

▶ Hong Kong Corporate Finance Regulation 2014 & 2015 and IPO Sponsor Due Diligence Update



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Introduction

Hong Kong Corporate Finance Regulation – 2014 Highlights and the Year Ahead

- ▶ Hong Kong markets continue to reap the benefits of their first-mover advantage created by Mainland China experimenting with policy changes in Hong Kong first, before rolling them out in other jurisdictions, and the development of more RMB-denominated investment products. In terms of regulation, 2014 saw continued efforts to ensure Hong Kong's regulatory framework keeps pace with market developments and changes in international regulation.

2014 Top 10 Regulatory Highlights

1. **China-Hong Kong Mutual Market Access**
 - Shanghai-Hong Kong Stock Connect commenced November 2014
 - New Developments for Covered Short-selling of A Shares and Dealing with China's Pre-trade checking requirement
 - Shenzhen-Hong Kong Stock Connect expected in 2nd half 2015
 - China-Hong Kong Mutual Recognition of Funds (MRF) Scheme in final stages
2. **First RMB-denominated Commodities Contracts Commenced Trading on 1 December 2014**
3. **HKEx's Weighted Voting Rights Concept Paper**
4. **Improved Regulatory Regime for Funds**
 - New Open-ended Fund Company Structure proposed for Investment Funds
 - Stamp Duty Waiver for all Hong Kong-listed ETFs took effect on 13 February 2015
 - Profits tax exemption for offshore funds to be extended to offshore private equity funds
5. **Full Implementation of New Regulatory Regime for Hong Kong IPOs**
6. **SFC Drops Proposed Amendments to Sponsors' Statutory Liability for Prospectus Misstatements**
7. **New Companies Ordinance implemented 3 March 2014**

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2014 Top 10 Regulatory Highlights (Cont'd)

8. **New Mandatory Reporting Obligations for OTC Derivatives expected in 2015**
9. **Significant Disciplinary Decisions**
 - Court Orders Ernst & Young (EY) to Produce Chinese Accounting Records to the SFC
 - IPO Sponsor Fined HK\$12 million and has Licence Suspended
 - SFC Disciplines Moody's for Red Flags Report on Chinese Companies
 - SFC Starts Market Misconduct Proceedings over Alleged False Research Report
 - SFC Disciplines Investment Banks for Regulatory Breaches
10. **Other Major Regulatory Developments**
 - Hong Kong Lays Basis for Uncertificated Securities Market
 - FSTB Moves to Increase Independence of Regulatory Regime for Listed Entity Auditors
 - SFC Consults on Regulation of Alternative Liquidity Pools
 - Hong Kong Government Consults on Resolution Regime for Failing Financial Institutions
 - Improvements to Hong Kong's Corporate Insolvency Law and Proposed New Statutory Corporate Rescue Procedure
 - Introduction of 3 Days' Statutory Paternity Leave from 27 Feb 2015

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2015 – The Year Ahead– The Top 11

Top 11 regulatory developments expected in 2015:

1. New Measures for **Shanghai-Hong Kong Stock Connect** :
 - Covered short-selling of eligible A Shares allowed since 2 March 2015;
 - Improvements in pre-trade checking requirements mean that institutional investors can sell A Shares without transfer to brokers' accounts one day prior to sale (with effect from 26 March 2015);
 - Chinese mutual funds were allowed to trade HK-listed shares through the southbound link from 30 March. Move led to April southbound trading reaching HK\$235 billion – up 559% on the previous month and HKEx's market cap exceeding HK\$31,000 billion (about US\$4 trillion) for the first time
2. Implementation of **Shenzhen-Hong Kong Stock Connect**
3. New **China-Hong Kong Mutual Recognition of Funds (MRF) scheme** to be introduced to allow Hong Kong domiciled funds authorised by the SFC to be sold in China and CSRC-authorized funds to be sold in Hong Kong
4. Publication of HKEx's conclusions on its **Weighted Voting Rights Concept Paper** and a decision on whether its Listing Rules should be amended to allow companies with dual class share structures and other WVR structures to list. If WVRs are to be allowed to list, HKEx has said it will publish a further consultation paper on the rule changes
5. FSTB should publish its consultation conclusions on allowing **open-ended investment funds in corporate form** under amendments to the SFO

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2015 – The Year Ahead– The Top 11 (cont'd)

Top 11 regulatory developments in 2015 (cont'd):

6. **Waiver of Stamp duty on ETFs** took effect on 13 February 2015 following the passing of the Stamp Duty (Amendment) Bill on 2 February
7. Extension of the **profits tax exemption** for offshore funds to **private equity funds**
8. **New mandatory reporting obligations for OTC derivatives** are expected to come into force in Q1 2015 on implementation of the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules
9. New fathers' statutory entitlement to **3 days' paid paternity leave** took effect on 27 Feb 2015.
10. The Securities and Futures Appeal Tribunal will begin its review of the SFC's disciplinary decision against **Moody's Investors Service** on 10 Sept 2015
11. **EY's appeal** against the court order to produce documents held by its Mainland affiliate should be heard in 2015

China-Hong Kong Mutual Market Access

Shanghai-Hong Kong Stock Connect commenced November 2014

- ▶ Launched on 17th Nov 2014
- ▶ Allows Mainland Chinese investors to trade Hong Kong stocks and Hong Kong and international investors to trade Shanghai-listed stocks through Hong Kong
- ▶ Major step in opening China's capital markets and internationalisation of the RMB. Strengthens Hong Kong's position as the gateway to China – investors worldwide can trade Shanghai-listed stocks through HK
- ▶ Current restrictions:
 - Eligible stocks limited to constituent stocks of the Shanghai Stock Exchange 180 and 380 Indexes and the Hang Seng Composite LargeCap and MidCap Indexes. A and H shares not included in the specified indexes, but which have equivalent H or A shares listed on the other market, are also eligible for trading
 - Aggregate and daily quotas apply on a net-buy basis
 - Only Mainland “professional investors” (i.e. institutional investors and individuals with RMB 500,000 in cash and securities) can participate in the scheme
- ▶ Scalable in size, scope and markets. Restrictions expected to be relaxed in future

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China-Hong Kong Mutual Market Access (cont'd)

New Developments for Covered Short-selling of A Shares and Dealing with China's Pre-trade checking requirement

- ▶ Hong Kong and international investors can now conduct covered short-selling of eligible A shares under Stock Connect's northbound trading link
- ▶ Short-selling of A shares first allowed on 2 March 2015
- ▶ List of eligible shares available at:
http://www.hkex.com.hk/eng/market/sec_tradinfra/chinaconnect/Eligiblestock.htm
- ▶ Hong Kong Stock Exchange (**HKEx**) implemented a new system in Mar 2015
 - Institutional investors who hold A shares through custodians no longer need to transfer their A shares to brokers the day before they want to sell in order to comply with China's pre-trade checking requirement
 - The requirement had been criticised for being contrary to standard international practice which allows settlement within 2 days after sale and is followed in Hong Kong and other leading markets
- ▶ On 30 March 2015, the Chinese regulators allowed Chinese mutual funds to trade Hong Kong-listed shares through Stock Connect giving a huge boost to southbound trading. Southbound trading in April reached HK\$235 billion – up 559% on the previous month
- ▶ HKEx market cap exceeded HK\$31,000 bln (about US\$4 trln) for the first time on 27 April

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China-Hong Kong Mutual Market Access (cont'd)

Shenzhen-Hong Kong Stock Connect expected in 2015

- ▶ China's State Council has reportedly signed off on a Shenzhen-Hong Kong trading link and this is expected to be launched in 2nd half 2015
- ▶ Shenzhen link is expected to provide greater access to Chinese technology, consumer and health-care stocks

China-Hong Kong Mutual Recognition of Funds (MRF) Scheme in final stages

- ▶ Approvals for a China-Hong Kong MRF scheme, the “through train” for Chinese and Hong Kong funds and the first such scheme between the Mainland and a foreign market, were in the final stages in Oct 2014 according to a speech given by Alexa Lam, SFC Deputy CEO.
- ▶ Scheme will give Hong Kong funds access for the first time to the Mainland's 1.3 billion potential investors
- ▶ MRF scheme expected to promote growth in Hong Kong's fund management industry since participation will require funds to:
 - Have a Hong Kong domicile; and
 - Be managed by an SFC-licensed asset management company
- ▶ Launch expected in second half of 2015

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China-Hong Kong Mutual Market Access (cont'd)

China-Hong Kong Mutual Recognition of Funds (MRF) Scheme in final stages (Cont'd)

- ▶ When implemented, MRF Scheme will allow:
 - Hong Kong domiciled funds which are authorised by Hong Kong's Securities and Futures Commission (**SFC**) for retail offering to be sold in Mainland China; and
 - Chinese funds authorised by the China Securities Regulatory Commission to be sold in Hong Kong.

- ▶ The fund manager must also be licensed by the home regulator – the CSRC for Chinese funds and the SFC for Hong Kong funds

- ▶ Hong Kong funds recognised under the scheme will be subject to a streamlined vetting procedure by the CSRC while China funds will benefit from streamlined vetting by the SFC

First RMB-denominated Commodities Contracts commenced Trading on 1 December

- ▶ On 1 Dec 2014, trading in RMB-denominated metal contracts in zinc, copper and aluminium started on the Hong Kong Futures Exchange
- ▶ This is the Exchange's first step in increasing commodities trading on the exchange following its acquisition of the London Metal Exchange in 2012
- ▶ So-called London Metal Mini Futures trade on the Hong Kong Futures Exchange and are cash-settled futures contracts
- ▶ They are settled at the official settlement prices for the relevant metal published by the LME
- ▶ HKEx's aims:
 - Match Chinese physical players' exposure to commodities contracts priced in RMB
 - Establish RMB pricing of metals in Asian trading hours

Hong Kong Stock Exchange's Weighted Voting Rights Concept Paper

- ▶ HKEx retained its 2nd place ranking among the world's top IPO fund-raising exchanges in 2014
 - Raising HK\$227.8 billion (US\$29.3 billion) in 115 IPOs (exc. transfers from GEM to MB)
 - An increase of 33% on the HK\$171.3 billion raised in 2013
- ▶ Top IPO exchange was NYSE, for 3rd year running
 - Raising US\$74.1 billion, up 62% on 2013
 - Boosted by Alibaba's NYSE listing in Sept 2014 – which raised US\$25 bn in largest IPO ever
- ▶ HKEx was Alibaba's first choice listing venue, but its management structure allowing the company's founders and senior management to nominate 50% of the board without holding an equivalent number of the company's shares, would have contravened the Exchange's "one-share one-vote" (**OSOV**) principle
- ▶ HKEx published its Weighted Voting Rights Concept Paper in Aug 2014
 - question: whether Hong Kong's Listing Rules should be amended to allow companies with dual class shares and other weighted voting rights (**WVR**) structures to list

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Hong Kong Stock Exchange's Weighted Voting Rights Concept Paper (cont'd)

- ▶ Those in favour are keen for Hong Kong to recover its competitive position as the international fund raising market of choice for Mainland Chinese companies
- ▶ NYSE and Nasdaq have been popular listing venues for Chinese tech stocks
 - Companies with WVR structures accounted for 86% by market capitalisation of the Mainland Chinese companies primary listed in the US at 31 Oct 2014
 - Technology was the leading sector for IPOs worldwide in terms of capital raised in 2014, with the sector raising US\$50.2 billion worldwide
- ▶ WVR structures are particularly common among tech companies
- ▶ HKEx's OSOV principle effectively prevents the Hong Kong listing of many Chinese tech companies which, like Alibaba, Baidu, JD.com Inc. and Weibo Corp., list in the US where WVR structures are not an obstacle to listing
- ▶ Arguments against listing companies with WVR structures focus on investor protection concerns
- ▶ Allayed to a degree by the Exchange's already comprehensive regulation of connected and related party transactions and the provisions of the Takeovers Code requiring equal treatment of shareholders in takeovers

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Hong Kong Stock Exchange's Weighted Voting Rights Concept Paper (cont'd)

- ▶ Argument raised that listing companies with WVR structures is not appropriate because Hong Kong does not have a class action regime or allow contingency fees as in the US
- ▶ However, class action argument is a red-herring. Research on US securities class action filings in 2013 shows that:
 - 84% of the claims in 2013's 166 securities class action filings were claims under Rule 10b-5
 - 97% of all claims involved allegations of misrepresentation in financial documents
 - 54% of all claims involved allegations of false forward-looking statements
 - 152 securities class action claims were filed against listed companies in 2013 (55 against NYSE listed companies and 97 against Nasdaq listed companies)
 - in 2013, approximately one in 30 companies was the subject of a class action
 - filings against foreign companies were most commonly against Chinese companies

"Securities Class Action Filings 2013 Year in Review" - Stanford Law School and Cornerstone Research

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Hong Kong Stock Exchange's Weighted Voting Rights Concept Paper (cont'd)

- ▶ Principal claim in a US class action suit is usually securities fraud (under section 10(b) of the Exchange Act of 1934 and Rule 10b-5 of the SEC adopted under the Exchange Act)
- ▶ US class action suits typically used where investors suffer loss due to company fraud or misleading disclosure which triggers a drop in the share price
- ▶ Class action suit allows one shareholder to bring a representative action against the company on behalf of a class of shareholders who have the same direct claim against the company
- ▶ Remedy in a class action suit is payment of damages to shareholders for loss suffered
- ▶ Class action regime does not assist shareholders who suffer loss as result of types of wrongdoing likely in case of companies with WVR structures (i.e. controllers' breach of fiduciary duties owed as directors; failure of controller directors to act in best interests of the company and shareholders as a whole; directors wasting corporate assets; directors breach of duties to shareholders as result of mismanagement or self-dealing)
- ▶ In case of wrongdoing by company directors, appropriate action is not a class action against the company but a derivative action brought by a shareholder(s) on behalf of the company against the directors for a wrong done to the company
- ▶ In a derivative action, the shareholder has no direct claim against the company, his action is derivative to the company's action.

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Hong Kong Stock Exchange's Weighted Voting Rights Concept Paper (cont'd)

- ▶ In a derivative action – improvements in company's governance will be ordered and any damages are awarded to the company. The minority shareholders benefit indirectly from improvement in the share price due to improved governance
- ▶ Hong Kong shareholders can already bring a derivative action on behalf of a company against a wrongdoer under the Companies Ordinance
- ▶ Relatively little shareholder litigation in Hong Kong – partly a cultural phenomenon, but also reflects cost and difficulty of bringing a derivative action
- ▶ Hong Kong doesn't allow lawyers to charge on a contingency fee basis, hence best course of action for a minority shareholder is often to sell out
- ▶ SFC obtains legal remedies on behalf of public shareholders of HK-listed cos using powers under ss 212-214 Securities and Futures Ordinance
 - In 2012, Court ordered Hontex to repurchase shares from around 7,700 public shareholders following disclosure of false or misleading information in its IPO prospectus
 - SFC currently seeking orders for Qunxing Paper Holdings Company Limited to restore its public shareholders and warrant holders to pre-acquisition position based on allegations of false or misleading disclosure in its IPO prospectus and annual results
 - In Sept 2014, SFC started proceedings against CITIC for false or misleading disclosure in a transaction circular to compensate up to 4,500 shareholders

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Hong Kong Stock Exchange's Weighted Voting Rights Concept Paper (cont'd)

Class Action Regime a Red-herring?

- ▶ US-style class action regime in HK would not assist minority shareholders in bringing derivative actions against WVR company controllers who breach fiduciary duties to the company
- ▶ US class actions only available where shareholders have **direct claims** against the wrongdoers but are not available where a shareholder brings a derivative action
- ▶ Existence of a class action regime appears irrelevant to question of whether to allow listing of cos with WVR structures

Cut-off date for responding to the Concept Paper was the end of November 2014 and the Exchange's consultation conclusions are expected soon. If responses favour allowing these companies to list, HKEx will publish a consultation paper on the proposals

Improved Regulatory Regime for Funds

New Open-ended Fund Company Structure proposed for Investment Funds

- ▶ 3-month public consultation on introducing a new open-ended fund company (**OFC**) structure for investment funds
- ▶ Proposed to allow an OFC structure under the Securities and Futures Ordinance to attract more mutual funds and private funds to domicile in Hong Kong
- ▶ Open-ended investment funds require flexibility to vary their capital to satisfy investor applications and redemptions
- ▶ Currently, an open-ended investment fund can be established in HK in the form of a unit trust, but not in corporate form due to various restrictions on capital reduction under the Companies Ordinance
- ▶ Internationally, corporate fund structure is more popular than unit trusts
- ▶ Continued growth in the number of Hong Kong-domiciled funds is expected to be driven by the China-Hong Kong MRF scheme
- ▶ Consultation closed on 19 Jun 2014 and consultation conclusion should be published soon

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Improved Regulatory Regime for Funds (cont'd)

Stamp Duty Waiver for all Hong Kong-listed Exchange Traded Funds (ETFs) from 13 Feb

- ▶ Stamp duty waiver for all HKEx-traded ETFs proposed as further boost to HK's asset management industry
- ▶ HKEx ETF turnover reached record high of HK\$1.2 trillion in 2014
- ▶ Currently 141 ETFs are listed on HKEx compared with 69 at the end of 2010
- ▶ Yet Hong Kong faces serious challenge from other exchanges in the Asia-Pacific region as a regional ETF hub
- ▶ Stamp duty waiver took effect on 13 February 2015 and applies to all ETFs listed on the Exchange irrespective of % of HK stocks in their portfolios
- ▶ Previous waiver did not apply to ETFs comprising >40% of HK-listed stocks making 26 HK-listed ETFs subject to stamp duty
- ▶ Waiver implemented by the Stamp Duty (Amendment) Ordinance 2014 took effect on 13 February 2015

Extension of Profits Tax Exemption for Offshore Funds to Private Equity Funds Proposed

- ▶ Transactions in securities in an eligible private company will be exempt from profits tax
- ▶ The transactions need not be conducted by a "specified person" (i.e. an SFC-licensed intermediary) if the fund is a "qualifying fund"

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Full Implementation of New Regulatory Regime for Hong Kong IPOs

- ▶ 1 Oct 2014 was the 1st anniversary of the more stringent regulatory regime for Hong Kong IPOs and their sponsors
- ▶ Majority of HK listed companies are incorporated offshore, primarily in Mainland China with result that, in cases of corporate wrongdoing, the companies and their directors are beyond the reach of the Hong Kong courts
- ▶ Concerns that prospectus disclosure was sometimes falling short of the standard expected led to a new requirement for issuers to publish the draft prospectus (the Application Proof) on the Exchange's website on submitting their listing application
- ▶ Application Proof found not to be “substantially complete” may be rejected by HKEx and the issuer and sponsor “named and shamed” by publication of fact of rejection on HKEx website
- ▶ SFC imposed new broadly written sponsor due diligence obligations – difficult to be certain that “all reasonable” due diligence has been conducted
- ▶ Various transitional arrangements, including HKEx's “Initial 3-Day Check” of Application Proofs, fell away on 1 Oct 2014

SFC Drops Proposed Amendments to Sponsors' Statutory Liability for Prospectus Misstatements

- ▶ SFC decided not to proceed with proposals to make explicit that sponsors may be subject to criminal and civil liability for deficiencies in IPO prospectuses as proposed in the initial consultation on sponsor regulation
- ▶ SFC concluded that legislative amendments were unnecessary as sponsors are already included in the existing category of "persons who authorise the issue of a prospectus" who are potentially liable for prospectus inaccuracies under the Companies (Winding Up and Miscellaneous Provisions) Ordinance.

Supplemental Consultation Conclusions on the Regulation of IPO Sponsors – Prospectus Liability” published by the SFC in August 2014

New Companies Ordinance implemented 3 March 2014

- ▶ Companies Ordinance (Cap. 622) (the **CO**) came into effect on 3 Mar to enhance Hong Kong's attractiveness as a leading international business and financial centre
- ▶ Key improvements:
 - Allowing companies to dispense with AGMs by unanimous shareholders' consent
 - A new court-free procedure for reduction of capital based on a solvency test
 - Facilitating simplified financial reporting by small and medium enterprises
 - Abolition of par value for company shares
 - Abolition of the requirement for Hong Kong companies to have a memorandum of association
 - Requiring all private companies to have at least one director who is an individual
 - A new statutory duty of care, skill and diligence for directors, subject to both a subjective and an objective test

New Companies Ordinance implemented 3 March 2014 (cont'd)

- ▶ Key improvements (cont'd):
 - A reduction in the shareholding requirement for demanding a poll to 5% (from 10%)
 - Requiring public and large private companies and guarantee companies to prepare more comprehensive directors' reports including an analytical and forward-looking "business review". Private companies may opt out by special resolution
 - Requiring approval by disinterested shareholders where shareholders' approval is required for connected party transactions of directors of public companies and their subsidiaries
 - For schemes of compromise or arrangement, the court has a new discretion to dispense with the headcount test in appropriate circumstances

New Mandatory Reporting Obligations for OTC Derivatives expected in 2015

- ▶ Draft rules for reporting over-the-counter (**OTC**) derivatives transactions published by the SFC and Hong Kong Monetary Authority are to be submitted to Legco for negative vetting and are expected to be implemented in 2015, according to the SFC/HKMA Consultation Conclusions on the rules
- ▶ The Securities and Futures (OTC Derivative Transactions - Reporting and Record Keeping Obligations) Rules (**OTC Derivatives Reporting Rules**) will implement the first phase of a new regulatory regime set out in the Securities and Futures (Amendment) Ordinance 2014 passed in Mar 2014
- ▶ Detailed requirements for the new regime will be set out in subsidiary legislation of which the OTC Derivatives Reporting Rules will be the first to be implemented
- ▶ The new regime will be introduced in phases:
 - Starting with mandatory reporting
 - Followed by mandatory clearing
 - Finally mandatory trading
 - Record keeping obligation will be implemented in phases at the time the relevant mandatory obligation takes effect

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Significant Disciplinary Actions

Court Orders Ernst & Young to Produce Chinese Accounting Records to the SFC

- ▶ In May 2014, the Court of First Instance ordered Ernst & Young (EY) to hand over to the SFC the accounting records relating to its work as the reporting accountant and auditor on the failed listing application of Standard Water Limited
- ▶ The Court rejected EY's argument that it was prevented from handing over the accounting records by PRC state secrecy laws
- ▶ EY is appealing the court order to produce documents held by its Mainland affiliate, EY Hua Ming, having produced a disc of documents held by it in Hong Kong

IPO Sponsor fined HK\$12 million and has licence suspended

- ▶ In Jan 2014, the Securities and Futures Appeal Tribunal affirmed the SFC's disciplinary decision against Sun Hung Kai International Limited for deficiencies in its sponsor work on the listing of Sino-Life Group Limited on the Growth Enterprise Market in 2009

Significant Disciplinary Actions (cont'd)

SFC Disciplines Moody's for Red Flags Report on Chinese Companies

- ▶ Moody's Investors Service Hong Kong Limited (**Moody's**) was fined HK\$23 million and publicly reprimanded for breach of provisions of the SFC's code of conduct on 3 Nov 2014
- ▶ Moody's published a report which identified red flags in terms of potential governance or accounting risks at 61 Chinese non-financial companies
- ▶ SFC's decision notice is not yet publicly available and nature of the allegations against Moody's is not known. Moody's is appealing the decision

SFC Starts Market Misconduct Proceedings over Alleged False Research Report

- ▶ In Dec 2014, the SFC started proceedings against the head of a US-based research company, Citron Research, before the Market Misconduct Tribunal
- ▶ SFC alleges that information contained in a research report on a Chinese property developer, Evergrande Real Estate Group Limited, was false or misleading
- ▶ The research report alleged that Evergrande was insolvent and had published fraudulent information
- ▶ Andrew Left, head of Citron, had short-sold 4.1 mln Evergrande shares before publishing the report which he later bought back making approx. HK\$1.7 mln in realised profit

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Significant Disciplinary Actions (cont'd)

SFC Disciplines Investment Banks for Regulatory Breaches

- ▶ The SFC reprimanded and fined ICBCI Capital and ICBCI Securities HK\$12.5 million each for failing to ensure the independence of places for the subscription of shares of Powerlong Real Estate Holdings Limited on its 2009 listing on HKEx
- ▶ The SFC also reprimanded and fined Deutsche Bank HK\$1.6 million for regulatory breaches and internal control failings in relation to its failure to disclose changes to its percentage holdings of Up Energy Development Group Limited shares

Other Regulatory Developments

Hong Kong Lays Basis for Uncertificated Securities Market

- ▶ A bill to allow investors to choose to hold and transfer securities without paper documents and register the securities kept in the CCASS in their own names has been introduced to LegCo for consideration
- ▶ Regime will initially cover shares listed or to be listed on HKEx, while listed debentures and unit trusts will be covered at a later stage
- ▶ If passed, the bill will amend the SFO and empower the SFC to make the necessary subsidiary legislation to provide for the operation and regulation of the uncertificated securities market

Other Regulatory Developments (cont'd)

FSTB Moves to Increase Independence of Regulatory Regime for Listed Entity Auditors

- ▶ FSTB proposed making the Financial Reporting Council (**FRC**) the independent oversight body for auditors of Hong Kong listed entities in a consultation published in Jan 2014
- ▶ FRC would be given disciplinary and inspection powers to complement its existing investigatory powers
- ▶ Proposals seek to ensure that Hong Kong qualifies for membership of the International Forum of Independent Audit Regulators
 - Entry is restricted to regulators that are independent of the audit profession and professional bodies
- ▶ Hong Kong Institute of Certified Public Accountants, the professional body, will perform various statutory functions such as registration, setting standards on professional ethics, auditing and assurance and stipulating common professional development requirements

Other Regulatory Developments (cont'd)

SFC Consults on Regulation of Alternative Liquidity Pools

- ▶ In Feb 2014, the SFC published a consultation paper proposing to regulate operators of alternative liquidity pools (**ALPs**), also known as “dark pools”, on which trades are executed anonymously outside of “lit” markets.
- ▶ Requirements under the SFC’s code of conduct for regulated entities similar to the conditions currently imposed on the licences of ALP operators are proposed to be included

Hong Kong Government Consults on Resolution Regime for Failing Financial Institutions

- ▶ G20 consensus requires member jurisdictions to establish a “resolution regime” to:
 - Give authorities powers to deal with failing financial institutions; and
 - Ensure the costs of failure are borne by shareholders and creditors rather than taxpayers
- ▶ In Mar 2014, Hong Kong’s regulatory authorities published a consultation on proposals for the establishment of such a regime in Hong Kong

Other Regulatory Developments (cont'd)

Improvements to Hong Kong's Corporate Insolvency Law and Proposed New Statutory Corporate Rescue Procedure

- ▶ The FSTB published consultation conclusions on its proposals to modernise and streamline Hong Kong's corporate insolvency provisions in May 2014, and plans to introduce an amendment bill to LegCo in 2015
- ▶ Amendments aim to facilitate more efficient administration of the winding-up process and increasing protection for creditors

Introduction of 3 Days' Statutory Paternity Leave from 27 Feb 2015

- ▶ From 27 Feb 2015, male employees will be entitled to 3 days' statutory paternity leave at 80% of their average daily wages under recent amendments to the Employment Ordinance
- ▶ Condition - the employee must have been employed for at least 40 weeks under a continuous contract
- ▶ Employers who fail to grant paternity leave or pay eligible employees for paternity leave are liable to prosecution and may be fined HK\$50,000

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Due Diligence Update

The New IPO Regime: A Recap of Sponsors' Due Diligence Obligations

- ▶ New sponsor regime implemented 1 Oct 2013 under new Paragraph 17 of the SFC's Code of Conduct for Persons Licensed by or Registered with the SFC (**Paragraph 17**) and amendments to the Listing Rules

- ▶ **Reasonable Due Diligence Requirement**

"Before submitting an application on behalf of a listing applicant to the Stock Exchange a sponsor should have (i) performed all reasonable due diligence on the listing applicant except in relation to matters that by their nature can only be dealt with at a later date, and ensure that all material information as a result of due diligence has been included in the Application Proof." (Paragraph 17.4(a))

- ▶ **Obligation to Identify Material Issues**

"When submitting an application on behalf of a listing applicant to the Stock Exchange, a sponsor should ensure that all material issues known to it which, in its reasonable opinion, are necessary for the consideration of:

- whether the listing applicant is suitable for listing; and*
- Whether the listing of the applicant's securities is contrary to the interest of the investing public or to the public interest,*

are disclosed in writing to the Stock Exchange." (Paragraph 17.4(d))

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Due Diligence Update (cont'd)

Deficiencies in Returned Application Proofs

- ▶ 4 out of 18 Application Proofs were returned in the 1st 4 months of the new sponsor regime (to 31 Jan 2014) for failing the Initial 3-Day Check. The deficiencies related to:
 - Failure to follow Guidance letter HKEx GL6-09A. The listing application was filed before the end of the trading record period and did not provide 9-month financials for the latest financial year end
 - Paragraph 4.2(b)(ii) of HKEx GL6-09A requires an applicant that can't include financial information for the most recent financial year in an audited or advanced form in its Application Proof to include with its listing application financial information for a stub period of at least 9 months and comparative information together with the related MD&A
 - Paragraph 5.2 provides that the earliest time for filing a listing application is **after** the end of the 3-year trading record period
 - Insufficient information to assess whether the applicant satisfies the ownership continuity and control requirement under Main Board LR 8.05(1)(c)
 - Insufficient information to assess whether the applicant satisfies the minimum profit requirement

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Due Diligence Update (cont'd)

Deficiencies in Returned Application Proofs (Cont'd)

- Failure to submit a reply to the outstanding comments on the applicant's compliance with the GEM minimum cash flow requirement raised by the Exchange during the last application
- Failure to provide Liquidity Disclosure as defined in Guidance Letter HKEx-GL38-12 to a date no more than 2 months before the date of the Application Proof
- Failure to disclose a controlling shareholder's conviction
- Insufficient disclosure on the proposed issuance of corporate bonds of which guidance was previously provided in a pre-IPO enquiry
- Insufficient disclosure on the performance of the listing applicant's business

Due Diligence Update (cont'd)

Deficiencies noted in qualitative assessment

- ▶ Two other cases that passed the Initial 3-day Check, but failed the subsequent qualitative assessment, were returned because the disclosure of information in the Application Proof was not substantially complete in all material respects. The deficiencies included:
 - Insufficient disclosure on the applicant's business model, non-compliance incidents, use of proceeds and hedging policy
 - Insufficient information to enable investors to assess the extent of the applicant's reliance on a major customer
 - Insufficient information to enable investors to assess the impact of certain disputes and complaints, suitability of directors and sustainability of the applicant's business
 - Insufficient information to assess whether the applicant satisfied the management continuity requirement under GEM Listing Rule 11.12A(3)

Due Diligence Update (cont'd)

Disciplinary Decisions to Date under Old IPO Regime

▶ **Mega Capital (Asia) Company Limited (Mega Capital)**

- SFC revoked Mega Capital's Type 6 licence (to advise on corporate finance) and fined it HK\$42 million for failing to discharge its duties as a sponsor on the listing application of Hontex International Holdings Company Limited (**Hontex**) in 2009. Findings against Mega Capital of:
 - i. Inadequate and sub-standard due diligence work
 - Principal businesses of Hontex group were fabric sales and garment manufacturing (on an OEM basis for apparel owners and for Hontex's franchisees) which required due diligence on the group's customers, suppliers and franchisees to assess the authenticity of the group's business performance

Due Diligence Update (cont'd)

Disciplinary Decisions to Date under Old IPO Regime

▶ Mega Capital (Asia) Company Limited (Mega Capital)

i. Inadequate and sub-standard due diligence work (cont'd)

- Mega Capital's due diligence work was found to be inadequate and sub-standard on the basis that: (a) material information (such as transaction figures with the group) was missing from questionnaires that Mega Capital completed with suppliers and customers; (b) it failed to follow up on the missing information; (c) a number of interviews with suppliers and customers were conducted by phone in haste on the day Hontex filed its listing application; (d) franchisees' information provided by Hontex (name, address and turnover of each franchisee) was not properly verified and transaction records between franchisees and the group were not obtained

Due Diligence Update (cont'd)

Disciplinary Decisions to Date under Old IPO Regime

▶ Mega Capital (Asia) Company Limited (Mega Capital)(Cont'd)

ii. Failure to act independently and impartially

- Important aspects of Mega Capital's due diligence work on Hontex's suppliers, customers and franchisees were sourced from Hontex without independent scrutiny, displaying inappropriate reliance on Hontex
 - Mega Capital acceded to Hontex's request that it should not approach the group's suppliers, customers and franchisees directly. Accordingly, all interviews were arranged by Hontex and conducted in the presence of its representatives
 - Mega Capital accepted Hontex's representation, without any inquiries, that some suppliers/customers refused face-to-face interviews with Mega Capital
 - Mega Capital agreed to have telephone interviews with suppliers and customers arranged by Hontex
 - Written confirmations from franchisees that they were independent from Hontex were obtained through Hontex

Due Diligence Update (cont'd)

Disciplinary Decisions to Date under Old IPO Regime

▶ Mega Capital (Asia) Company Limited (Mega Capital)(Cont'd)

iii. Inadequate audit trail of due diligence work

- Mega Capital did not adequately document its due diligence planning and significant aspects of its due diligence work. E.g. no records were kept showing what background or other due diligence searches were conducted on the group's suppliers, customers and franchisees

iv. Inadequate supervision of staff

- Most of the due diligence work was handled by junior and inexperienced staff of Mega Capital without adequate supervision

Due Diligence Update (cont'd)

Disciplinary Decisions to Date under Old IPO Regime

▶ **Mega Capital (Asia) Company Limited (Mega Capital)(Cont'd)**

v. Breach of sponsor's undertaking and filing untrue declaration with HKEx

- SFC claimed that Mega Capital had breached its undertaking and declaration to HKEx that it would/had made reasonable due diligence inquiries and believed that all information provided to HKEx during the listing application process, including information in the IPO prospectus, was true in all material respects and did not omit any material information
 - SFC found Mega Capital had failed to use reasonable endeavours to ensure that all information provided to HKEx during the listing application did not omit any material information and its declaration that it had made all reasonable due diligence inquiries was not true
- ▶ There was no evidence that Mega Capital was involved in any fraud and it denied all allegations of wrongdoing
- ▶ Separately, Hontex was ordered to repurchase its shares from around 7,700 public shareholders based on its admission of disclosure of false or misleading information

Due Diligence Update (cont'd)

Disciplinary Decisions to Date under Old IPO Regime

Sun Hung Kai International Limited (Sun Hung Kai)

- ▶ Securities and Futures Appeals Tribunal (SFAT) affirmed SFC's disciplinary decision against Sun Hung Kai in Jan 2014 and fined it HK\$12 million and suspended its licence for 1 year for due diligence failures as sponsor of the IPO of Sino-Life Group Limited (**Sino-Life**)
- ▶ October 2007 – Sino-Life appointed Sun Hung Kai to manage its listing application on GEM
- ▶ May 2008 – GEM Listing Rules changed to require positive cash flow of HK\$20 million in preceding 2 financial years
- ▶ Sun Hung Kai requested a waiver of the new cash flow requirement since the draft audit report showed positive cash flow of < HK\$20 million
- ▶ Waiver was refused by the Exchange and no listing application was filed
- ▶ October 2008 – Sino-Life revived listing application and appointed Sun Hung Kai as its sponsor

Due Diligence Update (cont'd)

Disciplinary Decisions to Date under Old IPO Regime

Sun Hung Kai International Limited (Sun Hung Kai)(Cont'd)

- ▶ Different accounting firm was employed and the audit report submitted to HKEx showed operating cash flow which met the HK\$20 million requirement
- ▶ A material difference was later found in the cash flow figure for the financial year ended 2007 used in the original and new audit reports
- ▶ The original audit report recorded cash flow of RMB 7.007 million for the year ended 2007
- ▶ The new audit report recorded cash flow of RMB 10.230 million for the same period, a difference of RMB 3.223 million

Due Diligence Update (cont'd)

Disciplinary Decisions to Date under Old IPO Regime

Sun Hung Kai International Limited (Sun Hung Kai)(Cont'd)

- ▶ The SFC's investigation lasted 3 and a half years and found that Sun Hung Kai failed to carry out proper due diligence in relation to 5 matters:
 - i. assess the accuracy and the completeness of the information submitted by Sino-Life to demonstrate that it satisfied the financial requirements to list on GEM
 - ii. ascertain the existence of various encumbrances on the title of a major business deal of Sino-Life in Taiwan
 - iii. properly assess the business of Sino-Life's wholly-owned subsidiary in Taiwan
 - iv. ensure true, accurate and complete disclosure was made to HKEx and in Sino-Life's prospectus and breach of the sponsor undertaking to the HKEx by filing untrue statements in the sponsor declaration
 - v. keep proper books and records in relation to the sponsor work conducted
- ▶ The SFC considered that Sun Hung Kai had been selective in its disclosure to HKEx during the listing process

Due Diligence Update (cont'd)

Disciplinary Decisions to Date under Old IPO Regime

Sun Hung Kai International Limited (Sun Hung Kai)(Cont'd)

- ▶ The SFAT confirmed most of the SFC's findings and considered that Sun Hung Kai's breaches were not the result of negligence

Failure to disclose and explain difference in 2007 cash flow figures

- ▶ Re. the 45% discrepancy in the cash flow figures between the original draft audit report and the report submitted with the listing application, SFC found that Sun Hung Kai team was aware of the discrepancy and its importance to the listing application
- ▶ Sun Hung Kai team found to have chosen to ignore the difference and failed to reveal it to HKEx upon subsequent inquiries
- ▶ The omission was a breach of Rule 6A.04 and 6A.15 of the GEM Listing Rules which require sponsors to exercise reasonable due diligence in ensuring that any opinions or forward-looking statements of the directors of the applicant have been made on fair and reasonable bases and assumptions and that all information is true in all material respects and does not omit material information

Due Diligence Update (cont'd)

Disciplinary Decisions to Date under Old IPO Regime

Sun Hung Kai International Limited (Sun Hung Kai)(Cont'd)

Failure to ascertain and disclose encumbrances on title of a major business deal

- ▶ IPO prospectus disclosed Sino-Life's intention to invest HK\$13.1 million of IPO funds to furnish a columbarium in Taiwan

Failure to ascertain and disclose encumbrances on title of a major business deal

- ▶ An internet search by Sun Hung Kai staff showed that auction proceedings for the colombarium had been halted
- ▶ The discovery prompted Sun Hung Kai to seek an opinion from a Taiwanese lawyer
- ▶ Although Sun Hung Kai urged Sino-Life to disclose relevant risks in the prospectus, the issue was not taken further and not mentioned in the prospectus
- ▶ SFAT found that Sun Hung Kai had failed to pursue irregularities discovered and accepted the advice of the Taiwanese lawyer at face value despite the advice being considered inadequate in breach of Paragraph 2.3 of the Corporate Finance Adviser Code of Conduct

Due Diligence Update Guidance Letters (cont'd)

Updates to IPO Listing Document Disclosure Requirements since October 2013

- ▶ Updated disclosure requirements set out in new and updated guidance letters
- ▶ If guidance letters are not complied with, HKEx may treat an Application Proof as not “substantially complete” as required under the Listing Rules
- ▶ HKEx may return the listing application to the sponsor and publish the fact of the return naming the listing applicant and sponsor on its website
- ▶ An 8-week moratorium applies before a new application can be submitted

Due Diligence Update Guidance Letters (cont'd)

GL41-12 (updated Jan. 2014)

- ▶ Provides guidance on disclosure of material adverse changes in financial, operational and/or trading position after the trading record period
- ▶ Updates:
 - HKEx requires disclosure in the “Summary” section of either qualitative or quantitative disclosure with commentary on how the adverse changes would affect the financial, operational and/or trading position after the trading record period. Disclosure must give sense of materiality of adverse changes
 - disclosure of comparative financial information to non-profit forecast financial information (e.g. revenue, gross profit) is not compulsory, but voluntary disclosure of such information should at least be reviewed by the applicant’s sponsor
 - any material adverse changes must also be highlighted in the “Risk Factors” and “Financial Information” sections of listing documents. These changes must be disclosed notwithstanding any mitigating factors which may reduce the potential impact of financial or operational loss to the applicant

Due Diligence Update Guidance Letters (cont'd)

GL27-12 (updated Jan. 2015)

- ▶ Provides guidance on the disclosure requirements for the “Summary and Highlights” section of listing documents
- ▶ Updates:
 - revisions aligning GL27 with the new requirements under GL41 re. inclusion of material adverse changes after the track record period to be included in the “Summary” section
 - requirement to include underwriting commission in the total amount of listing expenses relating to an offer as stated in the “Summary and Highlights” section

Due Diligence Update Guidance Letters (cont'd)

GL65-13 (updated in Jan 2015)

- ▶ Provides guidance on the information to be included in property valuation reports and market reports included in IPO listing documents
- ▶ Update:
 - requires applicants to make
“clear reference to tenure and other specific factors such as title defects and special requirements imposed on the properties by the land grant contracts, and the associated value implications, if material”
in their property valuation reports

Due Diligence Update Guidance Letters (cont'd)

GL32-12 (updated in Oct 2014)

- ▶ Provides guidance on accounting and disclosure requirements for (A) acquisitions of subsidiaries and businesses during or after the trading record period and (B) stub period comparatives

- ▶ Updates:

Applicability

- clarified the scope of MB LR 4.04(2) & (4) which require listing applicant to include in its accountants' report the results and balance sheets of any subsidiary or business acquired or agreed/proposed to be acquired since the date to which its latest audited accounts have been made up for the 3 financial years (2 financial years for GEM) preceding the listing document issue, or since the incorporation of the subsidiary or commencement of the business, if this occurred less than 3 years (or 2 years for GEM) prior to issue of the listing document
- clarified that MB LR 4.05A applies to acquisitions of a material subsidiary or business during an applicant's trading record period. Rule 4.05A requires listing document disclosure of pre-acquisition financial information on a material subsidiary or business acquired during the trading record period which would be classified as a major transaction or a very substantial transaction (i.e. 25% or more)

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Due Diligence Update Guidance Letters (cont'd)

GL32-12 (updated in Oct 2014)(Cont'd)

- Total assets, profits and revenue for the most recent financial year of the trading record period of the subsidiary or business should be compared to those of the applicant for the same financial year. If financial years are not coterminous, comparison of figures should be between the most recent financial year of the subsidiary or business and the applicant's for the most recent financial year of its trading record period
- MB LR 4.28 requires disclosure of pro forma financial information for a business or company acquired/proposed to be acquired after trading record period (including one subject to an acquisition agreement entered after the trading record period but not completed at listing and an intended acquisition of a specific subsidiary or business where there is no binding agreement) which would be a major subsidiary at the date of the listing application or any later day of acquisition before listing
- New Paragraph 4.6A of GL32-12 requires all acquisitions or proposed acquisitions of businesses or companies since the end of the trading record period to be aggregated in determining whether LR 4.28 applies
- If part of listing proceeds will apply to an acquisition under LR 4.04(2) & (4), paras 32 and 33 of 3rd Schedule to Companies (Winding Up and Miscellaneous Provisions) Ordinance apply and financial information for the acquisition must be subject to separate accountants' report

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Due Diligence Update Guidance Letters (cont'd)

GL32-12 (updated in Oct 2014)(Cont'd)

○ *Conditions for Waiver*

Acquisitions of equity securities in applicant's ordinary and usual course of business

- % ratios of each acquisition to be < 5% by reference to most recent financial year of applicant's trading record period
- applicant cannot exercise any control or significant influence over underlying company or business and
- listing document must include reasons for the acquisitions and confirmation that counterparties and their ultimate beneficial owners are independent 3rd parties of the applicant and its connected persons

Acquisitions of a business or subsidiary

- % ratios of acquired/to be acquired business/subsidiary <5% by reference to most recent financial year of applicant's trading record period
- historical financial information of acquired/to be acquired business/subsidiary is not available or would be unduly burdensome to obtain or prepare and
- listing document includes information required for a discloseable transaction under MB Ch. 14 (GEM Ch. 19)

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Due Diligence Update Guidance Letters (cont'd)

GL6-09A (updated in May 2014)

- ▶ Provides guidance on financial information for the trading record period expected in the Application Proof
- ▶ Updates:
 - certain historical financial information of a company/business acquired/to be acquired after trading record period and pro forma financial information of the enlarged group must be included in the Application Proof if the 25% threshold is met (see GL32-12)
 - such information need not be included in the Application Proof if the applicant's financial information in its subsequent draft listing document will be updated to cover a later period which includes the acquisition
 - pre-acquisition financial information for acquisitions made during the trading record period and any stub period, however, must be included in the Application Proof

Due Diligence Update Guidance Letters (cont'd)

GL72-14 (updated in Jan 2014)

- ▶ Provides guidance on disclosure in the “Applicable Laws and Regulations” section of listing documents to make the section succinct and easy to read
- ▶ Section to describe the rules and regulations that are material to the applicant’s current and/or future business
- ▶ Updates:
 - Inclusion of information on relevant laws/regulations elsewhere in the listing document rather than in a standalone section may assist investors’ understanding
 - Avoid Use of Legalistic Language
 - Legalistic language or long complex descriptions should not be used
 - Applicants are recommended to define titles of laws/regulations with concise definition

Due Diligence Update Guidance Letters (cont'd)

GL72-14 (updated in Jan 2014)

▶ Updates (cont'd):

- Key Laws and Regulations of Relevant Jurisdictions
 - laws and regulations of jurisdictions that are specific to and have a material impact on an applicant's business should be included
 - boiler plate disclosure of laws and regulations that do not materially impact the applicant's business should be avoided
 - if applicant has material businesses in many jurisdictions, description should be proportionate to their importance to the applicant
- Key Changes in Laws and Regulations
 - disclosure of changes in laws/regulations that will have material impact on listing applicant's business – and cross-referencing to “Business” and “Risk Factor” sections
 - changes made before or during the track record period should not be disclosed unless applicant is subject to grandfathering provisions or changes have a material impact on the business
- Relevance to the Applicant
 - disclose clearly how laws/regulations are relevant to the applicant
 - abstract summaries should be avoided

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Due Diligence Update Guidance Letters (cont'd)

GL72-14 (updated in Jan 2014)

▶ Updates (cont'd):

- Highly Regulated Industries (e.g. banking, insurance & gambling)
 - ensure that the “Applicable Laws and Regulations” section focuses not only on local statutory laws governing the industries
 - section should include internationally implemented industry specific rules and regulations
- Laws of the Issuer’s Jurisdiction of Incorporation
 - Refer to Joint Policy Statement Regarding Listing of Overseas Companies
 - Disclosure of regulatory provisions in relation to an applicant’s jurisdiction of incorporation should be set out in a section separate from the “Applicable Laws and Regulations” section

Due Diligence Update Guidance Letters (cont'd)

GL68-13 (Newly published Dec. 2013)

- ▶ Provides guidance on suitability of listing applicants
- ▶ Non-exhaustive list of factors that may affect suitability of a listing applicant
 - Suitability of director and controlling shareholders
 - Engagement of a person likely to exercise substantial influence on the applicant after listing who has a past non-compliance or conviction record that raises serious concern as to the person's integrity
 - Non-compliances
 - Systematic, intentional, and/or repeated breaches of laws and regulations
 - Exchange considers nature, extent, reasons for, and impact of breaches, and rectification and precautionary measures taken

Due Diligence Update Guidance Letters (cont'd)

GL68-13 (updated in Dec 2013)

▶ Updates (cont'd):

- Deteriorating financial performance
- Excessive reliance on certain parties
 1. Parent group
 - whether the functions relied on are important
 - where there are overlapping directors and industry sector, whether adequate internal measures are in place to manage potential conflicts of interest and delineation of businesses
 2. Connected persons
 - material part of applicant's turnover and profits derived from transactions with connected persons

Due Diligence Update Guidance Letters (cont'd)

GL68-13 (updated in Dec 2013)

▶ Updates (cont'd):

3. Major customer
 - extreme reliance on a single major customer – HKEx considers:
 - i. applicant's ability to find replacement customers
 - ii. likelihood of reduced reliance in the future
 - iii. industry landscape
 - iv. whether the reliance is mutual and complimentary
 - v. existence of long-term contractual arrangements
 - vi. applicant's ability to sustain its revenue and profitability in the long-term
4. Captive business model – same party dominates applicant's sourcing of key raw materials and customer channel
 - whether applicant can operate independently of such party

Due Diligence Update Guidance Letters (cont'd)

GL68-13 (updated in Dec 2013)

- ▶ Updates (cont'd):
 - Gambling
 - not suitable in general
 - unless satisfy the requirements stated in the Exchange's announcement entitled "Gambling Activities Undertaken by Listing Applicants and/or Listed Issuers" and Listing Committee Report 2006
 - Contractual Arrangements (VIEs)
 - Must satisfy the conditions specified in the Listing Decision "HKEx-LD43-3"
 - Reliance on unrealised fair value gains to meet profit requirement
 - If the applicant cannot meet profit requirement after excluding unrealised fair value gains and it did not have a substantive business during its track record period, it must demonstrate existence of a sustainable business

Due Diligence Update Guidance Letters (cont'd)

GL63-13 (updated in May 2014)

- ▶ Deals with disclosure of material non-compliance incidents
- ▶ 3 categories:
 - Material Impact Non-compliance Incidents
 - Systemic Non-compliance Incidents
 - Immaterial Non-compliance Incidents
- ▶ Serious non-compliance incidents (e.g. director fraud/systemic failure of internal controls/matters having significant financial impact) may raise issues as to directors' suitability and/or applicant's suitability for listing
- ▶ Update – serious non-compliance incidents may result in:
 - rejection of listing application
 - HKEx requesting a demonstration period of compliance from last non-compliance incident to show rectification measures and enhanced internal controls are effective and that there is no financial impact on the applicant. The demonstration period normally an audited period

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Due Diligence Update Guidance Letters (cont'd)

GL63-13 (updated in May 2014)(Cont'd)

- ▶ Where non-compliance incidents do not impact suitability for listing, the Exchange requires:
 - **Material Impact Non-compliance Incidents** to be highlighted in the “Summary and Highlights” section of listing documents and listing document disclosure of information in para 3.4 of GL63-13
 - **Systemic Non-compliance Incidents** to be highlighted in “Summary and Highlights” section of listing documents and listing document disclosure of views of the directors and the sponsor(s) on the adequacy and effectiveness of applicant’s internal controls, the suitability of its directors and the applicant’s suitability for listing
- ▶ **Disclosure of major customers’ identities**
 - Listing applicants should disclose the identities of their major customers in their listing documents, particularly if a few customers only account for a large part of revenues
 - If major customers’ identities are not disclosed in the listing document, they must not be included in marketing communications with analysts or investors (SFC Corporate Regulation Newsletter Issue No. 2 of April 2015)

Due Diligence Update (cont'd)

Discussion of other Due Diligence Issues

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- ▶ Charltons' extensive experience in corporate finance makes us uniquely qualified to provide a first class legal service
- ▶ Charltons have representative offices in Shanghai, Beijing and Yangon
- ▶ Charltons was named the **"Corporate Finance Law Firm of the Year in Hong Kong"** in the Corporate Intl Magazine Global Award 2014
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