the person connected with that subsidiary. An 'insignificant subsidiary' is a subsidiary of the listed issuer whose total assets, profits and revenue are less than (i) 10% under the percentages for each of the latest three financial years; or (ii) 5% under the percentage ratios for the latest financial year.

The rules will be revised to exclude all the persons connected with the listed issuer's insignificant subsidiaries from the definition of connected person, rather than exempting transactions conducted with these persons.

3. Amendments to the definition of associate

Exemption for trustee interests

Under the current rules, 'associate' includes the trustees acting in their capacity as trustees of any trust of which a director, chief executive or substantial shareholder (or if such person is a natural person, any of his immediate family) is a beneficiary.

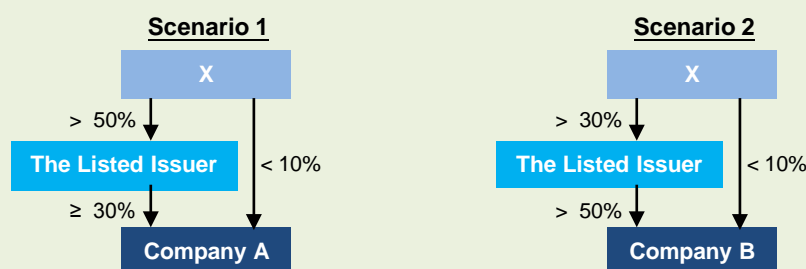
The revised rules will exclude from the definition of 'associate' the trustees of an employee share scheme or occupational pension scheme if the connected persons' interests in the scheme are less than 30% and the scheme is established for a wide scope of participants.

Exemption for connected person holding an interest in an associate through the listed issuer

Under the current rules, 'associate' also includes an entity in which a connected person has a 30% or more direct or indirect interest. However, an entity is exempt from being treated as an 'associate' if the connected person holds an interest in the entity only through the connected person's shareholding in the listed issuer.

The exemption rule will be modified to clarify that it would apply if the interests of the connected person and his associates in the entity (other than those held through the listed issuer) are together less than 10%. A simplified illustration of the revised rule is set out in the diagrams below. Under the revised rule, neither Company A nor Company B will be treated as an associate of X if X's direct interest in each of these entities is less than 10%.

Illustration of the exemption rule for connected person holding an interest in an associate through the listed issuer and of which the interest of the connected person and his associates in the entity are less than 10%.





4. Scope of connection transactions ~ acquisition or disposal of interest in a target company

Under the current rules, connected transactions include any acquisition or disposal of interests in a target company in the circumstances described in MB Rule 14A.13(1)(b) where each of the listed issuer and its controller is, or will be, a shareholder of the target company. A 'controller' is a director, chief executive or controlling shareholder (i.e. 30% or more shareholding) of the listed issuer or any of its subsidiaries.

The amendments will exclude the following transactions from the connected transaction rules:

- transaction with a third party involving a target company partly owned by 'controller' at the subsidiary level;
- disposal of interests by the listed issuer in the target company to a third party where a controller at the listed issuer level is a substantial shareholder of the target company; and
- transactions with third parties described in paragraphs (ii) to (iv) of MB Rule 14A.13(1)(b) which involve the listed issuer (or its controller) acquiring interests in a target company in very specific circumstances where the controller has an insignificant (<10%) interest in the target company.

5. Requirements for connected transactions involving option arrangements

Alternative method for calculating the size of the transfer or non-exercise of option

Under the current rules, a listed issuer is required to calculate the size of a transfer or non-exercise of an option involving a connected person as if the option is exercised.

The revised rules allow the use of an alternative method as follows:

Call Options
Higher of the value of the assets subject to the option over the exercise price and the difference between the exercise price and the value of the assets subject to the option
Put Options
Higher of the exercise price over the value of the assets subject to the option and the difference between the exercise price and the value of the assets subject to the option

Nevertheless, the listed issuer may adopt the alternative method only if the value of the option assets is readily ascertainable and the listed issuer is able to provide (i) a value of the option assets prepared by an independent expert using generally acceptable methodologies; and (ii) a confirmation from the INEDs and the independent financial adviser (IFA) that the transfer or non-exercise of the option is fair and reasonable and in the interests of the listed issuer and its shareholders as a whole.

In addition, if the listed issuer adopts the alternative method, it must announce the transfer or non-exercise of the option with the views of the INEDs and the IFA.

Termination of option

Under the revised rules, termination of an option will be treated in the same way as the transfer or non-exercise of an option unless the listed issuer has no discretion over the termination.

6. Exemptions for connected transactions

De minimis exemptions

Under the revised rules, the monetary threshold for full exemption reporting will be increased from HK\$1 million to HK\$3 million.

Removal of 1% cap on transaction value for full exemption of all connected transaction requirements for provision or receipt of consumer goods or services

The 1% cap on transaction value, which is one of several conditions for full exemption of all connected transactions requirements, is removed under the revised rules.

Exemptions for provision of director's indemnity

The revised rules provide exemptions to the connected transaction rules in respect of indemnity to, or purchase and maintaining insurance for, a director if:

- the indemnity/insurance is for liabilities that may be incurred by the director in the course of the performing his duties; and
- the indemnity/insurance is permitted under the Hong Kong law or where the company purchasing or providing the insurance is incorporated outside Hong Kong, it does not contravene the law of that company's place of incorporation.

7. Independent advice on connected transactions

The revised rules clarify that the independent board committee needs to advise on whether the connected transaction is on normal commercial terms and in the listed issuer's ordinary and usual course of business.

8. Auditor's confirmation letter

The current rule in relation to auditor's confirmation on continuing connected transactions will be modified to align with Practice Note 740, *Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules*, issued by the Hong Kong Institute of Certified Public Accountants.

II. Alignment of the definitions of 'connected person' and 'associate'

Currently Chapter 1 of the MB Rule contains the general definitions of 'connected persons' and 'associate' which are used throughout the rules. Chapter 14A of the MB Rule also uses these definitions but extends their meanings to a wider scope of persons for purposes of the connected transaction requirements in that chapter.

The major difference between the definitions in Chapters 1 and 14A is that the Chapter 14A definitions include the following persons not included in the Chapter 1 definitions:

- for 'connected persons': - any former directors of the listed issuer or its subsidiaries in the last 12 months and their associates; and
- for 'associates': - extended family members of a connected person who is an individual. These include any person cohabiting with him as a spouse; his or his spouse's children of age 18 years or above; his parents; his siblings; and companies controlled by them.



The revised rules renamed the definition of 'connected person' and 'associate' in Chapter 1 of the MB Rule to 'core connected person' and 'close associate', respectively.

In addition, the rules will be revised to apply the Chapter 14A definition of connected person or associate in the following areas:

- the reverse takeover rules in Chapter 14 of the MB Rule will include significant acquisitions from the incoming controlling shareholder's extended family members and companies controlled by them;
- significant corporate actions (e.g. withdrawal of listing or refreshment of general mandate), spin-off proposals and directors' service contracts that require shareholders' approval where the controlling shareholder or directors and their associates may not vote;
- the grant of share options to connected persons under Chapter 17 of the MB Rule.
- in the case of a new listing application, the sponsor must confirm whether it is a connected person as defined in Chapter 14A of the MB Rule of the new applicant;
- in the case of a connected transaction, the IFA must confirm whether it is, or holds more than 5% interest in, an associate as defined in Chapter 14A of the MB Rule of the counterparty of the transaction; and
- to use the Chapter 14A of the MB Rule definitions of connected person and associate in the rules that are corollary to Chapter 14A of the MB Rule.

The extension of the Chapter 14A definition of connected person or associate to significant corporate actions, including the granting of share options, essentially means that the connected persons' extended family members and companies controlled by them cannot vote in general meeting to approve these matters.

III. Guidance on pricing policies for continuing connected transactions and their disclosures

The Exchange published a new Guidance Letter ([GL73-14](#)) in March on pricing policies for continuing connected transactions and their disclosures which provides guidance on:

- a) pricing policies;
- b) disclosure of information;
- c) internal controls;
- d) role of INEDs; and
- e) annual review by auditors.

Pricing policies

Listed issuers should agree specific pricing terms, such as fixed monetary consideration, a pre-determined formula, or fixed per unit consideration when enter into agreements with connected persons. In particular, the Exchange expects the following guidelines to be observed when negotiating the terms of the agreements with connected persons:

- Avoid describing pricing policies in generic terms, such as 'prevailing market price' or 'prices based on arm's length negotiations'.
- The listed issuer should disclose the methods and procedures the management will follow to determine the price and terms of the transactions. For example, for purchases of goods and services, disclosure should be provided in respect of the procedures for obtaining quotations and tenders from the connected persons and a sufficient number of independent suppliers, the assessment criteria and the approval process.
- The listed issuer should explain why its directors consider that the methods and procedures can ensure that the transactions will be conducted on normal commercial terms and are not prejudicial to the interests of the listed issuer and its minority shareholders.

Disclosure of information

The listed issuer is required to disclose in its announcement and circular (if any) the specific pricing terms or formula set out in the agreement and material information about pricing policies and guidelines as described in the section above. The listed issuer is also required to disclose in its annual report whether it has followed these policies and guidelines when determining the price and terms of the transactions conducted during the year.

Internal controls

The listed issuer should ensure that it has an adequate system of controls to safeguard the transactions, and to provide information for the INEDs and auditors to properly review the transactions annually.

Role of INEDs

INEDs are obliged to confirm that the terms of the agreement are fair and reasonable at the time the agreement is announced, and to make annual confirmations that the transactions are in the listed issuer's ordinary and usual course of business, on normal commercial terms (or terms no less favourable to the listed issuer than the terms available to or from independent third parties), and that the terms are fair and reasonable and are in the interest of shareholders as a whole.

As set out in GL73-14, the Exchange requires the INEDs to ensure that:

- a) the pricing mechanism and the terms of the transactions set out in the agreement are clear and specific;
- b) the annual caps are reasonable taking into account historical transactions and management projections;
- c) the methods and procedures established by the listed issuer are sufficient to ensure that the transactions will be conducted on normal commercial terms and are not prejudicial to the interests of the listed issuer and its minority shareholders;
- d) appropriate internal control procedures are in place, and its internal audit would need to review these transactions; and
- e) they are provided by the management with sufficient information for the discharge of their duties.

Annual review by auditors

Under the MB Rule, the listed issuer is required to engage its auditors to report on the continuing connected transactions every year.

IV. Listing Decisions on Connected Transactions

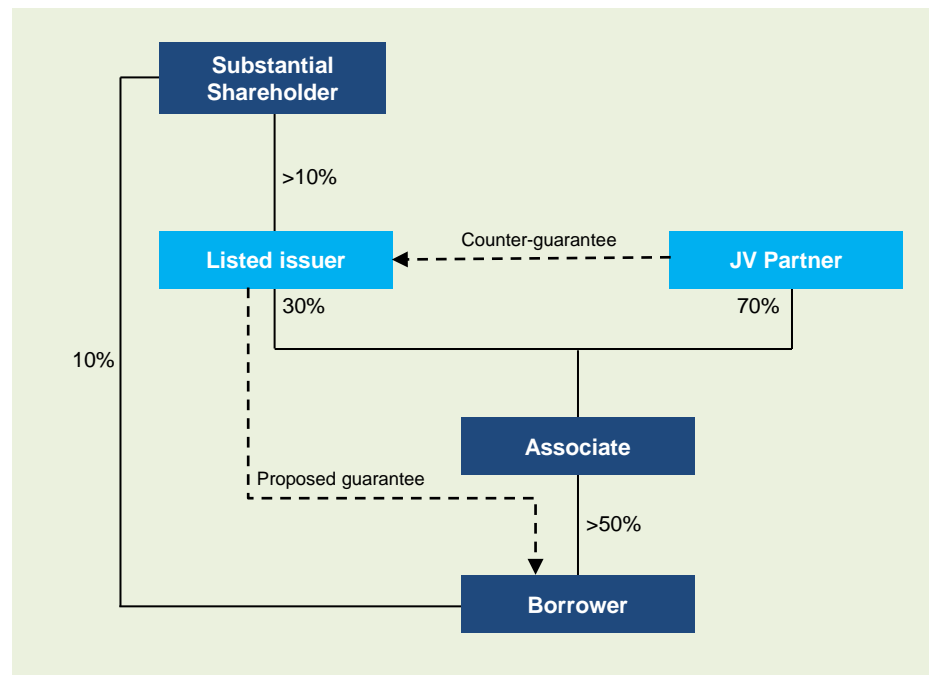
In [LD79-2014](#) and [LD78-2014](#), the Exchange provided guidance as to whether the transactions undertaken by the listed issuers were subject to connected transaction requirements.

In one of the cases, the listed issuer proposed to spin-off its subsidiary ("Newco") for a separate listing on the Exchange. The proposal would involve the listed issuer distributing in specie all its interest in Newco to the existing shareholders of the listed issuer such that the listed issuer would no longer hold any interest in Newco after the completion of the proposal. However, Newco would become a connected person of the listed issuer as both the listed issuer and the Newco would be owned as to more than 30% by the same parent holding company ("Holdco").

In order to delineate the businesses of the three companies upon completion of the spin-off, a non-competition agreement would be executed whereby Holdco would undertake not to compete with Newco and would exercise its influence on the listed issuer so as to cause the listed issuer to comply with the undertaking.

In this case, the Exchange concluded that the non-competition agreement constituted a connected transaction for the listed issuer. In addition, restricting the listed issuer from engaging in certain business of which the transaction value cannot be quantified would result in the transaction not qualify for the de minimis exemption. The Exchange considered that the non-competition agreement required approval by independent shareholders of the listed issuer under Chapter 14A of the MB Rule.

The guidance set out in GL73-14 serves as a useful starting point for the listed issuer to consider the pricing policies and the follow up actions that need to be undertaken by the listed issuer and its directors when the listed issuer engages in continuing connected transactions. Listed issuers may also consult the Exchange for an interpretation of the connected transaction rules and the guidance from the Exchange when in doubt.



In the other case with a simplified shareholding structure as set out above, the listed issuer proposed to provide a guarantee in favour of a bank for a loan facility to be granted to the borrower (the "Proposed Guarantee") while the JV Partner would provide a counter guarantee in favour of the listed issuer against all its liabilities arising out of the Proposed Guarantee. The Exchange considered the substance of the transaction and determined that the Proposed Guarantee should be subject

to the connected transaction requirements. Under this arrangement, the listed issuer is effectively providing financial assistance to a commonly held entity and the Proposed Guarantee by the listed issuer confers a benefit to the substantial shareholder through the substantial shareholder's substantial interest in the borrower.

Listed issuers may refer to the Guide on Connected Transaction Rules which has been codified and included in [GL70-14](#). As indicated earlier, further modifications will be made to the guide to take into account the comments received from the respondents to the consultation paper on proposal to amend the connected transaction rules. Listed issuers may also consult the Exchange for guidance when in doubt whether certain proposed transactions would constitute connected transactions.

V. Frequently Asked Questions (“FAQs”) relating to the new Companies Ordinance (“New CO”) and its impact on listed issuers by the Exchange

The Exchange issued [FAQs series 26 – Questions relating to the New CO and its impact on issuers](#) in February 2014 which provides further explanation of the operation of the amended Listing Rules on annual listing fees. The FAQs also address the impact of the abolition of nominal (par) value on other areas of the MB Rule and provide guidance on those rules that may be affected by other provisions of the New CO - including provisions relating to the disclosure requirements for financial statements, loans to directors and connected entities, provisions of financial assistance by a company, common and official seal, general meetings and abolition of memorandum of association.

The New CO applies primarily to companies incorporated in Hong Kong. However, certain provisions apply to companies which are incorporated outside Hong Kong or are subsidiaries of Hong Kong companies. Listed issuers are recommended to seek legal advice to understand the specific requirements which may apply to them.

Listed issuers or applicants who are interested in learning more about the areas of change and key requirements under the New CO can also refer to our Firm’s publications on the topics below in respect of the impact of the New CO:



What's new for full financial statements?



What's new for directors' reports?



What's new for share capital?



Non-Public Company Reporting Exemption: impact on directors' reports and financial statements

VI. Results of the Exchange's review of listed issuers' financial reports

The Exchange published the [Financial Statements Review Programme Report 2013](#) in February 2014 which summarises key observations and findings from its review of 120 periodic financial reports released by listed issuers between October 2012 and September 2013.

Key observations and findings included:

- Listed issuers are reminded that in addition to the disclosure requirements in respect of the accounting standards, they are also expected to follow the disclosure requirements relating to financial information under Appendix 16 to the MB Rule;
- Listed issuers should enhance their explanations of significant events and transactions in their annual and interim reports. They are encouraged to consult their auditors at an early stage when they enter into a complex or material transaction to ensure that the transaction is properly accounted for in accordance with the accounting requirements;
- Listed issuers should pay special attention to the key areas of financial reporting that involve significant management judgments and provide the best possible disclosure in their financial reports. Areas of particular concerns include proper identification of identifiable assets, including intangible assets, at business acquisition date, goodwill recognition, asset impairment at each reporting period end and the reasonableness of the underlying assumptions in impairment testing; and
- Only a few listed issuers who provide 'non-GAAP' financial information provided brief explanation on the purpose or reason for disclosing the non-GAAP financial information and the disclosures of non-GAAP financial information was generally not a more meaningful presentation of financial information when compared with financial information prepared in accordance with the relevant accounting standards. Listed issuers who present non-GAAP financial information are expected to provide adequate definition of the non-GAAP financial information, how the measures are computed and what they are intended to indicate in the financial reports so that the users would not be confused or misled.



VII. Results of the Exchange's review of disclosure in listed issuers' annual reports

The Exchange published a report on their [findings and recommendations for improvement in disclosures in the listed issuers' annual reports](#) in March 2014 from its review of certain listed issuers' annual reports for the financial years ended between December 2012 and November 2013.

The Exchange's review covered the disclosures on:

- proposed and actual use of funds raised through issue of equity or convertible securities;
- significant changes to financial performance and material reliance on key customers;
- details of valuation methodology and assumptions of biological assets, including sensitivity analysis on changes in material inputs and full details of the listed issuers' licenses, rights and permits to carry out the agricultural activities;

- updates on material changes after acquisitions;
- results of auditor's review and/or independent directors' review on connected transactions; and
- details of exploration, development and mining production activities for mineral companies and a summary of expenditures incurred and an annual update of resources and reserves as required under Chapter 18 of MB Rule.

The Exchange has stated that reviewing listed issuers' disclosures over time helped to identify cases of potentially misleading disclosures in corporate documents, possible corporate misconduct and issues with directors' role in safeguarding corporate assets.

The Exchange's review covers not only the disclosures in the listed issuers' annual report, but also the consistency and materiality of the disclosures in other corporate communications (e.g. announcements, circulars). Listed issuers are reminded to ensure that consistent information is released to the public.

Disclosure Requirements for Listing Applicants

Topics

- New Guidance Letters published in Q1 2014
 - Guidance on what constitutes a failure of the Initial 3-day Check
 - Simplification series - Disclosures in listing documents – ‘Applicable Laws and Regulations’ section
- Updated Guidance Letters published in Q1 2014
 - Guidance on disclosures in listing documents – material changes in financial, operational and/or trading position after trading record period
 - Simplification series - Disclosures in listing documents – ‘Summary and Highlights’ section
 - Simplification series - Disclosures in listing documents – ‘Industry Overview’ section
 - Guidance on disclosures of indebtedness, liquidity, financial resources and capital structure in the listing documents and the sponsor’s confirmation on working capital sufficiency statement
 - Guidance on the financial information for the trading record period expected in the first draft listing document for listing applications
 - Guidance on the accounting and disclosure requirements for acquisitions of subsidiaries and businesses conducted during or after the track record period and stub period comparative
 - Disclosures in listing documents – ‘Directors, Supervisors and Senior Management’ section

New Guidance Letters published in Q1 2014

Guidance on what constitutes a failure of the Initial 3-day Check

In [GL74-14](#) (March 2014), the Exchange provides guidance on what constitutes a failure of the Initial 3-day Check. In particular, the Exchange will return an Application Proof only if the deficiencies in the Initial 3-day Checklist are sufficiently material to result in the Application Proof being considered as not substantially complete.

Simplification series - Disclosures in listing documents – ‘Applicable Laws and Regulations’ section

In [GL72-14](#) (January 2014), the Exchange provided guidance on the disclosure in the ‘Applicable Laws and Regulation’ section of the listing document. The Exchange expects the listing applicant to include a discussion of the laws and regulations that are specific to, and have a material impact on, the listing applicant’s business.

If the listing applicant has or plans to have material businesses in a number of jurisdictions, the listing applicant should include an appropriate description of the laws and regulations that have a material impact on the listing applicant’s businesses in each of these jurisdictions in this section. In addition, changes in laws and regulations that are expected to have a material impact on the listing applicant’s business should also be discussed.

The Exchange also expects the listing applicant to disclose clearly how each law and regulation is relevant to them and where there is a risk that the listing applicant’s business may breach a law or regulation, the steps that the listing applicant has taken and plans to take to ensure compliance should be disclosed. In addition, the listing applicant may need to obtain an opinion from a legal adviser as to the likelihood of breach and the maximum liability resulting from non-compliance.

Application Proof is defined as a draft listing document that is required to be substantially complete and is submitted to the Exchange together with a listing application form. [GL56-13](#) sets out what the Exchange will inspect in an Application Proof during the Initial 3-day period after a listing application and related documents are submitted, for the sole purpose of determining whether it will be accepted for detailed vetting and consequently be published on the Exchange’s website. An Application Proof cannot be substantially complete if it does not materially satisfy the Initial 3-day Check. Failure to satisfy the Initial 3-day Check will result in rejection by the Exchange for detailed vetting.

Updated Guidance Letters published in Q1 2014

Guidance on disclosures in listing documents – material changes in financial, operational and/or trading position after trading record period

[GL41-12](#) (August 2012 and updated in November 2013 and January 2014), which provides guidance on disclosures of material changes in financial,

operational and/or trading position after trading record period in the listing document, was updated with the following amendments:

Former requirement:	Updated requirement:
Qualitative and quantitative disclosure to be made in a separate section in the Summary and other relevant sections of the listing document to give significant highlights to the investors.	Either qualitative or quantitative disclosure with commentary on how the adverse changes, including but not limited to adverse changes in the trend of financial performance compared with the historical financial results, loss of major customers/suppliers, loss of permits/licenses/patents etc., affect the financial, operational and/or trading position after the track record period.
Disclosure of selected figures of updated key operating data to be made in the listing document in relation to the deterioration of financial performance of the listing applicant.	Where a listing applicant discloses quantitative information relating to its financial performance after the track record period other than net profit/loss (e.g. revenue, gross profit, etc.), this non-profit forecast financial information should be reviewed by the reporting accountants, and a statement must be included in the listing document that the non-profit forecast financial information has been reviewed by the reporting accountants.

Simplification series - Disclosures in listing documents – ‘Summary and Highlights’ section

[GL27-12](#) (January 2012 and updated in June, July and November 2013 and January 2014), which provides guidance on the disclosures in the ‘Summary and Highlights’ section of the listing document, was also updated to reflect the amendments to GL41-12 as set out above.

Listing applicants may refer to section 4.2 of GL41-12 for a list of examples of material adverse changes which the Exchange expects disclosures to be made by listing applicants.

Listing applicants are also recommended to consider in advance whether any post-track record period financial information will be disclosed in the listing document as that could result in additional work required of the listing applicant to prepare interim financial information for review by the reporting accountants in accordance with Hong Kong Standard on Review Engagements (HKSRE) 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*.



Simplification series - Disclosures in listing documents – ‘Industry Overview’ section

The Exchange updated [GL48-13](#) (January 2013, updated in July 2013 and January 2014) to require disclosure of data/information specifically relating to the listing applicant's business. As a general guidance, the Exchange considers the inclusion of pages of global economic trend data, or gross domestic product or consumer price index data in countries in which the listing applicant engaged in sales of consumer products as irrelevant or non-material information to investors.

Please see the article entitled ‘Other market and regulatory matters’ in our [Issue 2 of Hong Kong Capital Markets Update](#) published in April 2013 for a more detailed discussion of GL48-13.

Guidance on disclosures of indebtedness, liquidity, financial resources and capital structure in the listing documents and the sponsor's confirmation on working capital sufficiency statement

The Exchange sets out in [GL37-12](#) (June 2012 and updated in July 2013, September 2013 and January 2014) that listing applicants with certain specified liquidity issues (including net current liabilities, negative operating cash flows for most of the track record period, high gearing ratios) are expected to disclose the basis upon which the directors form the view that the listing applicant can meet the working capital requirements for at least the next 12 months from the date of the listing document and, with basis, whether the sponsor concurs with the directors' view.

It is also set out in GL37-12 that the Exchange expects the sponsor to provide a final or an advanced draft confirmation, at the time of submission of a listing application and an Application Proof, confirming that the working capital sufficiency statement in the Application Proof has been made by the directors after due and careful enquiry. However, the sponsor is not required to confirm upon submission of an Application Proof that the persons or institutions providing finance have stated in writing, that such facilities exist.

Guidance on the financial information for the trading record period expected in the first draft listing document for listing applications

The Exchange sets out in [GL6-09A](#) (July 2013 and updated in January 2014) the requirements on the financial information to be included in the first Application Proof, including the relevant requirements for an unaudited stub period financial information for at least nine months (with comparative information) in situations where the listing applicant files to the Exchange an application within two calendar months after the end of its track record period and is not yet able to include the financial information for the most recent financial year in an audited or advance form in its first Application Proof. GL6-09A was updated in January 2014 to clarify that listing applicants are allowed to include condensed financial statements or a complete set of financial statements in respect of the stub period financial information so long as the stub period financial information include the same items as in the audited financial information.

Guidance on the accounting and disclosure requirements for acquisitions of subsidiaries and businesses conducted during or after the track record period and stub period comparative

The Exchange clarified in [GL32-12](#) (March 2012 and updated in January and March 2014) that where an applicant acquired or proposed to acquire any businesses or companies after the track record period and any of the percentage ratios calculated in accordance with MB Rule 14.04(9) represents 5% or more but less than 100%, the listing applicant should disclose, as a minimum, a pro forma statement of assets and liabilities of the enlarged group. Where any of the percentage ratios is 100% or more, the listing applicant should disclose, as a minimum, a pro forma balance sheet, a pro forma income statement and a pro forma cash flow statement of the enlarged group.

**Disclosures in listing documents –
'Directors, Supervisors and Senior
Management' section**

[GL62-13](#) (July 2013 and updated in January and March 2014), which provides guidance on disclosure of directors, supervisors and senior management section in listing documents, was updated to:

- 1) include, in the 'Relevant Requirements' section of the guidance letter:
 - the Exchange's expectations on the directors to fulfil their fiduciary duties and to have duties of skill, care and diligence to a standard which at least equals to the standard under the Hong Kong law;
 - the requirements that every director must have the character, experience and integrity and is able to demonstrate a standard of competence commensurate with his position as director; and
 - the Guide on Directors' Duties published by the Companies Registry which provides guidance on the duties of the directors;
- 2) require disclosures in the listing document in relation to the academic background of each director, supervisor and senior management whether the courses attended by them were long distance learning courses or online courses; and
- 3) exclude disclosures of directors' remuneration in the accountants' report if the relevant directors were not appointed during the track record period.



Other Guidance for Listing Applicants

Topics

- Reasons for return of listing applicants by the Exchange
- Adequate internal controls on hedging and proper disclosure in the listing document relating to hedging

Reasons for return of listing applicants by the Exchange

In [LD84-2014](#) (February 2014), the Exchange sets out some of the reasons why certain listing applications were returned during the period from May to September 2013. The returns were predominantly due to deficiencies in disclosures. Some of the fatal defects (not an exhaustive list) identified by the Exchange are set out below:

- lack of disclosures on how the pricing of continuing connected and related party transactions was determined and whether those continuing connected transactions were conducted on normal commercial terms.
- unable to demonstrate to the Exchange that the listing applicant is able to obtain assurance from the regulator that it can renew its operation license upon its reorganisation.
- insufficient disclosure on sustainability of business taking into account heavy reliance on a few customers and suppliers and whether the track record results were reflective of future performance. In particular, the listing document lacked disclosure on the risk of reliance and how the reliance could be dealt with.

- insufficient disclosure on details of non-compliance incidents which include how the non-compliances were detected, the period in which the non-compliances occurred, the directors' involvement in the non-compliances, the operational and financial impacts, rectification and precautionary measures implemented, the sponsor's and internal control adviser's views on the adequacy and effectiveness of the internal control measures and the sponsor's views on directors' suitability.
- insufficient disclosure on non-compliances with the relevant laws and regulations by the listing applicant, the date of implementation of enhanced internal control measures, the disclosure of financial results for a demonstration period of at least 12 months from the date it ceased all non-compliant activities and the sponsor's view on the adequacy of internal control measures and the suitability of the directors.
- failure to make the required disclosures on the distributorship business model.

Adequate internal controls on hedging and proper disclosure in the listing document relating to hedging

In [LD77-2014](#), the Exchange considered a listing applicant which entered into forward purchase contracts with its suppliers as suitable to listing due to implementation of several measures on internal controls relating to its hedging activities and proper disclosures of these measures in the listing document. These controls include establishing a formal risk management committee with directors having the relevant experience, setting position limits for the forward purchases, establishing formal procedures to approve positions exceeding limits, establishing formal procedures to set and vary counterparty limits, and to authorise any excesses over those limits and monitoring value at risks.

The Exchange expects the listing applicants to follow all the disclosure requirements set out in the relevant guidance letters and listing decisions.

Under the new sponsor regime, which became effective on 1 October 2013, the Application Proof must be substantially complete upon submission, applicants should assess carefully whether they have satisfied all the disclosure requirements before submitting the application.

Effective from 1 April 2014, the Exchange publishes on its website the name of the listing applicant whose listing application has been returned, together with the name of the sponsor and the date of the return decision. The listing application may only be re-submitted eight weeks after the date of the decision to return the application. To avoid undue delay of the listing application, it is recommended that the listing applicant ensures that all relevant Exchange requirements are followed and proper disclosures are made in the listing document prior to the submission.

Waivers and Other Guidance for Listed Issuers

Topics

- Reverse takeover within the scope of the '1997 Red Chip Guidelines' (GuoFa [1997] No.21)
- Acceptance by the Exchange for a dual listed issuer proposed to withdraw its listing in the overseas stock exchange by making a share repurchase offer
- Guidance – Waiver of the requirements on the minimum number and spread of warrant holders at the time of listing of the warrants which was granted as bonus to subscribers of rights issue
- Guidance – Waiver for exclusion of a working capital sufficiency statement in an insurance company's listing document for a rights issue
- Guidance – Company's proposed guarantee for a bank loan to be granted to a joint venture should be aggregated with its initial capital contribution

Reverse takeover within the scope of the '1997 Red Chip Guidelines' (GuoFa [1997] No.21)

The Exchange updated [GL55-13](#) (July 2013 and updated in September 2013, February 2014 and March 2014) to include a requirement for situations where a listed issuer conducts a reverse takeover and is treated as if it were a new listing applicant under MB Rule 14.54. The listed issuer is required to submit to the Exchange, a draft and final legal opinion from a PRC legal adviser, confirming whether the reverse takeover falls within the scope of the '1997 Red Chip Guidelines' (GuoFa [1997] No.21) and, if so, that the transaction has been duly reported to the competent PRC authorities and all required prior consents and approvals have been obtained. The PRC legal adviser must state in their submission to the Exchange the reasons and bases for (i) its opinion; and (ii) consultation or non-consultation with the China Securities Regulatory Commission on this issue.

Acceptance by the Exchange for a dual listed issuer proposed to withdraw its listing in the overseas stock exchange by making a share repurchase offer

In [LD82-2014](#), the Exchange accepted the proposal taking into account: (i) the purpose of the offer was to facilitate the withdrawal of listing from the overseas stock exchange and the listed issuer intended to maintain a listing of its shares on the Exchange; (ii) the listed issuer had a wide spread of shareholders and a number of shareholders undertook not to accept the offer and hence the concern about a lack of open market in its shares

would arise only if there was a very high take up of the offer; and (iii) the listed issuer proposes to place new shares to independent placees to ensure an open market for trading of its shares in Hong Kong upon completion of the offer. In addition, the Exchange also gave consent for conducting possible placing by the listed issuer within 30 days after the offer to ensure an adequate spread of shareholders in Hong Kong after the offer.

Guidance – Waiver of the requirements on the minimum number and spread of warrant holders at the time of listing of the warrants which was granted as bonus to subscribers of rights issue

In [LD83-2014](#), the Exchange provided guidance on whether a waiver from MB Rule 8.08(2) and (3) would be granted when the listed issuer proposed a rights issue along with bonus warrants for each rights share subscribed and after which the warrants will be listed on the Exchange.

Having considered that the listed issuer had a wide spread of shareholders and hence it is likely to have an open market in the warrants at the time of listing and the listing of the warrants would provide a market for the shareholders to trade the warrants taken up by them, the Exchange considered it acceptable to waive the requirements on the number and spread of the warrant holders at the time of listing of the warrants. However, the Exchange noted that if there were only a small number of warrant holders upon completion of the rights issue, the Exchange had the right to request the listed issuer and the underwriters to explore the opportunity for placing some warrants to independent places to increase the number of warrant holders at the time of listing.



Guidance – Waiver for exclusion of a working capital sufficiency statement in an insurance company's listing document for a rights issue

In [LD81-2014](#) (January 2014), the Exchange decided to grant a waiver from the requirement of inclusion of a working capital sufficiency statement by the directors of an insurance listed issuer in the listing document for a rights issue and the submission of a confirmation letter to the Exchange by the listed issuer's financial adviser or auditors on the working capital statement. In granting the waiver, the Exchange considered the listed issuer's solvency and capital adequacy were subject to prudential supervision by the relevant regulatory body for the insurance business and the alternative disclosures proposed by the listed issuer would enable its shareholders to assess the solvency and liquidity of the group.

Guidance – Company's proposed guarantee for a bank loan to be granted to a joint venture should be aggregated with its initial capital contribution

In [LD80-2014](#) (January 2014), the Exchange made reference to MB Rule 14.15(2) which provides that where a joint venture is established for a future purpose and the total capital commitment cannot be calculated at the outset, the Exchange will require the listed issuer to recalculate the relevant percentage ratios for the purposes of classifying a transaction at the time when that purpose is carried out. As a result, the Exchange considered that the initial capital contribution by the joint venturers and the subsequent provision of guarantees for bank loan facilities by the venturers to satisfy the total investments (i.e. capital commitment amounts) should be aggregated for calculating the percentage ratios under Chapter 14 of the MB Rule.





Contact us

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