

## ¶2-222 PRC Securities Law

PRC regulatory efforts in the securities areas seek to regulate conduct by potential issuers and issuers in four major areas: the regulation of issuance and overseas listing of H-shares, disclosure requirements, corporate governance and the interaction with foreign exchanges. The following PRC securities-related laws are listed chronologically based on the date they were enacted.

### *Special Regulations*

In July 1994, the State Council of the PRC promulgated the Special Regulations of the State Council Concerning Overseas Offering and Listing of Shares Abroad by Joint Stock Limited Companies (“国务院关于股份有限公司境外募集股份及上市的特别规定”; “Special Regulations”) to prepare for H-share listing.<sup>12</sup> The Special Regulations govern foreign-invested shares which are listed overseas e.g. H-shares. They govern matters like share issuance, share management, protection of shareholders’ interests, etc.

### *Mandatory Provisions and Opinion Letter of Supplementary Amendments*

In addition, the operation of a company depends heavily on its Articles of Association, the constitution of an enterprise. To ensure that PRC companies are operated in accordance with international standards, the State Council Securities Committee (“SCSC”) and State Commission for Restructuring the Economic System (“SCREC”) jointly issued the Mandatory Provisions for the Articles of Association of Companies Listing Overseas (“到境外上市公司章程必备条款”; “Mandatory Provisions”) on 27 August 1994<sup>13</sup> to specify the minimum standards and model requirements.<sup>14</sup>

The Mandatory Provisions cover issues such as registered capital, reduction of capital, share repurchase, financial assistance, share and shareholder registers, shareholders’ rights and obligations, procedures regarding annual general meetings and board of directors’ meetings, qualifications and obligations of directors, company secretary, supervisors, general managers and senior management personnel, accounting systems, profit allocation, mergers and spin-offs, liquidation procedures, dispute settlement, amendments of Articles of Association.

The Mandatory Provisions were amended by the Letter of Opinion on Supplements and Amendments to the Articles of Association of Companies Listed in Hong Kong (“到香港上市公司对公司章程作补充修改的意见的函”; “Opinion Letter of Supplementary

<sup>12</sup> See *ibid.*, 129.

<sup>13</sup> *DAO JINGWAI SHANGSHI GONGSI ZHANGCHENG BIBEI TIAOKUAN* in Zheng Wei Fa (1994) No. 21 on 27 August 1994 promulgated by the State Council Securities Policy Committee and the State Commission for Restructuring the Economic System (hereinafter “Mandatory Provisions”).

<sup>14</sup> See *ibid.*

Amendments”) promulgated by CSRC and SCREC on 3 April 1995 in response to the then new Appendix 3 (Articles of Association) and Appendix 13, Section D, Section 1 (Additional Requirements re PRC) of the Hong Kong Main Board Rules which is equivalent to Appendix 3 and Appendix 11, Section C, Section 1 of the GEM Rules.

### *Securities Law*

On 1 July 1999, the Securities Law of the PRC came into effect. On 27 October 2005 the Standing Committee of the National People’s Congress revised the Law and the subsequent revision came into effect on 1 January 2006. The revised 2005 Securities Law which consists of 229 articles is a major extension of securities law. The Standing Committee revision amended 95 of the previous articles and added 29 entirely new articles. It provides for, among other things, disclosure requirements, trading regulations and share issuance requirements with which a listed company should comply. By virtue of the revised Securities Law,<sup>15</sup> CSRC is the chief regulator of the securities market. Domestic enterprises must obtain approval from the CSRC before listing abroad in accordance with Art 238 of the PRC Securities Law (2005 Revision). Article 238 requires CSRC approved both direct overseas listing and indirect overseas listing, and therefore, its coverage should extend to all situations involving domestic enterprises’ indirect overseas listing. CSRC’s approval is required for listing of H-shares in Hong Kong.

### *Repeal of the 4-5-6 Rule and Streamlining Approval Procedures*

On 14 July 1999, CSRC promulgated the Notice on Relevant Issues relating to Enterprises Applying for Overseas Listing (“关于企业申请境外上市有关问题的通知”; the “1999 Notice”). Under the Notice, applicants for overseas listing need to have net assets of not less than RMB400 million, post-tax profit of not less than RMB60 million and the proposed proceeds to be raised shall not be less than US\$50 million (the 4-5-6 Rule). The notice also provided for the approval procedures. An applicant needed to obtain an approval from its provincial government or the relevant department under the State Council before it submitted its application to CSRC for approval. Under the Notice, certain documents including recommendations from foreign sponsor were to be submitted to CSRC three months before the submission of Form A1.<sup>16</sup> In addition, the applicant had to obtain a letter approval from CSRC on whether CSRC accepted the application for overseas listing and before engaging any intermediaries. It has to first file details of the intermediaries with CSRC, and Form A1 to CSRC within five days before the scheduled submission and obtain CSRC’s formal approval within ten days before it submitted the formal application to the HKSE (HKSE’s listing hearing date).

The 1999 Notice is now repealed and replaced by Regulatory Guidelines Relating to the Document Submission and Vetting and Approval Procedures for Share Issuance and

<sup>15</sup> Chapter X of the revised Securities Law.

<sup>16</sup> Form A1 refers to Main Board listing. GEM was only established later that year so the 1999 Notice does not provide for GEM listing.

## ¶2-370 PRC Government Approvals

While the Hong Kong Stock Exchange adopts a disclosure-based policy regarding listing, the PRC approach is vetting-based (prior examination based on substantive procedural or merit criteria), and so, obtaining the appropriate approvals from relevant ministries are essential for the listing of PRC companies. The securities industry and stock markets in the PRC are governed by a matrix of ministries and Government departments under the State Council. While some Government bodies regulate the securities industry without issuing approvals, approvals for listing and listing-related matters have to be obtained from the others. Over the years, the PRC Government had taken measures to rationalise the Government structure and streamline the approval process for securities issuance but it continues to suffer from organisational and procedural complexity.

Under the Notice promulgated by State Council "Concerning Further Strengthening Macro-Administration of the Securities Markets"<sup>27</sup> in 1992 (the "1992 Notice"), SCSC is the authority responsible for the unified overall administration of the National securities market, and CSRC is its executive arm.<sup>28</sup> Other Government bodies under the State Council and the local or provincial governments responsible for the macro-administration of the PRC securities markets as stated in the 1992 Notice include the following: the State Planning Commission ("SPC"), State Council Office for Restructuring Economic System ("SCRES"), People's Bank of China ("PBOC"), Ministry of Finance ("MOF") and the two exchanges (i.e. Shenzhen and Shanghai) in PRC.<sup>29</sup> Since then, many changes have taken place to the abovementioned organisations. They are listed as follows:

- in 1998, SCSC was abolished; CSRC was elevated to ministry level under the State Council, and became the prime regulatory body of the securities industry;<sup>30</sup>

<sup>27</sup> The 1992 Notice, para 1.1.

<sup>28</sup> The 1992 Notice, para 1.2.

<sup>29</sup> The 1992 Notice, para 1.3.

<sup>30</sup> In the early stage, PBOC and its local branches oversaw the securities markets. As the national stock exchanges are located in Shanghai and Shenzhen, the respective local Governments in these two municipalities also participate in the regulation of the stock exchanges in conjunction with the local branches of PBOC in Shanghai and Shenzhen. Different aspects of securities activities are also regulated by various Government bodies including SPC, SCREC, and MOF, making the bureaucratic structure more complicated. Widespread fraud and government corruption in the stock markets involving PBOC resulted in a riot in Shenzhen in 1992. In its place, SCSC was established as an independent body to coordinate various ministries, formulate policies and draft laws and regulations for the securities markets. SCSC was made up of various government ministries and commissions including the PBOC, SPC, SCREC, MOF, State Bureau for the Administration of State Assets, State Administration of Industry and Commerce, State Tax Bureau, Supreme Court and State Administration for Foreign Currency Control. CSRC was established as the executive arm of SCSC to implement the administrative measures of SCSC. As CSRC was a quasi-government vice-ministerial body, it could not communicate with ministry-level departments unless through the SCSC. Bearing in mind the composition of SCSC, any action taken by CSRC in China might need the approval and cooperation of a galaxy of bureaucratic ministries. CSRC therefore devoted most of its time to explore listing mainland companies in Hong Kong. See ZHU SANZHU, *SECURITIES REGULATION IN CHINA* 8-14 (Transnational Publishers & Simmonds & Hill Publishing, 2001); CARL E. WALTER ET AL., *TO GET RICH IS GLORIOUS - CHINA'S STOCK MARKETS IN THE '80S AND '90S* 10-11 (Palgrave, 2001) and; Jay Zhe Zhang, *Securities Markets and Securities Regulation in China*, 22 N.C. J. Int'l L. & Com. Reg. 557 (Winter 1997).

- under the 1992 Notice,<sup>31</sup> SPC is to prepare a development plan for the securities industry after considering the plans and proposals made by the SCSC. SPC has been renamed as the State Development and Planning Commission ("SDPC"). One of its functions is to develop the securities markets by recommending the enlargement of the scope of direct financing, helping enterprises to restructure and list, setting up a high-tech board with its own listing requirements and improving the regulation of securities markets.<sup>32</sup> In 2003, after the Government restructuring, it was renamed the National Development and Reform Commission ("NDRC");<sup>33</sup>

- SCRES was responsible for drafting regulations for trial shareholding enterprises as well as organising and coordinating related matters.<sup>34</sup> SCRES lost its primary patron along with many of its policymaking functions when Zhao Ziyang, its founder, lost his power due to his sympathy for the protestors at Tiananmen Square.<sup>35</sup> In 1998, its power to issue orders to enterprises, and to oversee enterprise reform, was transferred to the State Economic and Trade Commission ("SETC"). It was demoted to an office and renamed as Economic Restructuring Office of the State Council.<sup>36</sup> It was abolished in the 2003 restructuring, and its functions were taken over by NDRC;

SETC is not mentioned in the 1992 Notice but since then it has taken up some of the functions of SPC and SCRES. SETC was formerly known as the State Economic Commission. It served as a counterweight to SPC by concerning itself less with long-term plans and goals, and more with coordinating with day-to-day enterprise or business operations and advocating for their interests.<sup>37</sup> SETC has been amalgamated with SPC, and was later separated under different names.<sup>38</sup> It was once called the Production Office in the early 1990s, and subsequently, SETC in the late 1990s.<sup>39</sup> It has also taken up some functions from SCRES. In the 2003 reorganisation, it was abolished, and its function was divided between the newly created State-owned Asset Supervision and Administration Commission ("SASAC") and the super-ministry, the Ministry of Commerce;<sup>40</sup>

<sup>31</sup> The 1992 Notice, para 1.3.

<sup>32</sup> *Ministry Profile: State Development Planning Commission (SDPC)* at [http://www.chinaonline.com/refer/ministry\\_profile/c01040362.asp](http://www.chinaonline.com/refer/ministry_profile/c01040362.asp).

<sup>33</sup> See its official websites at <http://www.sdpc.gov.cn> or <http://www.ndrc.gov.cn>.

<sup>34</sup> The 1992 Notice, para 1.3.

<sup>35</sup> *Ministry Profile: Economic Restructuring Office of the State Council (SERO)* at [http://www.chinaonline.com/refer/ministry\\_profile/c00121168.asp](http://www.chinaonline.com/refer/ministry_profile/c00121168.asp).

<sup>36</sup> See *ibid.*

<sup>37</sup> Barry Naughton, *The State Asset Commission: A Powerful New Government Body*, 8 CHINA LEADERSHIP MONITOR 1 (2003) available at <http://www.chinaleadershipmonitor.org/20034/default.htm>.

<sup>38</sup> See *ibid.*

<sup>39</sup> See *ibid.*

<sup>40</sup> See *ibid.*

	As at 2001	As at 2013
	<ul style="list-style-type: none"> <li>- 100% of H-shares to be held by the public;</li> <li>- H-shares to be not less than 10% of the total issued share capital; and</li> <li>- the aggregate amount of H-shares and other securities held by the public to be:</li> </ul> <p>* 25% of total issued capital if MC <math>\leq</math> HK\$4 billion; * the higher of (i) HK1,000 million in public hands and (ii) 20% if MC <math>\geq</math> HK\$4 billion.</p>	<ul style="list-style-type: none"> <li>- the class of securities for which listing is sought not less than 15% less than of the existing issued share capital;</li> <li>- the aggregate amount of the class of securities for which listing is sought and other existing securities held by the public to be:</li> </ul> <p>* 25% of total issued capital; or * not less than 15% having MC not less than HK\$30 million</p>
Profit Requirements	<ul style="list-style-type: none"> <li>• none other than "a business of both substance and potential"<sup>70</sup></li> </ul>	positive operating cash flow $\geq$ HK\$20 million in aggregate for the latest two financial years
Operating History	<ul style="list-style-type: none"> <li>• at least two financial years for the active business pursuit (or one year if the active business pursuit is allowed to be shortened to one year)</li> </ul>	<ul style="list-style-type: none"> <li>• latest two financial years under the same management</li> </ul>

<sup>70</sup> GEM Rules 11.12(3)(d) Note 3 (repealed 1 July 2008).

	As at 2001	As at 2013
Market Capitalisation	<ul style="list-style-type: none"> <li>• HK\$30 million (HK\$46 million in effect)<sup>71</sup></li> </ul>	<ul style="list-style-type: none"> <li>• MC <math>\geq</math> HK\$100 million</li> </ul>
Spread of shareholders	<ul style="list-style-type: none"> <li>• a minimum shareholder spread of 100 public shareholders (as a guideline);</li> <li>• initial management shareholders (5% or more of the voting power at general meeting and ability to influence the management) and significant shareholders (5% or more of the voting power at general meeting), together hold at least 35% of the issued share capital.<sup>72</sup></li> </ul>	<ul style="list-style-type: none"> <li>• a minimum shareholder spread of 100 public shareholders (as a guideline);</li> <li>• <math>\leq</math> 50% owned by three largest public holders.</li> </ul>
Shareholding Requirements for initial management shareholders	<ul style="list-style-type: none"> <li>• twelve-month moratorium period (originally two years) for initial management shareholders; (to include senior management, directors including non-executive directors and investors with board representation<sup>73</sup>),<sup>74</sup></li> </ul>	<ul style="list-style-type: none"> <li>• ownership continuity and control for the most recent financial year;</li> </ul>

<sup>71</sup> Consultation Paper on the Growth Enterprise Market, July 2007 issued by HKEx, para 79 note 4: "GEM Listing Rule 11.23(2)(a) requires a minimum public float of HK\$30 million at the time of listing. Rule 11.22 requires that the initial management shareholders and significant shareholders must, between them, hold at least 35% of the issued share capital of the issuer at the time of listing. Rule 11.23(5), Note 2 (repealed 1 July 2008), excludes initial management shareholders and significant shareholders from the public float at the time of listing. Therefore, the maximum public holding allowed is 65%. Dividing HK\$30million by 65% yields HK\$46 million".

<sup>72</sup> GEM Rule 11.22 which was repealed on 1 July 2008.

<sup>73</sup> GEM Rule 13.15(2) which was repealed on 1 July 2008.

<sup>74</sup> GEM Rule 13.16(1)(a) which was repealed on 1 July 2008 (placed in escrow with an escrow agent all his relevant securities). Also see GEM Rule 13.16(2) for disposal of any direct and indirect interest in his relevant securities which was also repealed on 1 July 2008. Relevant shares are defined under the GEM Rule 13.15(4) which was also repealed on 1 July 2008.

discussion paper which suggested three possible alternatives to the current market: GEM as a second board would be positioned as a stepping stone to the Main Board; GEM and the Main Board would merge into a single board with either undifferentiated market or two tiers with a growth market that would have separate admission criteria; or GEM to be replaced by a new alternative market was issued in January 2006. Submissions were released on the HKEx website after consultation in July 2006.<sup>18</sup> A consultation paper was published in July 2007 to position GEM as a second board. Existing GEM issuers could continue to be listed on GEM with the trading mechanism remain unchanged. The process of transfer of listing from GEM to the Main Board was streamlined and the continuing obligations for GEM and the Main Board were brought into line. New quantitative admission requirements were introduced for GEM.

It is important to understand the difference in listing requirements between the Main Board and GEM. The Main Board enables established companies that meet a higher profit or other financial standards requirement to raise funds in the market. Equity securities can be listed on the Main Board in the form of shares or depositary receipts. With effect from 1 July 2008, GEM was positioned as a second board and a stepping stone towards the Main Board. By the end of June 2007, sixteen issuers had already transferred from GEM to the Main Board.

GEM is operated under a modified disclosure-based, light-touch, buyers-beware regulatory regime. Originally, it had a separate listing committee and staffing structure, but this separate institutional arrangement apart from the HKSE resulted in different practice and interpretation of the listing rules. In May 2003, the listing committees of the Main Board and GEM were consolidated into one committee with a common membership. In March 2004, the new consolidated listing standardised practice and interpretation of the GEM rules with the Main Board Rules.

Previously, Mainland-related companies that could meet the relatively high thresholds (the so-called “4-5-6 rule”) set by the Mainland authorities were not permitted to list on overseas main market such as the HKSE even if they might meet the admission requirements.<sup>19</sup> Under the CSRC’s rule issued in July 1999, enterprises must have had RMB400 million of net assets, raise US\$50 million of funds, and had an after-tax profit of not less than RMB60 million before they could apply for listing on overseas markets, including Hong Kong’s. This requirement is removed effective 1 January 2013,<sup>20</sup> and its removal should help promote the development of small and medium companies in the PRC by listing on both the Main Board and GEM.<sup>21</sup>

<sup>18</sup> Please see ¶1-316 in Chapter 1.

<sup>19</sup> Paragraph 1 of Notice on Relevant Issues relating to Enterprises Applying for Overseas Listing 关于企业申请境外上市有关问题的通知, issued by CSRC on 14 July 1999.

<sup>20</sup> Regulatory Guidelines Relating to the Document Submission and Review Procedure for Share Issuance and Overseas Listing by Joint Stock Companies (关于股份有限公司境外发行股票和上市申报文件及审核程序的监管指引, promulgated by CSRC on 20 December 2012, effective on 1 January 2013.

<sup>21</sup> Paragraph 74 and Note 3 of the Consultation Paper on the Growth Enterprise Market issued by the Hong Kong Exchanges and Clearing Limited dated July 2007.

PRC companies seeking to list on the GEM board are required to meet the requirements laid down by the “Guidelines on the Vetting and Regulation of Applications for Listing on the Hong Kong GEM by Domestic Enterprises” (“境内企业申请到香港创业板上市审批与监管指引”) approved by the PRC State Council on 6 September 1999, and promulgated by CSRC on 21 September 1999. While the guidelines do not specify any financial requirements, they require a prospective issuer:

- to have the approval from either the provincial people’s government or the State Economic and Trade Commission;
- to be a duly incorporated as a joint-stock limited company;
- not to have committed any material breach of relevant laws and regulations for the previous two years; and
- to meet the GEM Listing Rule requirements and to have retained a qualified sponsor to support the application and act as underwriter.

The Guidelines give priority to high-tech enterprises certified by the Ministry of Science and Technology of the PRC.

#### ¶3-200 Differences between the entry requirements of GEM and the Main Board in Hong Kong

	GEM	Main Board
<b>Open Market (Minimum public float)</b>	<ul style="list-style-type: none"> <li>• at least HK\$30 million; or</li> <li>• 25%, or 15-25% the issued share capital if MC<sup>22</sup> &gt; HK\$10 billion.</li> </ul>	<ul style="list-style-type: none"> <li>• at least HK\$50 million; or</li> <li>• 25%, or 15-25% the issued share capital if MC &gt; HK\$10 billion.</li> </ul>
<b>Profit Requirement</b>	<ul style="list-style-type: none"> <li>• positive cash flow from the ordinary and usual operations ≥ HK\$20 million in aggregate for the latest two financial years.</li> </ul>	<ul style="list-style-type: none"> <li>• <u>Profit (test 1)</u> <ul style="list-style-type: none"> <li>- HK\$50 million in last three years;</li> <li>- (HK\$20 million in the most recent audited financial year); and</li> </ul> </li> <li>• MC &gt; HK\$200 million.</li> </ul>

<sup>22</sup> Abbreviation for market capitalisation.

### ¶3-280 Appointment of Professionals

#### ¶3-281 Appointment of Underwriters (GEM Rule 11.24)

Underwriting is not compulsory. However, if the amount of new capital to be raised is not fully underwritten, then a listing may only proceed if the minimum subscription amount set out in the prospectus has been raised. Where the listing sets forth a minimum amount to be raised but anticipates a higher amount, the listing document must explain the impact to the issuer and its statement of business objectives of raising such excess amount.

Since underwriting is not compulsory, appointment of underwriters for GEM listing is not mandatory but an issuer always appoints at least one underwriter. Underwriting provides a degree of certainty to an issuer through the commitment of sound financial institutions to the issuance process. Having an underwriter, whose ordinary course of business is underwriting on the listing team, also means the IPO is managed and reviewed by an independent professional party with expertise to deal with the complicated listing process.

#### Free Choice of Offering Mechanism

Under Main Board Rule 7.10, the HKSE may not permit a new applicant to be listed by way of a placing if there is likely to be a significant public demand for the securities. There is no similar requirement for GEM. A GEM issuer tends to be of smaller size that will attract relatively less publicity in the initial public offering; therefore, the question of public demand may not arise. The issuer can decide its own offering mechanism so long as full disclosure is made. GEM issuers can list exclusively by way of placing and they often raise funds by placing only.

#### ¶3-282 Appointment of Sponsor (GEM Rules 6A.02 to 6A.18)

Before 1 January 2007, in order to undertake work as a sponsor or compliance adviser, a firm must be acceptable to the HKSE. However, to prevent regulatory overlap regarding the eligibility of sponsors and compliance advisers, it is no longer required under the Listing Rules. The HKSE will allow the sponsor and compliance to undertake its work as long as the firm is properly licensed and registered by the SFC. The HKSE no longer has any role in relation to monitoring a firm's on-going eligibility as a sponsor or compliance adviser, as such a role has become the sole responsibility of the SFC, which is also responsible for the discipline and sanctioning of sponsors.

Investing in GEM-listed companies is expected to be a higher risk than investing in Main Board companies. Sponsors are therefore expected to provide guidance and assistance to GEM-listed companies to help them comply with their responsibilities under the GEM Rules, and to reassure investors. As such, the standards for, and responsibilities of, GEM Board sponsors are higher than those for the Main Board.

The rules governing sponsors have been toughened because in the view of the SFC the market relies heavily on the sponsor being the gatekeeper to protect investors. A sponsor is required to advise and guide listings through the Listing Rules and other regulatory requirements, and its primary responsibility is to ensure that due diligence is properly conducted.

#### A. Independence of Sponsors (GEM Rule 6A.07)

Like the Main Board, the sponsor has to demonstrate its independence from the issuer, and the test of its independence is laid down in GEM Rules 6A.07, which is the same as the Main Board. Sponsors must make the "Sponsor's undertaking and statement of independence" no later than the date on which any documents in connection with the listing application are first submitted to the HKSE.<sup>42</sup>

If only one sponsor is appointed, that sponsor must be independent from the applicant. Sponsors will be required to give the HKSE a statement addressing whether they are independent, and if they are not, how their lack of independence arises. The prescribed form for the statement is set out in Form K of Appendix 7 of the GEM Rules which is almost identical to the statement required under the Main Board rules.

If there are two or more sponsors, at least one sponsor must be independent and the listing document must disclose whether each sponsor is independent in accordance with the GEM Rule 6A.07 test (GEM Rule 6A.10(2)).

#### B. Role and Responsibility of Sponsors (GEM Rule 6A.11 & Practice Note 2)

The role and responsibility of sponsors in a GEM listing are similar to their counterparts in the Main Board listing, although the listing process is slightly different.<sup>43</sup> In general, each sponsor is responsible for ensuring that the sponsor's obligations under the Listing Rules are discharged.<sup>44</sup> In addition, one sponsor must be designated as the primary channel for communication with the HKSE.

A sponsor must be closely involved in the preparation of the prospectus.<sup>45</sup> The sponsor must ensure that if listing is not completed for more than six months after the date of the application form, a new application form together with the a further listing fee must be submitted to the HKSE and the previously paid fee is forfeited.<sup>46</sup>

<sup>42</sup> GEM Rule Appendix 7K.

<sup>43</sup> Please see Chapter 5 for the GEM listing process.

<sup>44</sup> GEM Rule 6A.10(3).

<sup>45</sup> GEM Rule 6A.11(1).

<sup>46</sup> GEM Rule 12.07.

controlling shareholder of a PRC issuer. A PRC Government body is defined in the GEM Rules as the PRC Central Government, PRC provincial-level governments, and PRC local governments immediately under the PRC provincial-level governments.<sup>113</sup> However, entities under the PRC Government that are engaging in commercial business or operating another commercial entity will be excluded from this definition.

Full disclosure requires disclosing facts to demonstrate that the applicant is capable of carrying on its business independently, and at arm's length from the competing business. The listing applicant must be able to demonstrate and disclose in its prospectus, that it is able to carry on business independently of its controlling shareholders<sup>114</sup> and its associates.<sup>115</sup> Under such circumstances, for competitive commercial businesses under the same government department, non-competition agreement may be signed to show that the businesses are not competing with each other (either because their target customers or the products provided are different), and are operated at arm's length. Moreover, in terms of provision of raw materials, production or sales assistance, the controlling shareholder will treat the listed company fairly and reasonably, as its other subsidiaries which are not included in the listed company.

The competition disclosure and precautionary actions required under the Main Board Rule 8.10 are more extensive than the GEM rules if a controller shareholder or director of an issuer has a competing business.

### ¶3-340 Special Companies: Project and Mineral Companies

There is a specific regime for listing newly formed "project" companies, i.e. infrastructure project companies or mineral companies. For these companies, some listing criteria may be relaxed (e.g. a shorter trading record period can be accepted), while additional requirements are imposed for disclosure and technical reporting.

#### ¶3-341 Project (Infrastructure Project) Companies (GEM Rule 11.14(1))

The exemption granted to newly-formed project or major infrastructure company by allowing for a shorter trading record, and/or waiving or varying the ownership, and management continuity is slightly different from the Main Board.

First, although trading record of project companies in both trading platforms can be shortened, the Main Board may waive or vary the profit or other financial standards requirement, while the GEM Board may waive or vary the ownership, and management continuity. Second, GEM Rule does not spell out the qualifications required by infrastructure companies as in the Main Board Rule 8.05B(2)(a) to (h).

<sup>113</sup> GEM Rule 25.04(2).

<sup>114</sup> A "controlling shareholder" is any shareholder or persons together entitled to exercise or control the exercise of 30% (or such other amount as may from time to time be specified in the Takeovers Code as the level for triggering a mandatory general offer) or more of the voting power at general meetings of the new applicant or who is or are in a position to control the composition of the majority of the applicant's board of directors.

<sup>115</sup> Para 27A of Part A of Appendix 1 of the GEM Rules.

### ¶3-342 Mineral Companies (GEM Rule 11.14(2), Chapter 18A & Practice Note 4)

Chapter 18A of the GEM Rules is almost identical to Chapter 18 of the Main Board Rules.

A mineral company applying for listing must satisfy the following requirements before the HKSE may accept a shorter trading record, and/or waive or vary the financial standards and management continuity:

- establish that it has the right to participate actively in the exploration for and/or extraction of natural resources;
- the mineral company must have discovered at least a portfolio of indicated resources or contingent resources (in the case of petroleum companies) of sufficient substance, identifiable under an accepted reporting standard and substantiated in a competent person's report;
- if the mineral company has commenced production, provide an estimate of cash operating costs per appropriate unit for the minerals and/or petroleum produced; if the mineral company has not yet begun production, the company must disclose its plans to proceed to production with indicative dates and costs supported by at least a scoping study, and substantiated by the opinion of a competent person;
- there is sufficient working capital for 125% of the group's present requirements, for at least twelve months from the date of the listing document supported by its working capital statement in the prospectus;
- where a mineral company seeks a waiver from the financial standards requirements (see GEM Rule 11.12A) it must establish that its directors and senior managers, taken together, have sufficient experience relevant to the exploration and/or extraction activity that the company is pursuing. The individuals being relied on must have a minimum of five years relevant industry experience; and
- the company must include a competent person's report in its listing document and, if the mineral companies are involved in the exploration for and/or extraction of petroleum resources and reserves, a report on its reserves and resources, prepared by a competent person in accordance with Appendix 18A of the GEM Rules. Competent persons must be independent of issuers (see GEM Rules 18A.21 to 18A.27).

The mineral reporting standard (see GEM Rules 18A.28-18A.33) is as follows:

- a mineral company must disclose information on mineral resources, reserves, and/or exploration results under the JORC Code NI 43-101, or the SAMREC Code. Information presented under other reporting standards must be reconciled to one of these codes. Valuation reports must conform to the VALMIN, CIMVAL or SAMVAL Code (see GEM Rules 18A.28 to 18A.30);

- the exercise of conversion rights attaching to warrants issued as part of the initial public offering;
- any capitalisation issue, capital reduction or consolidation, or sub-division of shares;
- the issue of shares or securities pursuant to an agreement entered into before the commencement of dealing, the material terms of which have been disclosed in the listing document issued in connection with the initial public offering; and
- any issue of shares or securities convertible into equity securities of a listed issuer (whether or not of a class already listed) which satisfies the following requirements:
  - the issue is for the purpose of an acquisition of assets which would complement the listed issuer's business described in the listed issuer's initial listing document, and the acquisition does not constitute a major transaction, very substantial acquisition, or reverse takeover pursuant to GEM Rules 19.06(3), (5) and (6) respectively;
  - the issue does not result in a controlling shareholder of the listed issuer ceasing to be a controlling shareholder after the issue, and in any event, must not result in a change in control of the listed issuer within the meaning of the Takeovers Code;
  - the issue and any transaction related to it is made subject to the approval of shareholders with the following persons abstaining from voting:
    - (i) any connected person and its associates; and
    - (ii) any shareholder who has a material interest in the issue and/or the related transaction, other than an interest arising solely by virtue of a shareholding in the listed issuer; and
  - the circular in respect of the issue and the related transaction which is dispatched to the shareholders of the listed issuer, must comply with the requirements of a circular as specified in Chapter 19 of the GEM Rules, and contain such information as is necessary for the independent shareholders to make an informed judgement on the issue and related transaction.

#### ¶4-300 Fundamental Change in the Nature of the Business (GEM Rules 17.25, 19.88 & 19.89)

Other than with the prior approval of independent shareholders, an issuer may not, during the period of twelve months from the date on which listing occurs, effect any fundamental change in its principal business activities or that of its group, and such a rule is similar to Main Board Rule 14.89.

The HKSE may grant a waiver of this prohibition if the circumstances are exceptional and the transaction or arrangement is approved by the shareholders in general meeting by a resolution on which any controlling shareholder (or if there are no controlling shareholders, any chief executive or directors (other than INEDs) of the listed issuer) and their respective associates are required to abstain from voting in favour. Shareholders with a material interest in the transaction and their associates are also required to abstain from voting on the transaction.<sup>4</sup>

#### ¶4-400 Maintenance of Public Float

The prescribed minimum percentage of listed securities required to be held by the public must be complied with at all times (GEM Rule 11.23(7)). For equity securities at least \$30,000,000 (determined as at the time of listing) must be in the hands of the public and should be held by at least 100 persons for the listed issuer to maintain a public float.<sup>5</sup> The total shares held by the public must be at least 25% of the issuer's total issued share capital and not more than 50% of the securities in public hands at the time of listing can be beneficially owned by the three largest public shareholders.<sup>6</sup>

If the issuer has one or more than one class of securities apart from the class of securities for which listing is sought, the total securities of the issuer held by the public (on all regulated stock market(s) including the HKSE) at the time of listing must be at least 25% of the issuer's total issued share capital. The class of securities for which listing is sought must be at least 15% of the issuer's total issued share capital and the expected market capitalisation at the time of listing must not be less than HK\$30,000,000.<sup>7</sup>

The HKSE may at its discretion accept a lower percentage of between 15% and 25% if the expected market capitalisation at the time of listing is over HK\$10 billion if the HKSE is satisfied that the market will operate properly with a lower percentage and there is sufficient disclosure and confirm sufficiency of public float in successive annual reports after listing. At the same time, the issuer has to agree with the HKSE in advance that a sufficient portion of any securities intended to be marketed contemporaneously within and outside Hong Kong must normally be offered in Hong Kong.<sup>8</sup>

If an issuer becomes aware that the number of its listed securities which are held by the public has fallen below the prescribed minimum percentage, it must immediately inform the HKSE and publish an announcement and seek to resume compliance as soon as is practicable.<sup>9</sup>

<sup>4</sup> GEM Rule 19.89.

<sup>5</sup> GEM Rule 11.23(2)(a) & (b).

<sup>6</sup> GEM Rule 11.23(7) & (8).

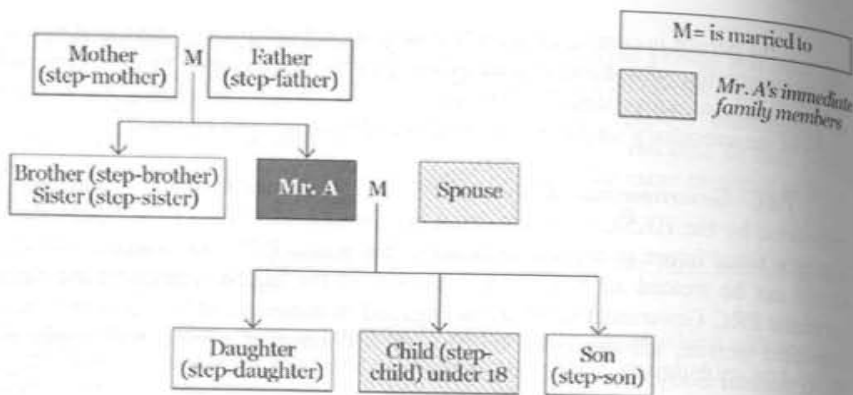
<sup>7</sup> GEM Rule 11.23(9).

<sup>8</sup> GEM Rule 11.23(10).

<sup>9</sup> GEM Rules 17.36 & 17.37.

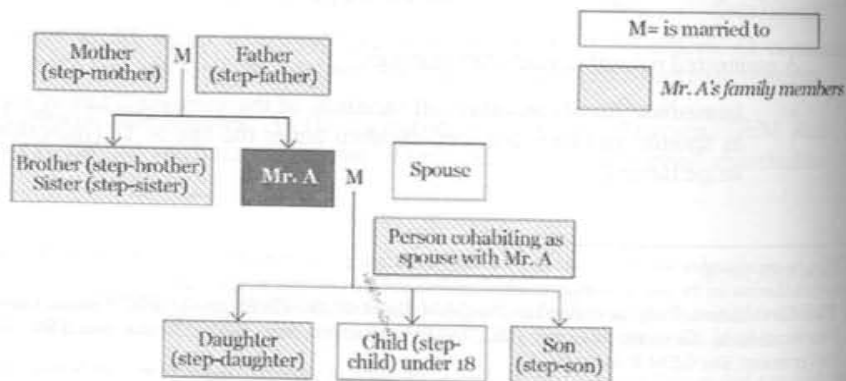
- **all family members:** all members of family members, such as cohabitating spouse, children and step-children, siblings and step-siblings, and parents and step-parents, step-brother or sister (indicated in shaded stripe boxes in the diagram immediately below);

GEM Rules 1.01, 20.10(1)(a) — Immediate family members



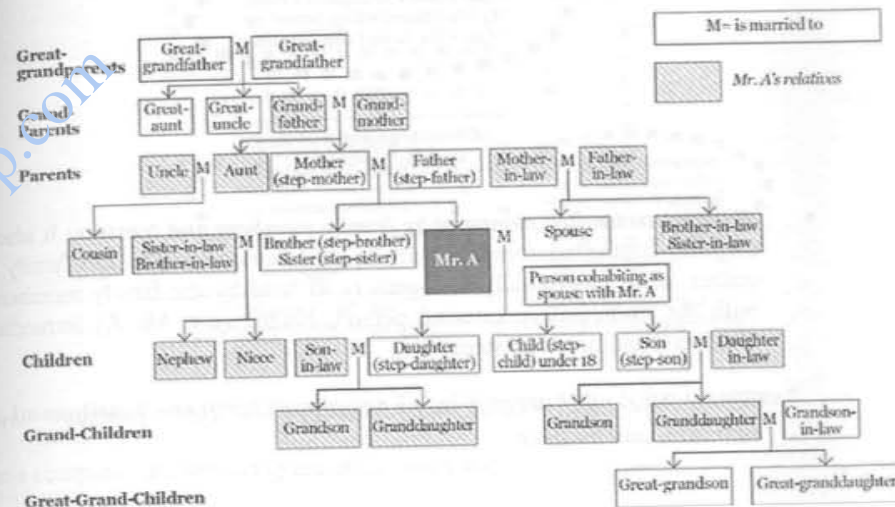
- **deemed connected persons:** all relatives (as deemed connected persons) including in-laws, step-siblings, nieces, nephews, cousins, grandparents, and a cohabitating spouse (indicated in shaded stripe boxes in the diagram following this bullet point). The list of family relations is probably not exhaustive as the HKSE has the power to deem other family members not included in this list as a “deemed connected person” if the HKSE is of the opinion that such family members have close association with the connected person, each depending on their particular circumstances. (GEM Rules 20.17, 20.18, 20.19).

GEM Rule 20.10(2)(a) — All family members



- **trustees:** trustees of any trust of which the individual or his immediate family member is a beneficiary or, in the case of a discretionary trust, is (to his knowledge) a discretionary object. It does not apply to a trust which is an employees' share scheme or occupational person scheme established for a wide scope of participants and the connected person's aggregate interests in the scheme are less than 30% (GEM Rule 20.10(1)(b)). The 30% limit is to safeguard against possible abuse by connected persons by setting up a scheme solely or mainly for the benefit of connected persons. 30% is also in line with the threshold currently adopted for defining an associate.

GEM Rule 20.19 — All relatives deemed connected person



- **immediate family trusts and 30%-controlled company:** If a trust is used for the immediate family, and the beneficiary is one or more of the immediate family members, the trustee shall also be regarded as a connected person. The connected person will include any 30%-controlled company held by persons referred to in the above relationships, their immediate family members, and/or the trustees and its subsidiaries.

The connected person will include any 30%-controlled company held by persons referred to in the above relationships, their immediate family members, and/or the trustees and its subsidiaries.



#### ¶4-952 Annual Reporting (GEM Rules, 20.47 & 20.69)

Connected transactions have to be disclosed during the financial year in the issuer's annual report. The content requirements are set in the GEM Rules.

#### ¶4-953 Annual Review (for continuing connected transactions only)

Before explaining what annual review is, it is important to understand the concept of continuing connected transactions as annual review only applies to this kind of transactions.

##### *Compliance Requirement for Continuing Connected Transactions*

Continuing connected transactions must be in writing and contain the basis for calculating the payments to be made.<sup>78</sup> The period of agreement must be fixed, reflecting normal commercial terms, and not exceeding three years. If the period is anything longer than three years, an IFA must be appointed to explain why it is so, and to confirm that it is the normal business practice for this type of transactions to be of such duration.<sup>79</sup>

The HKSE proposed to codify the current waiver practice in the GEM Rules to allow an issuer to obtain a shareholder mandate (or a mandate from the board if the transaction is exempt from the shareholder approval requirement) for continuing connected transactions (and therefore not require written agreement for the transactions) subject to certain conditions<sup>80</sup> as set out in the Listing Decision (LD82-1). Although the HKSE finally decided not to codify the current waiver practice, an individual waiver application would still be considered on a case-by-case basis having regard to their particular facts.

##### *Annual Cap (GEM Rules 20.35(2) & 20.52)*

The issuer must set an annual cap for the continuing connected transaction. The cap must be:

- expressed in monetary terms;
- determined by reference to previous transactions and figures in the group's published information. If there were no previous transactions, the cap must be set based on reasonable assumptions; and
- approved by shareholders if the transaction requires shareholders' approval.<sup>81</sup>

<sup>78</sup> GEM Rule 20.49.

<sup>79</sup> GEM Rule 20.50.

<sup>80</sup> For example, the parties' identities and connectedness with the issuer and the practical difficulty in getting them to sign the framework agreements.

<sup>81</sup> GEM Rule 20.51.

#### *Guidance on Pricing Policies for Continuing Connected Transactions*

The HKSE published HKEx Guidance Letter (HKEx GL73-14) in March 2014 — guidance on pricing policies for continuing connected transactions and their disclosure (the "Guidance Letter").

The main points of the Guidance Letter are as follows:

- it would not be sufficient to describe pricing policies in general terms with no expected quantum or percentage, such as "prevailing market price" or "prices based on arm's length negotiations" or "prices on normal commercial terms";
- when entering into agreements with connected persons, issuers should agree on specific pricing terms e.g. fixed monetary consideration, a pre-determined formula or fixed per unit consideration, and disclose them in its announcement and (if applicable) circular;
- if it is not commercially practical for the listed issuer to agree on a specific unit price or contract sum, it should disclose:
  - in its announcement and circular (if any): the methods and procedures the management will follow to determine the price and terms of the transactions; and the reasons why its directors consider that the methods and procedures can ensure that the transactions will be conducted on normal commercial terms and not prejudicial to the interests of the listed issuer and its minority shareholders; and
  - in its annual report whether the policies and guidelines disclosed in announcements and circulars (if any) have been followed when determining the price and terms of the transactions conducted during the year.
- if the pricing is determined based on a reference price such as government prescribed price, the listed issuer should disclose the name of government authority or organisation publishing the price, and how and where the price is disclosed or determined, and the frequency of update to the reference price;
- if the agreement covers transactions of different nature, the listed issuer should clearly explain the pricing policy for each type of transactions, instead of using generic "boilerplate" pricing mechanism;
- issuers should ensure that it has an adequate system of controls to safeguard the connected transactions, and to provide information for the INEDs and auditors to properly review the transactions annually;
- the INEDs should ensure that:
  - the pricing mechanism and the terms of the transactions set out in the agreement are clear and specific;

## ¶5-420 Before 5A Submission

- the sponsor, if not yet registered as a user of the HKEx's e-submission system ("HKEx-ESS"), must register as soon as possible but at least three-business days before submission of the listing application to use HKEx-ESS for publication of listing-related documents through HKEx-EPS. Details of the registration process are set out at [www.esubmission.hkex.com.hk](http://www.esubmission.hkex.com.hk); and

the sponsor must obtain for the applicant a company case number from the Listing Division – IPO Team by filing a request form set out in Enclosure 4 of Guidance Letter HKEx-GL57-13<sup>32</sup> at least one business day before the filing of the listing application.

## ¶5-430 5A Submission (draft timetable to be agreed with the HKSE before submission) (GEM Rules 12.12 to 12.14, 12.22 to 12.23 &amp; additional information in Form G104 to be submitted with Form 5A)

Unless otherwise stated, the HKSE requires two copies of each of the documents below:

- submit the listing application form (Form A in Appendix 5 of the GEM Rules)<sup>33</sup> with a timetable (GEM Rule 12.12) – previously the form was required to be lodged at least 25-clear business days prior to provisional hearing date of the application by the Listing Division but such a requirement was repealed on 1 October 2013;
- pay the full amount of the initial listing fee specified in Appendix 9 of the GEM Rules (GEM Rule 12.14(4));
- such number of copies of an Application Proof<sup>34</sup> as required by the HKSE and two CD-ROMs containing the Application Proof and other documents as the HKSE may require (GEM Rule 12.22(1));
- together with the Application Proof, either submit a) a signed copy of each of (i) the accountants' report on historical financial information, (ii) the reporting accountants' report on the pro forma financial information and (iii) the reporting accountants' report on profit forecast (if any) (the "Reports"); or b) at least an advanced form of the financial information if the financial information is not in

<sup>32</sup> HKEx Guidance Letter HKEx-GL57-13 (July 2013) (updated in September 2013 and February, March and June 2014) – effective for applications submitted on or after 1 October 2013 – Guidance on logistical arrangements for publication of Application Proofs, Post Hearing Information Packs ("PHIPs") and related materials on the Exchange's website for listing applicants.

<sup>33</sup> GEM Rule 12.13.

<sup>34</sup> Applicants are expected to submit an Application Proof for the HKSE's vetting and an Application Proof to be published on the HKSE's website (see Guidance Letter GL56-13 (July 2013) when a listing application is made to the HKSE.

a final form; the reporting accountants must provide a confirmation to the applicant with a copy of it be made to the sponsor, the HKSE and the SFC that no significant adjustment is expected to be made to the draft Reports based on the work done as of the date of the confirmation,<sup>35</sup>

- where the Application Proof contains an accountants' report, an advanced draft of any statement of adjustments relating to the accountants' report (GEM Rule 12.22(3));
- where the Application Proof is required to contain a statement by the directors as to the sufficiency of working capital, an advanced draft of a letter from its sponsor, confirming that it is satisfied that the sufficiency of working capital statement in the Application Proof has been made by the directors after due and careful enquiry (GEM Rule 12.22(13));
- where the Application Proof contains a profit forecast,<sup>36</sup> two copies of a draft of the board's profit forecast memorandum covering the same period of the profit forecast contained in the prospectus; and cash flow forecast memorandum covering at least twelve months from the expected date of publication of the prospectus with principal assumptions, accounting policies and calculations for the forecast;
- where the Application Proof does not contain a profit forecast,<sup>37</sup> two copies of a draft of the board's profit forecast memorandum covering the period up to the forthcoming financial year end date after the date of listing; and cash flow forecast memorandum covering at least twelve months from the expected date of publication of the prospectus with principal assumptions, accounting policies and calculations for the forecasts;
- a confirmation from the new applicant's legal advisers that the new applicant's articles of association are not inconsistent with the GEM Rules and the laws of place where the new applicant is incorporated or otherwise established (GEM Rule 12.22(2));
- a final proof of the formal notice (GEM Rule 12.22(5) – please see Appendix 10 of GEM Rules for the model forms of formal notice);

<sup>35</sup> A template of the reporting accountants' confirmation is in the Appendix of HKEx Guidance Letter GL58-13 (July 2013) ("the Appendix"). Where there is a delay in the listing timetable that results in the historical financial information, *pro forma* financial information or profit forecast (if any) being updated, the reporting accountants must also provide a confirmation similar to the Appendix on the updated financial information at the same time the information is submitted to the HKSE.

<sup>36</sup> GEM Rule 12.22 (14a).

<sup>37</sup> GEM Rule 12.22 (14b).

writing as soon as practicable by providing a copy of its engagement letter. When ceasing to act for a new applicant after its appointment, the sponsor must also forthwith inform the HKSE in writing with its reasons for ceasing to act even if a listing application has not been submitted.<sup>4</sup>

A listing application must not be submitted by a new applicant or on behalf of an applicant less than two months from the date of the sponsor's formal appointment.<sup>5</sup>

Where more than one sponsor is appointed in respect of a listing application, the listing application can only be submitted not less than two months from the date the last sponsor is formally appointed.<sup>6</sup>

If there is more than one sponsor, the HKSE must also be told which one is designated as the primary channel of communication with matters concerning the listing application.<sup>7</sup>

#### ¶6-112 Sponsor's Independence (GEM Rule 6A.07 and Appendix 7K)

A sponsor must perform its duties with impartiality and at least one sponsor must be independent of the new applicant. The sponsor has to demonstrate its independence or its lack of independence to the HKSE by addressing the matters set out in the GEM Rule 6A.07 in the form of Appendix 7K of the GEM Rules. Its independence also needs to be disclosed in the prospectus.<sup>8</sup> Sponsor's statement of independence is to be submitted at the same as Form 5A is submitted to the HKSE.

A sponsor may lose its independence because of its share ownership in the applicant, financial or business relationship with the applicant or because of its position in the company. It may also lose its independence if a connected person to the sponsor has the above relationship with the applicant. Specifically, in accordance with GEM Rule 6A.07, a sponsor will lose its independence if one of the following applies to them:

- the sponsor group and any director or close associate of a director of the sponsor collectively holds or will hold, directly or indirectly, more than 5% of the issued share capital of the new applicant, save and except where that holding arises as a result of an underwriting obligation (see note 1 below);
- the fair value of the direct or indirect current or prospective shareholding of the sponsor group in the new applicant exceeds or will exceed 15% of the net equity shown in the latest consolidated financial statements of the sponsor's ultimate holding company or, where there is no ultimate holding company, the sponsor (see note 1 below);

<sup>4</sup> GEM Rule 6A.02A.

<sup>5</sup> GEM Rule 6A.02B(1).

<sup>6</sup> GEM Rule 6A.02B(2).

<sup>7</sup> GEM Rule 6A.10.

<sup>8</sup> GEM Rule 6A.07.

- any member of the sponsor group or any director or close associate of a director of the sponsor is a close associate or connected person of the new applicant (see note 1 below);
- 15% or more of the proceeds raised from the initial public offering of the new applicant are to be applied directly or indirectly to settle debts due to the sponsor group, save and except where those debts are on account of fees payable to the sponsor group pursuant to its engagement by the new applicant for sponsorship services;
- the aggregate of:
  - amounts due to the sponsor group from the new applicant and its subsidiaries; and
  - all guarantees given by the sponsor group on behalf of the new applicant and its subsidiaries;

exceeds 30% of the total assets of the new applicant;

the aggregate of:

– amounts due to the sponsor group from:

- (i) the new applicant;
- (ii) the new applicant's subsidiaries;
- (iii) any controlling shareholder of the new applicant; and
- (iv) any close associates of any controlling shareholder of the new applicant; and

– all guarantees given by the sponsor group on behalf of:

- (i) the new applicant;
- (ii) the new applicant's subsidiaries;
- (iii) any controlling shareholder of the new applicant; and
- (iv) any close associates of any controlling shareholder of the new applicant;

exceeds 10% of the total assets shown in the latest consolidated financial statements of the sponsor's ultimate holding company or, where there is no ultimate holding company, the sponsor;

- the fair value of the direct or indirect shareholding of:
  - a director of the sponsor;
  - a director of any holding company of the sponsor;
  - a close associate of a director of the sponsor; or

### ¶6-163 Unaudited Pro Forma Financial Information

The accountants also need to review any interim financial statements that are not audited. The unaudited pro forma financial information is provided with reference to Accounting Guideline 7 "Preparation of *Pro Forma* Financial Information for Inclusion in Investment Circulars" issued by the Hong Kong Institute of Certified Public Accountants.

If an issuer includes pro forma financial information in any document, the information must comply with GEM Rule 7.31(1) to (6).

The reporting accountants are expected to give the following opinion for the pro forma financial information to be published.<sup>31</sup>

- the unaudited *pro forma* financial information has been properly compiled by the directors on the basis stated;
- such basis is consistent with the accounting policies of the group; and
- the adjustments are appropriate for the purposes of the unaudited *pro forma* financial information as disclosed pursuant to GEM Rules 7.31(1).

The reporting accountants may also need to prepare a statement of adjustments (if any) in relation to adjustments made to previously audited results for the preparation of the accountants' report. Such a statement of adjustments will not form part of the prospectus but a copy of such statement, needs to be made available for public inspection and filed with Companies Registry.<sup>32</sup>

### ¶6-164 Profit Forecast

The inclusion of a profit forecast is not mandatory for a prospectus but it is normally included because a potential investor will always consider the projected future profitability and because future profitability is important in investment decision, the HKSE has stringent requirement regarding the publication of a profit forecast. A prospectus must not contain reference (general or particular) to future profits or contain dividend forecasts based on an assumed future level of profits unless supported by a formal profit forecast. Dividend forecasts not based on assumed future profits are not subject to this rule.<sup>33</sup>

The assumptions, upon which any profit forecast appearing in a prospectus should draw the investors' attention to any uncertain factors, which could materially disturb the ultimate achievement of the forecast. If possible, they should be also quantified. The assumptions should be specific rather than general, definite rather than vague. All embracing

<sup>31</sup> GEM Rule 7.31(7).

<sup>32</sup> Companies (Winding Up and Miscellaneous Provisions) Ordinance Cap 32, s 38D(3)(b)(iii) & s 342C(3)(b)(iii).

<sup>33</sup> GEM Rule 14.28.

assumptions and those relating to the general accuracy of the estimates made in the profit forecast should be avoided.<sup>34</sup>

The accounting policies and calculations for the forecast must be reviewed and reported on by the reporting accountants and their report must be set out in the prospectus. In addition, the sponsors must report that they have satisfied themselves that the forecast has been made by the directors after due and careful enquiry, and such report must also be set out.<sup>35</sup>

### ¶6-165 Comfort Letters

The sponsor typically requires a comfort letter from the reporting accountants to lend credibility to the information on which their comments are made. The comfort letter gives assurance to underwriters and the board that the financial information included in the prospectus corresponds to the audited and unaudited financial statements and other financial records of the company. Reporting accountants should issue a comfort letter in accordance with the guidelines laid down in HKSIR 400.<sup>36</sup>

Only sponsors can determine what is sufficient for a reasonable due diligence and what information on which comfort is required and the procedures that will provide the required degree of comfort on that information. It is, therefore, important for reporting accountants, the issuer's management and sponsors to reach an early understanding and agreement as to the sponsors' requirements and the procedures the reporting accountants can properly perform.<sup>37</sup>

The terms of the arrangement to issue a comfort letter are recorded in an arrangement letter among the issuer, the sponsors, and the reporting accountants. The arrangement letter records and confirms the reporting accountants' acceptance of the arrangement, and the scope and nature of the procedures to be performed. It also records the responsibilities of the issuer and sponsors, and the extent of the reporting accountants' responsibilities to them.<sup>38</sup>

Sponsors may request reporting accountants to provide a letter reporting the updating of the procedures described in a previously issued comfort letter. This is commonly referred to as a "bring-down" letter. Such a letter should normally be issued at or shortly before the closing date. Comments contained in an earlier letter may, where appropriate, be

<sup>34</sup> GEM Rule 14.31.

<sup>35</sup> GEM Rule 14.29.

<sup>36</sup> Hong Kong Standard on Investment Circular Reporting Engagements 400, issued October 2005 and revised October 2011, December 2012, effective for engagements where the investment circular is dated on or after January 1, 2006 issued by the Hong Kong Institute of Certified Public Accountants ("HKSIR 400").

<sup>37</sup> Paragraphs 7a and 10 of HKSIR 400.

<sup>38</sup> Paragraph 15 of the HKSIR 400.

For an IPO that involves public subscription, this section should include the dates for the dispatch of share certificates to successful applicants and refund, and method of refund to unsuccessful applicants. Lastly the expected date of the dealing in shares on the HKSE should also be stated.<sup>22</sup>

For H-share issuers, there is a waiver of responsibility if the investor trades H-share before the receipt of H-share certificates or before the H-share certificate of title becomes valid. H-share certificates will only become valid from 8:00am on the listing date.

The expected timetable will be simpler for an issue that involves placing only. The following is an example of such expected timetable from the prospectus of an H-share issuer, Tianjin Binhai Teda Logistics (Group) Corporation Limited ('Teda'):

	2008
	(Note 1)
Expected Price Determination Date	25 April
Announcement of the Placing Price the level of indication of interests in the Placing and the basis of allocation of the Placing Shares to be published on the GEM website (www.hkgem.com) and the Company's website (www.tbtl.com.cn) on or before....	29 April
Allotment of the Placing Shares to places on or before	29 April
Deposit of the H-share certificates via CCASS on or before (Note 2).....	29 April
Dealings in the H-shares on GEM expected to commence on....	9:30 am on 30 April

Notes:

- 1) All references to times and dates in this prospectus are Hong Kong local time.
- 2) Placees of the Placing Shares will receive their Placing Shares via CCASS. The H-share certificate(s) for the Placing Shares is/are expected to be deposited into CCASS on or before 29 April 2008 for credit to the respective CCASS participants' stock accounts designated by the Underwriters, the respective placees or their agents (as the case may be). No temporary documents of title will be issued by the Company.
- 3) Details of the structure of Placing, including the conditions of the Placing, are set out in the section headed "Structure and conditions of the Placing" in this prospectus.

<sup>22</sup> Paragraph 22 of Part A of Appendix 1 of the GEM Rules.

- 4) Investors will be informed by public announcement on GEM website and the Company's website (www.tbtl.com.cn) of any change to the above expected timetable.

#### ¶7-240 Contents Page

Above the contents page, there will be an important notice to investors. The notice must state that a prospective investor should rely solely on the information provided in the prospectus to make his/her investment decision. Neither the issuer nor any of the underwriters authorises anyone to provide information other than the prospectus and the prospective investor should not make any investment decision based on any information or representation not contained in the prospectus.

For issuers whose offering structure involves an international placing tranche, the contents will reiterate that the prospectus is for Hong Kong investors only and the document does not constitute an offer to sell, or a solicitation of an offer to subscribe or buy any security other than the Hong Kong offer shares. This is done to avoid breaching any sale restrictions in other jurisdictions.

H-share issuers may also provide that all the English names of PRC governmental authorities are translated from Chinese and in the event of any inconsistency, the Chinese names shall prevail.

If there is over-allotment option, the prospectus may provide that any reference to shareholding in the company assumes no exercise of the over-allotment option.

The contents of a prospectus must include all information set out in either Part A or B of the Appendix 1 — Part A for new applicant while Part B for listed issuer<sup>23</sup> and information required under Chapter 14 of the GEM Rules. Special requirements for the prospectus issued by overseas issuers and PRC issuers are set out in Chapters 24 and 25 of the GEM Rules respectively.<sup>24</sup>

#### ¶7-250 Main Body of the Prospectus

##### ¶7-251 Summary and Highlights

A "Summary and Highlights" section provides the investors with an overview of the most important information in the prospectus.

Information contained in the prospectus must be clearly presented and in the plain language format specified or recommended by the HKSE and/or the SFC from time to time; and the information contained in the document must be accurate and complete in all material respects and not be misleading or deceptive.<sup>25</sup> In addition, GEM Rule 14.08(7) sets out an

<sup>23</sup> GEM Rules 14.08 and 14.09.

<sup>24</sup> GEM Rule 14.10.

<sup>25</sup> GEM Rule 17.56.

build-in mechanisms to protect minority shareholders. The HKSE decided that the level of reliance that the listing applicant had placed on its controlling shareholder could be addressed by prospectus disclosure of the arrangements between the issuer and the controlling shareholders, including a description of the associated risks.

#### *Financial Independence*

A common way to demonstrate the listing applicant's financial independence is by the release method where the applicant repays or capitalises all outstanding loans due to, and releases guarantees provided by, its parent before listing.<sup>65</sup>

While the HKSE accepts the release method to demonstrate an applicant's financial independence of its parent, it is not a mandatory requirement. The HKSE has accepted other mechanisms which can demonstrate an applicant's financial independence, such as using the IPO proceeds to repay shareholder loans. In Listing Decision LD48-1 (December 2005), the HKSE reported that the counter-guarantees granted by the applicant's controlling shareholder need not be released before listing subject to the applicant giving certain undertakings to the HKSE, including that the applicant would use its best endeavours to release all counter-guarantees in an orderly manner without delay within six months after listing, taking into consideration of the applicant's financial position and the complexity of the guarantee arrangement.

In Listing Decision LD69-1 (July 2009), the HKSE determined that the listing applicant could operate financially independently of its controlling shareholder, taking into account the following:

- it had a record of fund raising on a stand-alone basis without any credit support from the controlling shareholder;
- it had received firm offers from a number of independent financial institutions to provide generally equivalent finance facilities, on a stand-alone basis, to refinance the loans secured by the controlling shareholder's guarantees; and
- it had a strong financial position with its business operations in a relatively matured and developed market.

Satisfied that the listing applicant was financially independent of its controlling shareholder, the HKSE determined that (i) the controlling shareholder's guarantees of the listing applicant's banking facility need not be released before or at the time of listing; and (ii) the listing applicant might ask its controlling shareholder for a secured loan facility to refinance the existing loans, if the terms offered by independent third parties were considered by the directors to be less favourable.

<sup>65</sup> Listing Decision LD42-1 (December 2004).

#### 7-265 Connected Transactions

The connected transactions rules are designed to achieve the following: (i) ensuring that the interests of shareholders as a whole are taken into account by a listed issuer when the listed issuer enters into connected transactions and (ii) providing certain safeguards against listed issuers' (proposed) directors, (proposed) supervisors or substantial shareholders (or their associates) taking advantage of their positions.

Connected transactions may be either one-off transactions or continuing transactions. Generally speaking, connected transactions are required to be disclosed publicly by means of an announcement and are subject to independent shareholders' approval. The latter requires a circular to be sent to shareholders giving information about the transaction before the approval of the shareholders in a general meeting is given. Only when independent shareholders' approval is obtained that the transaction can proceed.

However, certain categories of transaction are exempt from the disclosure and independent shareholders' approval requirements, and certain transactions are subject only to disclosure requirements. Please see Chapter 4 for more details regarding connected transactions.

The connected transactions disclosure requires the disclosure of all connected transaction agreements and their terms, including the parties (how it is a connected transaction), scope of services, price determination, term, termination and proposed annual caps.

#### 7-266 Share Capital<sup>66</sup>

Typically it describes the entire issued share capital of the company before and immediately following completion of the global offering (assuming over-allotment is not exercised). For H-Share Company which has both A- and H-shares, the respective share totals should be separately listed and their differences explained.

The following is a summary of the differences between A- and H-shares in the prospectus published by Shanghai Fosun Pharmaceutical (Group) Co Ltd:<sup>67</sup>

- ...with limited exceptions, H-shares may only be subscribed for by, and traded in Hong Kong dollars between, legal or natural persons of Hong Kong, Macau, Taiwan or any country or region other than the PRC, or qualified domestic institutional investors in the PRC. A-shares, on the other hand, may only be subscribed for by, and traded between, legal and natural persons of the PRC (other than Hong Kong, Macau and Taiwan) or qualified foreign institutional

<sup>66</sup> Paragraphs 23 to 27 of Part A of Appendix 1 of the GEM Rules.

<sup>67</sup> Dated 17 October 2012. Even though it is a prospectus for the Main Board, there will not any differences in terms of the summary of differences between A and H-shares.

Under paragraph 68 of Part A of Appendix 1 of the GEM Rules, an H-share prospectus should give a description of applicable company law matters including material differences between the requirements of the PRC and of Hong Kong. Such description should include the following:

- the quorum and voting requirements for general meetings of shareholders and for separate meetings of holders of domestic shares and foreign shares (and, if applicable, H-shares);
- the PRC issuer's ability, by way of a special resolution in a general meeting, to issue, allot or grant up to 20% of its existing share capital in domestic shares and/or foreign shares (and, if applicable, H-shares) once every twelve months, without a separate vote by holders of foreign shares;
- the PRC issuer's ability to issue domestic shares and foreign shares (and, if applicable, H-shares) pursuant to a share issue plan adopted at the inaugural meeting of the PRC issuer without a separate vote by holders of foreign shares;
- any right of action a shareholder may have against directors of the PRC issuer;
- the special features of arbitration; and
- the standard of shareholder protection, which is different from that generally available in Hong Kong.

Under this section, H-share prospectus will typically describe the PRC legal system, judicial system, arbitration and enforcement of arbitral awards and will explain the following laws:

- *PRC Company Law*
  - the PRC Company Law, which was promulgated by the Standing Committee of the National People's Congress on 29 December 1993, took effect on 1 July 1994 and was amended as at 25 December 1999, 28 August 2004 and 27 October 2005. The latest revised Company Law came into effect on 1 January 2006;
  - the Special Regulations of the State Council Concerning the Overseas Offering and Listing of Shares Abroad by Joint Stock Limited Companies (《國務院關於股份有限公司境外募集股份及上市的特別規定》) (the 'Special Regulations'), which were promulgated by the State Council on 4 August 1994; and
  - the Mandatory Provisions for the Articles of Association of Companies Listing Overseas (《到境外上市公司章程必備條款》) (the 'Mandatory Provisions'), which were jointly promulgated by the Securities Committee of the State Council and the State Restructuring Commission on 29

September 1994, and which, as a joint stock limited liability company seeking an overseas listing, must be incorporated into the issuer's articles of association.

- *PRC Securities Law and Regulations*
- *PRC Foreign Exchange Regulation*
- *Material Differences between Certain Company Law Matters in the PRC and Hong Kong*
  - *Shareholder Meetings — Quorum*,<sup>116</sup>
  - *Shareholder Meetings — Voting*,<sup>117</sup>
  - *Variation of Class Rights*;
  - *Derivative Action by Minority Shareholders*;
  - *Minority Shareholder Protection*;
  - *Arbitration of Disputes*.

#### G. Appendix VII — Summary of Articles of Association

The prospectus should contain a summary of the Articles of Association as stipulated under paragraph 7 of Part A of Appendix 1 of the GEM Rules.<sup>118</sup> The principal objective is to provide potential investors with an overview of the Articles of Association.

The articles of association should be drafted in accordance with applicable laws and regulations, including the GEM Rules, in particular, Appendix 3 (and in the case of overseas issuer, also Appendix 11) of the GEM Rules.

For H-share issuer, the articles of association should also be drafted in accordance with the PRC Company Law, the Securities Law of the PRC, Opinion Letter of Supplementary Amendments, the Special Regulations, and the Mandatory Provisions.

The Articles of Association will become effective on the date that the issuer's shares are listed on the Hong Kong Stock Exchange. A copy of the issuer's articles of association must be available for inspection.

<sup>116</sup> Paragraph 59 of Part A of Appendix 1 of the GEM Rules.

<sup>117</sup> See *ibid.*

<sup>118</sup> See also s342(1)(a)(i) of the CWO. However this provision shall not apply in the case of a prospectus issued more than 2 years after the date at which the company is entitled to commence business. Also see s22 of Part I of the Third Schedule of CWO. For PRC issuer, the summary of the Articles of Association is required under GEM Rule 25.20(2). However this rule does not apply to listing documents issued by listed issuers unless they are issued in connection with an introduction or a deemed new listing under the GEM Rules (GEM Rule 25.20A).