

## Client Alert

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## SEHK consults the market to tighten the rules on backdoor listing and continuing listing criteria

### Summary

On 29 June 2018, The Stock Exchange of Hong Kong Limited (SEHK) published a [consultation paper](#) to seek comments on proposals relating to backdoor listing and continuing listing criteria. To deter circumvention of new listing requirements by backdoor listing and to address "shell" activities, SEHK proposed to codify the existing practices and/or impose additional requirements for reverse takeovers, extreme acquisitions, material disposals, large scale issues of securities and regulatory disclosures.

Together with the new Guidance Letter (GL96-18) on suitability for listing, the new rules aim at lowering the incentives to create, maintain and trade shell companies. Under the proposal, there is no transitional period for the reverse takeovers rules but a 12-month transitional period for satisfying the new continuing listing criteria.

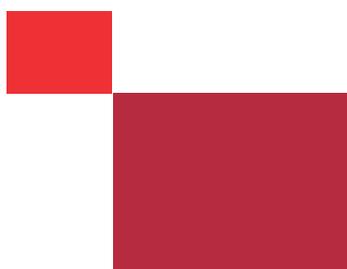
The Securities and Futures Commission (SFC) endorsed SEHK's initiatives to tackle backdoor listings by publishing a press release. The consultation period will end on 31 August 2018 (Friday).

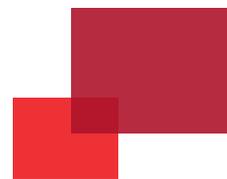
### Summary of the major proposed amendments to the Listing Rules

The proposed amendments to the Listing Rules increase the costs and time to maintain a shell company at IPO and post-listing in the following ways:

#### 1. Reverse takeover (RTO) or backdoor listing

- retain the bright line tests under the current Rule 14.06(6) and extend the aggregation period from 2 years to 3 years
- modify the current Rules 14.92 and 14.93 to restrict any material disposal at the time of or within 3 years after a change in control unless (i) the remaining business or (ii) any asset(s) acquired from the new controlling shareholder and any other person(s), would meet the track record requirements for new applicants. SEHK may also apply such restriction to a material disposal proposed at the time of or within 3 years after a change in the single largest substantial shareholder
- codify the principle based test as set out in the current Guidance Letter GL78-14 with modifications
- codify the "extreme very substantial acquisition" requirements in the current Guidance Letter GL78-14 into the Listing Rules and rename this category of transaction as "extreme transaction"
- impose additional requirements to transactions classified as RTOs and extreme transactions





- require that both the targets and the enlarged group must be suitable for listing and the targets must meet the track record requirements for new applicants and the enlarged group must meet all the new listing requirements (except Rule 8.05)
- for an issuer that has failed to comply with Rule 13.24, each of the acquisition target and the enlarged group must meet all the new listing requirements
- introduce a new rule to clarify the applicable track record period and the target's pro forma income statement requirements in an extreme transaction or a RTO that involves a series of transactions and/or arrangements
- add a new rule to codify the practice in the current Guidance Letter GL84-15 to regulate backdoor listings through large scale issue of securities

## 2. Continuing listing criteria

- amend Rule 13.24 to clarify that a listed issuer must carry out a business with sufficient operations and sufficient assets, not either one of them
- exclude the company's trading and securities investment when considering sufficiency of operations or assets

## 3. Cash company

- expand the definition of "short-dated securities" to include investment that are easily converted into cash, such as investment in listed securities
- confine the exemption for securities brokerage business to client's assets

## 4. Securities transactions

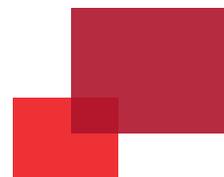
- confine the revenue exemption from the notifiable transaction requirements to sales and purchases of securities only if they are conducted by the members of the issuer group that are subject to the supervision of prudential regulators (i.e. banking companies, insurance companies or securities houses)
- require issuers to disclose details of each securities investment that represents 5% or more of the total assets in the annual reports

## 5. Distribution in specie

- codify Listing Decision LD75-4 to impose additional requirements on significant distribution in specie of unlisted assets comparable to requirements for a withdrawal of listing

## 6. Notifiable or connected transactions

- require disclosure in the next annual report regarding the outcome of any guarantee on the financial performance of an acquisition target that is subject to notifiable or connected transactions requirements



- require an announcement be made if there is (a) any subsequent change to the terms of the guarantee; or (b) the acquisition target's actual financial performance fails to meet the guarantee
- require disclosure of the identities of the parties to a transaction in the announcements of notifiable transactions
- require disclosure of the identities and activities of the parties to a transaction and of their ultimate beneficial owners in the announcements of connected transactions
- clarify that SEHK may apply an alternative size test to assess the materiality of a transaction where the percentage ratios produce anomalous results or is inappropriate to the sphere of activity of the listed issuer

## Actions to take

SEHK and SFC have repeatedly emphasized their determination to maintain the quality of the Hong Kong market. If any of the proposed rule amendments may accidentally affect the normal business activities of listed companies, relevant parties shall express their views to SEHK before the consultation period ends on 31 August 2018.

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