

HKE_x GUIDANCE LETTER
HKE_x-GL54-13 (May 2013)

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| Subject | Simplification Series – Disclosure in listing documents for IPO cases – the “Risk Factors” section |
| Listing Rules and Regulations | Main Board Rules 2.03(2), 2.13(2), 11.07 and 19A.42 GEM Rules 2.06(2), 14.08(7), 14.22 and 17.56(2) and Paragraph 67 of Part A of Appendix 1 |
| Related Publications | Main Board IPO Checklist I.N. – Standard Comment 4.10 GEM Board IPO Checklist I.T. – Standard Comment 4.10 |
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Important note: *This letter does not override the Listing Rules and is not a substitute for advice from qualified professional advisers. If there is any conflict or inconsistency between this letter and the Listing Rules, the Listing Rules prevail. You may consult the Listing Division on a confidential basis for an interpretation of the Listing Rules, or this letter.*

1. Purpose

1.1 This letter gives guidance on the disclosure in the “Risk Factors” section in listing documents. It supersedes standard comment 4.10 of Main Board IPO Checklist I.N. and GEM Board IPO Checklist I.T.. Specifically, it aims to ensure that the section:-

- is concise, organised logically, easy to read and in plain language;
- is relevant to applicants, and provides sufficient information to help investors understand and focus on the specific risks that affect the applicants, their operations or securities before making informed investment decisions; and
- explain how the risk affects the applicant or the securities being offered.

1.2 The Exchange expects applicants to follow this guidance letter when preparing listing applications. A listing document that does not follow this guidance may be considered not substantially complete.

1.3 However, whilst this guidance letter discusses good practice as to the presentation of risk factors it is not the role or intention of the Exchange to dictate to an applicant what the applicant should, or should not, disclose as being the risk of making an investment in its securities. There may be significant legal and/ or regulatory consequences if an applicant does not appropriately disclose the risks it is subject to. The applicant has the sole responsibility for determining what risks it wishes to include in the “Risk Factors” section of its listing document.

2. Relevant Listing Rules

- 2.1 Main Board Rule 2.03(2) (GEM Rule 2.06(2)) requires that potential investors are given sufficient information to enable them to make a properly informed assessment of an issuer.
- 2.2 Main Board Rule 2.13(2) (GEM Rule 17.56(2)) requires that the information contained in the listing document must be accurate and complete in all material respects and not be misleading or deceptive. In complying with this requirement, the issuer must not, among other things:-
 - (a) omit material facts of an unfavourable nature or fail to accord them with appropriate significance;
 - (b) present favourable possibilities as certain or as more probable than is likely to be the case; or
 - (c) present risk factors in a misleading way.
- 2.3 Main Board Rule 11.07 (GEM Rule 14.08(7)) sets out an overriding general duty of disclosure for the content of a listing document.
- 2.4 Main Board Rule 19A.42 (Paragraph 67 of Part A of Appendix 1 to the GEM Rule) sets out certain additional risks to be included in the listing documents for PRC applicants.
- 2.5 GEM Rule 14.22 sets out certain principles that should, as a minimum, be taken into account to give appropriate prominence to any risk factors in the listing documents which should be drawn to shareholders' and prospective investors' attention. These include: (i) whether or not there are risks that are relevant to the issuer itself; (ii) whether or not there are risks that are relevant to the issuer's business; and (iii) whether or not there are risks on a macro-scale that are relevant to the issuer.

3. Guidance

- 3.1 The "Risk Factors" section should be presented in a way that is concise, organised logically, easy to read and uses plain language. The goal in the risk factor disclosures, as in all disclosures to the market, should be clarity and not merely brevity. The section should include all the material risks associated with investing in an applicant. It should explain why these risks are material from investors' perspective so that investors have a basis on which to make a properly informed assessment of the applicant and of an investment in its securities.
- 3.2 Set out below are some guidance and principles on disclosure of risk factors.

Risks should be relevant to listing applicants

- 3.3 The section should present risks relevant to the particular applicant and should explain clearly how these risks are related/ apply to, and have a significant effect on, that applicant, its industry and/ or the offering.
- 3.4 Each risk factor should be described in context so that investors can understand the nature of, or circumstances giving rise to, the risk or uncertainty as it affects the applicant, its operations and securities, or the offering. If standardised language is used it is important to ensure that the particular circumstances of the applicant do not require modification of that language.

Make a quantitative disclosure and focus on the risks, but not the background information

- 3.5 The “Risk Factors” section should focus on the risks and on explaining the nature and extent of those risks. The section should not merely describe the circumstances that give rise to a risk and fall short of explaining what the risk is. The risk factor should avoid unnecessary factual background and should provide only enough detail to place the risk in context. There should, if possible and meaningful, be quantitative disclosure of the likely impact of the risks in addition to qualitative disclosure to allow investors to assess the magnitude and impact of the risks on the applicants’ business operations and financial position. More detailed discussion of the background information should be included in other parts of the listing document and only cross-referenced in the risk factors.

Identify risks individually, but avoid repetition and overlapping

- 3.6 Each risk factor should focus on disclosing a single principal risk and should avoid bundling together disclosures on multiple risks. Closely related risks, however, should not be unbundled into multiple separate risk factors if this results in undue repetition and overlapping of disclosures.

Risks are matters that are difficult for applicants to mitigate and that would have significant effects on the applicants if they occur

- 3.7 Risk factor disclosures should relate to risks that applicants are unable to mitigate adequately. Where mitigation is not difficult an applicant should not include a risk factor mainly because the applicant may not deal with the event or activity adequately. For example, it is not appropriate to include the applicants’ possible failure to comply with legal requirements as a risk factor because applicants are expected to be law-abiding and rule compliant unless there is a genuine legitimate reason that gives rise to this uncertainty to comply.
- 3.8 Risk factor disclosures should not be confined to risks that are considered to be reasonably likely to occur. If the occurrence of a particular risk would have a significant effect on the applicant, the applicant should disclose that particular risk even if it has a low probability of occurring.

Appropriate headings and sub-headings

- 3.9 Related risk factor disclosures should be grouped together, adopting appropriate and meaningful headings and sub-headings. As a guide, headings may include “risks relating to the applicant”, “risks relating to the applicant’s business”, “risks relating to the applicant’s industry” and “other relevant risks” (e.g. “any social, economic or political risks relating to countries where the applicant has substantial operations”, and “risks that are specific to the securities”), etc.
- 3.10 The sub-headings should not be too vague and generic, and should succinctly outline or reflect the risk that follows in the text as a result of certain facts/ uncertainties about the applicant. This means the headings need to say what the risk is and not merely disclose the facts or circumstances that give rise to the existence of the risk. For example, “*Reliance on major customers*” merely states a fact, whereas “*Our top five customers accounted for 75% of our revenue and any decrease in our sales to any one of them would affect our operations and financial results*” additionally describes the risk.

Order from the most to least important

- 3.11 As a general principle, applicants should seek to set out risk factors in an order that reflects their relative significance. Within each sub-section of risk factors, applicants should similarly seek to present the risk factors in order from most to least important. However, ordering will always require the making of subjective judgments as to the magnitude of each risk (both in terms of likelihood of occurrence and in terms of consequences if it does). Accordingly it is the sole responsibility of the applicant to determine the appropriate ordering having due regard to this general principle.

No mitigating facts

- 3.12 Mitigating facts should not be included in the description of a risk factor as they may divert investors’ attention from the magnitude and impact of the risks. Mitigating factors may however be included in other sections of the listing document, and to give a better assessment of the risk factor and how the applicant intends to mitigate it. Cross-referencing these factors to the relevant disclosures in other sections of the listing document may be appropriate.

Consistent disclosure

- 3.13 The risks included within the “Risk Factors” section should be consistent with the information in other sections of the listing document. A disclosure discussed elsewhere in the listing document that clearly suggests a significant risk or uncertainty to the applicant should be included in the “Risk Factors” section.

Remove outdated risk factors

- 3.14 The section should remove risk factors which are outdated and no longer applicable. For example, a new law, when promulgated, may create some uncertainties and risks during the initial implementation stage. The relevant uncertainties may no longer

exist after years of implementation of the law so that the relevant risk factor may become irrelevant and so should not be included in the section.

Avoid disclaimer statements that lack specificity

- 3.15 The purpose of the risk factor disclosures is to provide meaningful cautionary statements. The same result cannot be achieved by using disclaimers that merely say that there may be undisclosed risks, for example, “*the section is not complete and there may be risks that the applicant does not consider material at the date of listing document may become material in future*” and “*there may be risks that we have not yet identified at present*”. Accordingly the use of statements of this nature is discouraged.
