

GUIDANCE LETTER FOR LONG SUSPENDED COMPANIES

HKE_x GUIDANCE LETTER HKE_x-GL66-13 (September 2013)

Subject	Guidance for long suspended companies
Listing Rules	Main Board Rules 6.01, 6.04, 6.10, 13.24 and Practice Note 17 GEM Rules 9.01, 9.14, 9.15, 9.16 and 17.26

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.*

I. PURPOSE

1. This letter sets out the current practice and rationale for the continued suspension of companies that are suspended from trading due to insufficient operations or other material regulatory issues. It also sets out the criteria for resumption for long suspended companies and provides guidance on the administrative requirements for resumption proposals submitted by companies with insufficient operations.

II. CURRENT PRACTICE FOR LONG SUSPENDED COMPANIES

(a) Suspension criteria under the Rules

2. The Exchange is the front line regulator of listed companies and has an obligation to maintain a fair, orderly and efficient market for the trading of securities. It may, for the maintenance of an orderly market or the protection of investors, suspend trading in any securities. Where there are concerns about investor protection, the Exchange may require companies to address these specific concerns before granting resumption of trading.
3. In the interests of promoting a continuous market for the trading of listed securities, the period of suspension should be kept as short as possible. Resumption of trading normally takes place after the publication of information, and where applicable, fulfillments of conditions imposed by the Exchange.

(b) Long suspended companies

4. "Long suspended companies" are companies whose trading has been suspended for over three months. They include:
 - (a) companies which are in severe financial difficulties and/or have ceased to maintain sufficient operations and are in the delisting stages (**PN 17 companies**); and

(b) companies which are suspended due to material issues including (i) identified irregularities and/ or regulatory investigations, and (ii) failure to publish financial results or significant internal control weaknesses.

5. In most cases, a company is initially suspended due to failure to announce inside information or other material developments (e.g. regulatory investigation), or to release financial results before the deadline. These companies continue to be suspended until the issues giving rise to the initial suspension are clarified, or they experience severe financial difficulties or cease operations and they become a PN17 company.

(i) PN 17 companies

6. PN17 companies are companies that are in severe financial difficulties and/or have either ceased to operate their businesses or are carrying on minimal operations. They do not meet the Rule¹ requirement to maintain sufficient assets or level of operations and as a result, their shares cannot continue to trade. They enter into a three-stage delisting procedure (or one stage for GEM companies)² of a minimum of six months each, during which they may submit proposals for the resumption of trading. The Exchange monitors the development of the companies and at the end of each stage, makes a determination whether it is appropriate to enter into the next stage.

7. PN 17 companies must submit their resumption proposals to the Exchange for its approval in order for its shares to resume trading. The proposals must be clear, plausible and coherent and include sufficient details, including forecasts and future plans for business development, to enable them to be assessed by the Exchange.

8. A resumption proposal generally involves reactivation and/or acquisitions of businesses. The Rules do not set out specific criteria for a resumption proposal, other than the company must demonstrate that it carries on sufficient operations¹. It must carry on a business of substance and the business model must be viable and sustainable in the longer term.

9. PN 17 companies may submit resumption proposals at any time during the delisting stages. Upon the expiry of each stage and in the absence of a viable proposal, the Exchange will place the company into the next delisting stage or if it is in the final stage, cancel its listing. The companies may seek a review of the Exchange's decision to place them into the next delisting stage or to delist them³.

(ii) Companies suspended due to material issues

10. Some companies are identified to have issues such as being the subject of regulatory investigations, accounting irregularities, failure to release financial results or significant weakness in internal controls. Suspension is required under the Rules for the preservation of a fair, orderly and informed market.

¹ Rule 13.24 (GEM Rule 17.26) imposes a continuing obligation for listed companies to carry out a sufficient level of operations or have assets of sufficient value to warrant the continued listing of their securities on the Exchange.

² The procedure is set out in Practice Note 17 to the Rules (GEM Rule 9.15).

³ See Chapter 2B of the Rules (Chapter 4 of the GEM Rules) on Review Procedures.

11. Generally, these companies may apply for resumption once the matter giving rise to the suspension is addressed and announced to the market. The resumption proposal generally needs to address the following:

- (a) Where accounting irregularities or possible fraudulent activities are identified, the board would generally form an independent committee to review the issues, conduct an investigation and, where possible, take remedial actions. A number of these companies have engaged forensic accountants to investigate the issues and address regulatory concerns arising from them. In most cases these companies would be investigated by regulatory or law enforcement bodies.
- (b) Where the media reports investigations by regulatory authorities, the company would need to assess the implications to its operations and whether its public disclosure remains materially accurate. For example, if a company relied on false documents in the course of a material acquisition, they should appoint an independent committee to review the matter and address any issue about overstatement of assets.

In scenarios (a) and (b) where the allegations are material and there is a concern that the company's published information may be materially inaccurate, trading cannot be conducted in a fair, orderly and fully informed basis. If the Exchange identifies potential violations of laws and regulations by the company or its management, it will refer the matters to the relevant regulatory authorities⁴. It is likely that trading cannot resume until after the matter is addressed.

- (c) Where the company is delinquent in publishing its financial results, under the Rules it would remain suspended until the accounts are published.
 - (d) Where there are material internal control deficiencies identified, they must be corrected before resumption. An inadequate reporting system undermines the accuracy of information disclosed to shareholders.
 - (e) Where issues giving rise to suspension involve management and directors' integrity, the Exchange must be satisfied that the directors meet the required levels of skill, care and diligence; can act honestly and in good faith in the interest of the company as a whole; and act for proper purpose⁵.
12. The Rules do not specify a delisting procedure for these companies. If the management is unwilling to take action to resolve issues, or where the possible fraudulent activities are the acts of management/controlling shareholder, the Exchange may continue suspension or delist the company. Under the Rules, the Exchange may delist a company if it is no longer suitable for listing⁶ or if suspension continues for a prolonged period without the company taking adequate

⁴ For example, if a company's business or affairs may have been conducted in a manner which is unfairly prejudicial to shareholders, the Exchange will refer the case to the Securities and Futures Commission. Under the Securities and Futures Ordinance, the Commission may take certain legal actions to protect shareholders.

⁵ See Rules 3.08 and 3.09 (GEM Rules 5.01 and 5.02)

⁶ See Rules 6.01 and 6.10 (GEM Rules 9.01 and 9.15)

action to obtain restoration of listing⁷. In making these determinations, the Exchange will have regard to the interests of shareholders and the investing public.

(c) Disclosure made by long suspended companies

13. Like other listed companies, long suspended companies are required to timely publish information required under the Listing Rules and the Inside Information Provision under the Securities and Futures Ordinance (**SFO**), including material developments of their operations and any inside information. In addition, they are required to publish information about their resumption conditions and provide periodic updates to the market on their progress towards meeting the resumption conditions or delisting.
14. The Exchange currently publishes a monthly long suspension report⁸ on the HKExnews website which summarizes the suspension status of these companies. As part of its regular monitoring activities, the Exchange follows up with long suspended companies on their disclosures and requests them to keep the market updated of material information about their business and progress to resume trading.

III. GUIDANCE TO PN 17 COMPANIES ON THE RESUMPTION PROPOSALS

15. PN 17 companies are required to submit viable resumption proposals to the Exchange to demonstrate their compliance with Rule 13.24 (GEM Rule 17.26) and other resumption conditions imposed on it.

(a) Standards for resumption proposals

16. PN 17 companies generally have minimal or no operations and are in severe financial difficulties. Their resumption proposals may involve a white knight injecting funds to rescue the company and finance its acquisitions of assets or businesses, or the reactivation of its existing businesses.

(i) Business viability and sustainability

17. A resumption proposal needs to demonstrate that the PN 17 company has a viable and sustainable business to comply with Rule 13.24 (GEM Rule 17.26). While there are no quantitative criteria in the Rules, the business must have substance and the business model should be viable and sustainable in the longer term.
18. When making the assessment, we will take into account the nature and size of the restructured/enlarged group's business, its business model, competitive strengths and future plans, and its business performance and financial conditions e.g. profitability and sufficiency of assets and funds. The onus is on the company to provide all relevant information to prove its case:
 - The proposal should clearly describe the business model and contain sufficient details to support its viability, including a track record that indicates a meaningful scale of operations and a sustainable level of profitability, and a detailed business plan and credible evidence

⁷ See Rule 6.04 (GEM Rule 9.14)

⁸ <http://www.hkexnews.hk/reports/issuerinfo/issuerinfo.htm>

to support the achievability of its profit forecasts. A business that has a low profit margin or is loss making raises concern on the viability of its business model.

- The proposal should demonstrate that the group has sufficient assets and funds to achieve its business plans and the expected level of operations. It should also include a concrete plan for the use of proceeds from the fund raising exercise. If the group's assets would substantially comprise cash which is far beyond that needed for its present or projected business operations, the proposal would not be accepted as a cash company is not regarded as suitable for listing.

(ii) Application of the reverse takeover Rules

19. The reverse takeover Rules govern backdoor listing transactions and seek to prevent circumvention of the new listing requirements.
20. Resumption proposals may involve PN 17 companies making acquisitions of new businesses to improve their scale of operations and financial positions. As these companies generally retain minimal operations and assets, the acquisitions would be very substantial to them and would likely trigger the reverse takeover Rules.
21. The proposed very substantial acquisitions may involve injections of new businesses into the companies by the incoming investors (who would become the companies' controlling or single largest shareholders), or acquisitions of businesses that are different from the companies' original businesses. The Exchange would apply the reverse takeover Rules if the acquisitions:
 - trigger the bright line tests under the reverse takeover Rules (i.e. Rule 14.06(6)(a) or (b) (GEM Rule 19.06(6)(a) or (b))⁹; or
 - are regarded as extreme cases falling under the definition of reverse takeover in Rule 14.06(6)(GEM Rule 19.06(6))¹⁰.
22. Where the acquisitions constitute reverse takeovers, they could not proceed unless the enlarged group or the businesses to be acquired could meet the trading record requirements for new listings¹¹.

⁹ Rule 14.06(6) (GEM Rule 19.06(6)) defines "reverse takeover" as an acquisition or a series of acquisitions which represents, in the Exchange's opinion, an attempt to list the assets to be acquired and circumvent the new listing requirements. Paragraphs (a) and (b) of the Rule provide bright line tests which apply to two specific forms of reverse takeovers.

¹⁰ Transactions which are in substance backdoor listings but fall outside the bright line tests could still be treated as reverse takeovers. In making this assessment, the Exchange would consider whether the transaction represents an attempt to list the business to be acquired and to circumvent the new listing requirements. Please refer to Listing Decision LD95-1 for guidance.

¹¹ Under Rule 14.54 (GEM Rule 19.54), the company proposing a reverse takeover will be treated as if it were a new listing applicant.

(iii) Interests of minority shareholders

23. Resumption proposals generally involve issuance of substantial amount of securities to raise funds for acquisitions of businesses, repayment of debts and/or future operations. This would result in a material dilution of the minority shareholders' interests in the PN 17 company.
24. When reviewing a resumption proposal, the Exchange will take into account the benefit of the proposal to the company's minority shareholders. It views cases negatively where there is material dilution in the minority shareholders' interests in the company as any recovery to them would be insignificant. In these cases, the Exchange would require the PN 17 company to address the issue on material dilution, for example, by providing the minority shareholders with the opportunities to subscribe for securities through a pre-emptive offer.

(iv) Other resumption conditions

25. The Exchange may impose other resumption conditions on individual PN 17 companies based on the circumstances of each case. In general, many PN 17 companies are found to have other issues, including:
 - material internal control deficiencies – the company should engage independent advisers to review the restructured/enlarged group's internal control system and rectify all material weaknesses identified as an inadequate control system undermines the accuracy of information disclosed to the market. It needs to demonstrate that it has put in place an adequate and effective internal control system; and
 - failure to comply with the financial reporting requirements – the company must publish all outstanding financial results required by the Rules¹² and address any audit qualifications.
26. The companies must also demonstrate their compliance with all applicable Listing Rules.

(b) Administrative requirements for resumption proposals

(i) Time frame for submitting and implementing resumption proposals

27. PN 17 companies should submit resumption proposals to the Exchange as soon as they can and in any event not less than 10 business days before the end of the relevant delisting stage. This is intended to allow adequate time for the Exchange to evaluate the proposal. If a company submits a proposal at a very late stage, it runs the risk of the proposal failing to meet the Exchange's requirements and the company's listing being cancelled.
28. Where the Exchange allows a PN 17 company to proceed with its resumption proposal, it will require the company to complete the proposal within a reasonable period determined based on individual circumstances.

¹² Under Rule 13.50, trading in a company will be suspended if it fails to publish period financial information as required by the Rules. The suspension will remain in force until the company has announced the requisite financial information. (See also guidance under Listing Decision LD53-3 (2006) for GEM companies.)

29. If the company fails to complete the proposal before the deadline or the proposal does not materialise for any reason, the Exchange would place the company in the next delisting stage, or if it is in the final stage, proceed to cancel its listing.

(ii) Content and documentary requirements for resumption proposals

30. Resumption proposals should be clear, plausible and coherent, and contain sufficient detail to enable them to be assessed by the Exchange.

31. A resumption proposal should be submitted to us in its substantially final form. Major terms of the transactions and arrangements contemplated under the proposal should be supported by signed agreements. A proposal with terms yet to be finalized evidenced by a memorandum of understanding would generally not be accepted.

32. The proposal should be accompanied by a draft circular (or if a circular is not required under the Rules, a draft announcement) for the proposal in substantially final form. In addition to the disclosure required by applicable Rule requirements, the circular should also include the following information to enable the Exchange to assess the viability and sustainability of the restructured/enlarged group's business, and the dilution impact on the company's minority shareholders:

- a detailed description of the business, including the products and services provided, the business model, market competition, the group's competitive strength and business strategies, major customers and suppliers, licenses and permits required for the business, etc.
- a clear and detailed plan for the future development of the restructured/enlarged group's business, and how the company would achieve it;
- the intended use of proceeds from any proposed fund raising exercises;
- the historical financial information of the restructured/enlarged group's business, with the management discussion and analysis of the business performance and financial conditions. Where applicable, the draft accountants' report or management accounts on the target to be acquired should include figures in final or advanced form;
- the restructured/enlarged group's profit forecast for at least the period up to the forthcoming financial year end¹³, with all principal assumptions and the management discussion and analysis of any material fluctuations compared to the historical track record of the business;
- a statement of sufficient working capital by the directors for at least 12 months from the expected date of trading resumption¹¹;

¹³ The company should submit the profit and cashflow forecast memorandum together with draft comfort letters from the company's financial advisers and auditors under Rules 14.62(2) and (3) (GEM Rules 19.62 (2) and (3)).

- pro forma financial information of the restructured/enlarged group;
 - where applicable, an expert report (e.g. property valuation report, competent person's report on mineral assets) required by the Rules in final or advanced form. If the expert has not yet signed off his report, the draft circular should be submitted together with the expert's confirmation that no material change is expected to be made to the draft report, subject to unforeseen subsequent events which are out the expert's control; and
 - information showing the changes in the company's shareholding structure as a result of the implementation of the resumption proposal.
33. The resumption proposal should also include information and documents to demonstrate the company's fulfillment of other resumption conditions before trading resumption. These include and are not limited to:
- an advanced draft of all outstanding financial results of the company, and the company's actions and plans to address any audit qualifications; and/or
 - the results of any internal control review for the group conducted by an independent professional firm and the company's actions and plans to rectify the weaknesses identified. Where the proposal involves any material acquisition, the company should have engaged the professional firm to conduct an internal control review before trading resumption.
34. Resumption proposals that are not genuine or lack sufficient details and credibility would be rejected.

IV. GUIDANCE TO COMPANIES SUSPENDED DUE TO MATERIAL ISSUES

35. Listed companies may face incidents or events indicating possible irregularities with their groups. Set out below are some examples:

Case 1

- Accounting irregularities have been identified by the company's auditors when performing the audit procedures. The auditors issued a disclaimer of opinion on the company's accounts (or they resigned and the accounts were not released) because the company was unable to provide information or explanations for the material issues to the auditors' satisfaction. The issues include and are not limited to:
 - discrepancies between the group's accounting records on the transactions and balances with certain customers and/or suppliers and the information independently obtained by the auditors;
 - concern about the authenticity of documents in the group's accounting records on bank balances;

- lack of information and evidence to substantiate the existence or ownership of material assets; and/or
- concern about the nature and commercial substance of some material transactions.

Case 2

- The company cannot timely publish its audited accounts (or the auditors issued a disclaimer of opinion on the accounts) because the company has failed to keep proper books and records for the group, for example, some accounting records of a major subsidiary were lost during the relocation of office in the Mainland.

Case 3

- Potentially fraudulent activities (e.g. misappropriation of assets or funds) are discovered by the company's board of directors, for example:
 - material assets of the group have been transferred to third parties without the approval of the board;
 - a major subsidiary has received claims from banks for repayment of loans or guarantees given by the subsidiaries for bank loans granted to some third parties, but the board has no prior knowledge of such loans or guarantees.

Case 4

- The company (or any group members) and/or its directors are being investigated by regulatory authorities for material breach of laws or regulation. The investigation raises concern whether the company's published accounts and other disclosure in the public domain remain materially accurate, for example:
 - the company is suspected to have disclosed false or materially misleading information in its public documents;
 - the investigation relates to allegations that some directors used false documents to mislead the company's board and shareholders in the course of a material acquisition made by the company.

Case 5

- The company's directors (but not the company or its subsidiaries) are being investigated by regulatory authorities for material breach of laws or regulations, for example, offenses of bribery in relation to certain matters or transactions.

36. In the circumstances described above, the company's board of directors should look into the matter immediately and assess whether the company has a disclosure obligation under the Rules and/or the SFO.

37. For investor protection and maintenance of an orderly market, a trading halt or suspension would be necessary if:
- the company cannot timely announce material information relating to or arising from the matter¹⁴;
 - the matter raises concern that the shareholders' investments and the company's assets are not properly safeguarded, and the company's published accounts or other disclosures in the public domain are materially inaccurate or misleading. For example, there are potentially fraudulent activities in the group and/or significant deficiencies in the internal control system; and/or
 - the company cannot publish its financial results by the due date according to the Rules¹⁵.
38. The procedures for lifting the trading halt or suspension will depend on the circumstances of each case.
39. The company's board of directors, including its independent non-executive directors, should review the matter as soon as practicable and determine any further actions that the company needs to take. For cases involving regulatory investigations, the board may need to ascertain the nature and particulars of the investigations.
40. If any director of the company is, or is suspected to be, involved in the matter, the board should consider setting up a special committee to review the matter to avoid any conflict of interests which may arise during the review process. The special committee should also assess whether the relevant director can discharge his duties in the group and comply with Rules 3.08 and 3.09 (GEM Rules 5.01 and 5.02)¹⁶ while the internal review process and/or the regulatory investigation continues.
41. The board or special committee should consider engaging independent experts to assist them in reviewing the matter, particularly in the following circumstances:
- where the matter involves or indicates potentially fraudulent activities such as false accounting or misappropriation of assets (e.g. cases 1, 3 and 4), it should be investigated by forensic accountants with sufficient resources and professional staff with relevant qualifications and experiences in handling cases with similar nature and complexity;
 - where the matter raises concern about the reliability of the internal control system (e.g. cases 1 to 4), independent experts should be engaged to review the system and to identify material weaknesses with recommended remedial actions.

¹⁴ Under Rule 13.10A (GEM Rule 17.11A), a trading halt or suspension is required if the company cannot promptly announce any inside information under the SFO and Rule 13.09 (GEM Rule 17.10).

¹⁵ Under Rule 13.50, trading in a company will be suspended if it fails to publish periodic financial information as required by the Rules. The suspension will remain in force until the company has announced the requisite financial information. (See also guidance under Listing Decision LD53-3 (2006) for GEM companies.)

¹⁶ The Rules state that each director must meet the required levels of skill, care and diligence; can act honestly and in good faith in the interest of the company as a whole; and act for proper purpose.

42. The board or special committee should consider the findings of the review or investigation, assess the impact on the group, and ensure that the company takes appropriate remedial actions to address the regulatory concerns.
43. Before trading resumption, the company should demonstrate to the Exchange's satisfaction that it has addressed all material issues. For example, the company should demonstrate that:
- in cases 1, 3 and 4:
 - it has rectified any material misstatements or errors in its accounts, and has published information that is accurate and not misleading, to enable the investing public to appraise its position;
 - it has made necessary changes to the company's board of directors to ensure compliance with Rules 3.08 and 3.09 (see paragraph 11(e)); and
 - in cases 1 to 4:
 - it has put in place an adequate and effective internal control system;
 - it has published all outstanding financial results and addressed any audit qualifications; and
 - it has disclosed any other inside information required under the SFO and Rule 13.09 (GEM Rule 17.10).
44. In case 5, the investigation is initiated against the directors relating to some specific matters or transactions, and does not indicate false accounting or material irregularities within the group:
- trading may resume after the company has announced sufficient information to allow the investing public to appraise the position of the company in light of the regulatory investigation, including the nature and particulars of the investigation, the board's assessment of the impact of the matter on the group and whether the relevant directors are able to discharge their duties in the group while the investigation continues.
 - where any material development of the investigation raises concern about the integrity of the relevant directors, the company would need to demonstrate compliance with Rules 3.08 and 3.09.
45. The Exchange acknowledges that in many cases the issues are complex and the companies require considerable time to investigate and resolve the issues. However, in the interest of a fair and continuous market for the trading of listed securities, any suspension for a prolonged period should be avoided as it denies investors access to the market and prevents its proper functioning.
46. Listed companies should, as soon as they can after the trading suspension, submit concrete plans to the Exchange to demonstrate how they would resolve the issues and fulfill the resumption conditions, with an expected timetable for the major milestones. The Exchange may delist any problematic company if it is no longer suitable for listing or where suspension continues for a prolonged period without the company taking adequate action to resume trading.
