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## ABOUT THE AUTHOR

The author holds a PhD in law from the Centre for Commercial Studies, Queen Mary, University of London, a first class LLB honours degree and a postgraduate certificate in law (awarded with credit) from the City University of Hong Kong. He has previously worked at Baker & McKenzie, Hong Kong, and currently is a consultant in Edward Lau, Wong & Lou specialising in IPO and commercial law.

He has held the position of Visiting Fellow at The School of Law at the City University of Hong Kong for many years and is a member of the Hong Kong Law Society.

Dr. Simon Wu is the author of *A Guide to H Share Listings* published by Wolters Kluwer in 2013. He is also a principal contributor to *The Hong Kong Encyclopaedia of Forms and Precedents, Vol 3: Companies – General* and *The Hong Kong Encyclopaedia of Forms and Precedents, Vol 4: Companies – Formation and Regulation* edited by Rt. Hon Lord Millett published by LexisNexis/ Butterworth in 2015. He is also a contributor to the legal database *Lexis® Practical Guidance* responsible for the corporate section on GEM.

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# FOREWORD

GEM on the Hong Kong Stock Exchange (“HKSE”), reflecting Hong Kong’s position as a leading global financial market, has seen a record number of IPOs over the past few years. These IPOs, for Hong Kong, mainland Chinese and international companies, are expensive, time consuming and carry considerable risk for the participants as the HKSE has required high entry and stringent disclosure requirements for new issuers. As part of the listing process companies often need to adopt significantly different financial, organisational and governance structures. Unlike its Main Board counterpart, it is difficult to find any book on the GEM in Hong Kong.

*A Guide to GEM Listings in Hong Kong*, 2<sup>nd</sup> edition, provides a comprehensive guide for practitioners, academics, executives and other individuals involved in the IPO listing process on the GEM. Both experienced practitioners and novices can benefit from this book. The text is written in a clear and easy to understand manner and it nicely tracks the GEM Listing Rules in its step-by-step presentation to avoid confusion. It includes practical advice, templates of relevant legal documents and draws on the real-world experiences of practitioners in the listing process. The real-world guidance it provides will allow practitioners and participants to avoid many mistakes, obstacles and potential problems that are endemic in the listing process while outlining the appropriate process necessary for a successful listing. Using the book as part of a comprehensive IPO process should save time and money and lead to a more successful IPO.

*Professor Lin Feng*

*Associate Dean*

*School of Law, City University of Hong Kong*

# PREFACE

Because of my experience as both a university lecturer and a lawyer, I wanted to write a book that was of interest to both academics and IPO practitioners and as a result, this book reaches out to both groups of people. It will also be useful for senior management of companies who would like to have their companies listed on the Hong Kong Stock Exchange; I think this book will help them understand the challenges ahead of them and how to manage them.

*A Guide to GEM Listings in Hong Kong*, 2<sup>nd</sup> edition, is composed of nine chapters. The first chapter, which is the most academic of all the chapters, is an introduction to GEM listings and traces the historical development of the Hong Kong Stock Market in general and the GEM Market in particular. In this opening chapter I also discuss the rationale behind listing on the Hong Kong Stock Market.

Chapter 2 outlines and discusses the various laws and regulations governing GEM listing and the changes in GEM rules over time.

Chapter 3 is a practical guide to the entry requirements for companies seeking to be listed on the GEM Board and to put them in context. The entry requirements for the GEM Board are also compared with the requirements of the Main Board in Hong Kong.

Chapter 4 explains the post-listing continuing obligations required from the GEM issuers.

Chapter 5 gives a practical guide for IPO practitioners by explaining the IPO process. An understanding of this process will help listing applicants be better prepared for the challenges ahead.

Chapter 6 focuses on each and every party involved in the IPO process of listing on GEM and describes their respective responsibilities and obligations.

Chapter 7 explains how a GEM listing prospectus is drafted.

Chapter 8 provides a road map of how to transfer a listing from GEM to the Main Board. A listing on GEM may assist companies to move on and eventually get listed on the Main Board. GEM was previously marketed as a stepping-stone for the Main Board. However, with the latest change of the GEM Rules on 15 February 2018, GEM has now become a standalone board for small and mid-sized companies with a three-year transitional period for issuers listed on GEM since 16 June 2017.

Chapter 9 is very practical, giving sample drafting tips on IPO documentation. The samples are for reference only and should not be copied as each GEM listing is unique and drafting should take into consideration the characteristics of each individual company. The samples given only provide a starting point offering a quick road map guide for drafting.

Most of the chapters contain summary tables to succinctly recap what has been said and to help readers locate certain issues or documents more easily. I have also tried to footnote each chapter extensively so that readers can easily find primary and secondary source materials if they would like to do further research.

Listing rules and regulations are dynamic and constantly evolving and I hope this book contributes towards understanding this important development.

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## Chapter 2

# LAWS AND REGULATIONS RELATING TO GEM LISTINGS

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When companies are listed in Hong Kong, they can tap funds from Asian investors and get closer to the dynamic and fast-growing Mainland and Asian markets.

In addition to the explanation of rules and regulations regarding the listing of Hong Kong incorporated companies, this chapter also discusses all relevant rules and regulations regarding mainland incorporated companies (H-share companies) as the GEM Rules have significant additional requirements for such companies. Furthermore, the approval process and its related laws and regulations of mainland incorporated companies tend to be more complicated than those incorporated in other overseas jurisdictions.

### ¶2-100 Three-Tier Model of Regulation

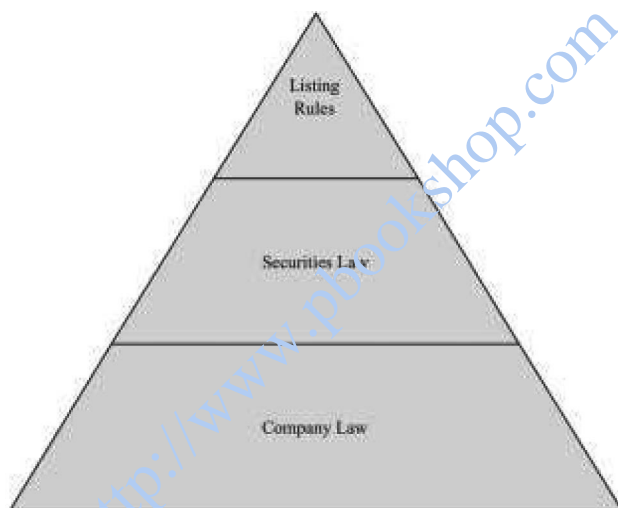


Figure 14: Three-tier model of regulation

Most countries which have equity and debt markets have a three-tier regulatory mechanism to ensure good corporate governance, protect against fraud and misrepresentation, enhance the liquidity and transparency of the market and protect investors. The three-tier model of regulation as shown in Figure 14 exists in most countries regarding the issue of securities and the subsequent trading of those securities among investors.

### **¶2-110 Company Law (Companies Ordinance (Cap 622) and Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32))**

Company law represents the lowest level of regulation. It applies generally to all companies incorporated in the jurisdiction as well as foreign incorporated companies which carry on business or have a place of business (whether listed or not) in the jurisdiction. Public companies (those companies which can list shares on the market if they choose) are often subject to a different set of rules from private companies under company law. Different rules are also applicable to domestic and foreign companies. Mandatory rules may be found in the company law that deals specifically with the issue of shares, corporate governance, director's duties and shareholder rights.

### **¶2-120 Securities Law (Securities and Futures Ordinance (Cap 571))**

Securities law represents the second tier of regulation. It does not apply to all companies as it will only affect companies that make public issues of securities. Unlike the Listing Rules, it also covers unlisted public companies which sell or have sold shares to the public.

### **¶2-130 Listing Rules (Main Board Rules and GEM Rules)**

Listing rules represent the top regulatory tier. Listing rules only apply to companies which seek to list securities on the public stock exchanges or those companies who have securities that are already listed on the exchange. Listing rules outline various substantive, merit-based, and disclosure obligations with which listed companies must comply in order to sell or trade their securities on the exchange and their ongoing obligations after listing. In short, listing rules lay down the conditions under which public companies can gain access to capital markets. The listing rules in Hong Kong are regulated by the Rules Governing the Listing of Securities on GEM ("GEM Rules") of The Stock Exchange of Hong Kong Limited ("Hong Kong Stock Exchange") as far as the GEM Board is concerned. The listing rules in Hong Kong do not have the force of law. Rather the obligations they place on the listed companies are part of the contractual agreement the listed company has with the Hong Kong Stock Exchange to enable them to sell securities in Hong Kong.

Within a single jurisdiction, the three tiers of regulation should be carefully coordinated so that conflict and overlapping can be avoided.

## ¶2-200 Rules and Regulations Governing GEM Listing

### ¶2-210 Hong Kong Laws, Rules and Codes

#### ¶2-211 Hong Kong Company Law

There are not many provisions in the *Companies Ordinance (Cap 622)* directly related to the listing of Hong Kong incorporated companies although indirectly it governs the setting up and compliance obligations of the Hong Kong companies and such provisions have to be complied with. The main provisions that are related to the registration of the prospectus and liabilities relating to misstatement in prospectuses are set out in the *Companies (Winding up and Miscellaneous Provisions) Ordinance (Cap 32)*.

If the listing vehicles are incorporated outside Hong Kong as an overseas company, the main relevance of the company law in Hong Kong is Part 16 of the *Companies Ordinance (Cap 622)* which requires a non-Hong Kong company that establishes a place of business in Hong Kong to apply to the Registrar for registration as a registered non-Hong Kong company within one month after the establishment of the place of business.<sup>1</sup> A place of business includes a share transfer office and a share registration office.<sup>2</sup> Other relevant legislation includes sections 40 and 40A and the Third Schedule of the *Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32)* which outlines requirements relating to the content of the prospectus and the civil and criminal liabilities for misstatements in the prospectus of overseas companies which would be listed on the HKSE.

#### ¶2-212 Hong Kong Securities Law & Various Codes

##### Securities and Futures Ordinance

The *Securities and Futures Ordinance (Cap 571)* ("SFO"), which consolidated ten previous ordinances,<sup>3</sup> was enacted on 13 March

1 Companies Ordinance Cap 622 s776(2).

2 Companies Ordinance Cap 622 s774.

3 The following 10 ordinances have been consolidated into the SFO and were repealed accordingly:

- *Securities and Futures Commission Ordinance (Cap 24)* (enacted 1989);
- *Commodities Trading Ordinance (Cap 250)* (enacted 1976);
- *Securities Ordinance (Cap 333)* (enacted 1974);
- *Protection of Investors Ordinance (Cap 335)* (enacted 1974);



2002 and became effective on 1 April 2003. It governs the licensing requirements of financial intermediaries, disclosure of interests, market misconduct, the extent of power of the Securities and Futures Commission (SFC), and remedies of aggrieved investors.

The SFO is important for the regulation of the IPO sponsors. Sponsors are particularly important in Hong Kong because most listing applicants are not experienced in listing matters and a large proportion of listed companies are domiciled and have a majority of their operations outside of Hong Kong. In the case of H-share companies, verifying information presents particular challenges and Chinese regulators are under no obligation to supervise or verify the information on these companies. The SFC as the licensing body has exclusive responsibility for the regulation of sponsors who are licensed and registered under Type 6 Regulated Activity of the SFO. The SFC is guided by the “Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission” (“Code of Conduct”) when considering whether a licensed or registered person satisfies the requirement that it is “fit and proper and otherwise qualified to act” to remain licensed or registered as a sponsor. On 12 December 2012, the SFC published its consultation conclusions on the regulation of Hong Kong IPO sponsors (the “Consultation Conclusions”). As a result, key obligations of sponsors were consolidated and centralised in a new Part 17 (the “Provisions”) of the Code of Conduct, effective 1 October 2013, with the latest version dated 9 June 2017.

### Various Codes and Guidelines

The revised sponsor regime was introduced in Hong Kong effective January 2007 and as a result, HKEx is no longer involved in approving or regulating sponsors. Eligibility standards have been raised, and annual licence renewal is subject to the continuing adherence to those standards. As the statutory regulator, the SFC is responsible for assessment of eligibility, on-going supervision, discipline and enforcement of the conduct of corporate finance advisers who discharge the work of sponsors and IFAs. The SFC has issued codes and guidelines and the following apply to sponsors and IFAs:

- *Stock Exchanges Unification Ordinance (Cap 361)* (enacted 1980);
- *Securities (Insider Dealing) Ordinance (Cap 395)* (enacted 1990);
- *Securities (Disclosure of Interests) Ordinance (Cap 396)* (enacted 1988);
- *Securities and Futures (Clearing Houses) Ordinance (Cap 420)* (enacted 1992);
- *Leveraged Foreign Exchange Trading Ordinance (Cap 451)* (enacted 1994); and
- *Exchanges and Clearing Houses (Merger) Ordinance (Cap 555)* (enacted 2000).

- “Additional Fit and Proper Guidelines for Corporations and Authorised Financial Institutions applying for continuing to act as Sponsors and Compliance Adviser” (“the Sponsor Guidelines”) (1 January 2007)
- “Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission” (“the Internal Control Guidelines”) (1 April 2003)
- “Corporate Finance Adviser Code of Conduct” (“the CFA Code”) (1 October 2013)
- Licensing Handbook (21 April 2017)
- Guideline to sponsors, underwriters and placing agents involved in the listing and placing of GEM stocks (20 Jan 2017).

The SFC has also issued guidelines regarding the disclosure of inside information and disclosure of interests which are relevant to companies which seek listing on the Hong Kong Stock Exchange:

- Guideline on Disclosure of Inside Information (June 2012)
- Outline of Part XV of the *Securities and Futures Ordinance (Cap 571)* - Disclosure of Interests (5 August 2014).

The above codes and guidelines do not have the force of law but are generally observed.

### **Securities and Futures (Stock Market Listing) Rules<sup>4</sup>**

The statutory regulator is the SFC, but issuers are required to submit documents to the HKSE and to comply with the Listing Rules set out by the HKSE. Under this dual-filing regime, the HKSE passes to the SFC copies of materials submitted by listing applicants and listed issuers upon listing applicants’ authorisation, and they are treated as having been submitted to the SFC by the applicant/issuer.<sup>5</sup> Through this dual-filing arrangement, the SFC is able to exercise its statutory powers of investigation in respect of persons whom it suspects has knowingly or recklessly provided false or misleading information.

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<sup>4</sup> Appendix 12 of the GEM Rules.

<sup>5</sup> Securities and Futures (Stock Market Listing) Rules, r5.

### ¶2-213 GEM Rules & Main Board Rules (collectively known as the Listing Rules)

As far as the listing requirements in Hong Kong are concerned, the governing rules of share listing are laid down in the GEM Rules and Main Board Rules published by the HKSE.

In addition to Chapter 5 (Authorised Representatives, Directors, Board Committees and Company Secretary) and Chapter 11 (Qualifications of Listing) of the GEM Rules, special provisions in Chapter 25 (Issuers Incorporated in the People's Republic of China) and Appendix 11 Part C (Additional Requirements in Respect of Certain Jurisdictions: The People's Republic of China) have been added to modify the listing requirements specifically for PRC companies. Special provisions for valuation of PRC properties are provided under Chapter 8 of the GEM Rules. Chapter 17 (Continuing Obligations) of the GEM Rules stipulates further listing requirements and post-listing continuing obligations for the PRC issuer.

Bermuda and the Cayman Islands incorporated companies should refer to Chapter 24 (Overseas Issuers) and Appendix 11 Part A/Part B of the GEM Rules.

### ¶2-220 PRC Laws and Regulations

As the PRC legal system is primarily a civil law system that is different from the common law system in Hong Kong, the legal protections rendered to investors under the PRC law is not as well-developed. Especially when H-share listings was first introduced, extra legal safeguards were required for the listing of PRC companies in Hong Kong under the Hong Kong regulatory structure. Other than the laws in Hong Kong, what kind of rules and regulations are provided by the PRC to deal with PRC companies listed offshore?

### ¶2-221 PRC Company Law

Actual listing is the last stage of a complex process which usually starts at a considerable time before the actual listing. Although the actual listing of shares is governed by the place where they are listed, i.e. Hong Kong, the first stage in an H-share listing process involves setting up a joint stock limited company<sup>6</sup> from a State-owned enterprise ("SOE"), or sometimes from private enterprises in the PRC

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6 GEM Rule 25.03(1).

in accordance with the Company Law<sup>7</sup> in the PRC. Therefore, a PRC company which is interested in listing H-shares in Hong Kong must first understand and comply with the PRC Company Law. This law is particularly relevant for the listing candidates in the restructuring process.

## ¶2-222 PRC Securities Law

PRC regulatory efforts in the securities sector seek to regulate conduct of potential 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 on the date they were enacted.

### Special Regulations

On 4 August 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. 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 operate 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

<sup>7</sup> *Zonghua Renmin Gongheguo Gongsifa* [the Company Law of the PRC] adopted at the Standing Committee of the National People’s Congress on 29 December 1993, effective as of 1 July 1994. First revised on 25 December 1999 and effective as of the same day. Revised for the second time on 28 August 2004 and effective as of the same day. On 27 October 2005, the PRC adopted a new Company Law, effective as of 1 January 2006. The new Company Law is a complete revision of the old law. It was further revised on 28 December 2013 and effective as of 1 March 2014.

Provisions”) on 27 August 1994<sup>8</sup> to specify the minimum standards and model requirements.

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, and 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 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 Securities Law of the PRC into Law of the PRC on Securities on 27 October 2005 (the PRC Securities Law (2005 Revision)) which came into effect on 1 January 2006. The PRC Securities Law (2005 Revision) consists of 229 articles is a major extension of securities law. The Standing Committee 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 PRC Securities Law (2005 Revision),<sup>9</sup> CSRC is the chief regulator of the securities market. Domestic enterprises must obtain approval from the CSRC before listing abroad in accordance with Article 238 of the PRC Securities Law (2005 Revision). Article

8 *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”).

9 Chapter X of the revised Securities Law.

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.

### 2013 Guidelines

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 a foreign sponsor needed to be submitted to CSRC three months before the submission of Form A1 to the Main Board (the equivalence of Form 5A for GEM listing).<sup>10</sup> In addition, the applicant had to obtain an approval letter 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 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 (the “Guidelines”). The 4-5-6 Rule is now removed. The few layers of pre-approval by a provincial government are now unnecessary as the applicant can directly submit its application to CSRC if it meets overseas listing requirements. Fewer documents are now required to be submitted as the Guidelines do not require the submission of the foreign sponsor's recommendations, or documents such as approval replies and confirmation documents issued by the land administration,

<sup>10</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.



audit reports, valuation reports, and profit forecasts. Without CSRC's substantial review, the sponsor may probably take up more work and shoulder more responsibilities. The whole approval procedure has also been streamlined by the Guidelines as the applicant can now submit its application to the HKSE after CSRC accepts its application without waiting for approval, and it can file the formal application with the HKSE after CSRC's approval is obtained — CSRC's approval is only valid for 12 months. A written report has to be submitted to CSRC within 15 days after the IPO.

It has been suggested that the relaxation of rules is due in part to the poor performance of the Shanghai and Shenzhen Stock Exchanges in 2012 as well as the restrictions the Notice placed on small to medium sized companies from listing overseas. Many Chinese companies are currently waiting for CSRC's approval for listing and the Guidelines are likely intended to encourage PRC companies to seek listing on overseas stock exchanges including the HKSE to ease the pressure on CSRC and the domestic stock market.

Documents required under the Guidelines are as follows:

- application report — restructuring and business overview, share structure, government governance, financial and business results, analysis of business risks, development strategy, use of proceeds, explanation of how the applicant meets the requirement of foreign listing, and offering structure;
- shareholders and “board of directors” resolutions;
- articles of association;
- business licence and industry permit (if applicable);
- supervisory opinion from the relevant industry supervisory committee (if applicable);
- approval from State Asset Administrative Bureau for disposal of State-owned shares and reduction of State-owned shares (if applicable);
- approval or filing for fundraising investment projects (if applicable);
- document showing discharge of tax payment;
- documents showing environmental protection;
- legal opinion(s);
- financial statements and audited reports;

- draft prospectus; and
- other documents required by CSRC.

Other than the above, there are a few PRC laws, administrative rules and guidelines that apply to overseas listing.

To sum up, the relevant PRC securities laws for overseas listing are primarily as follows:

- Securities Law (“中华人民共和国证券法”) (see above);
- Special Regulations (see above);
- Mandatory Provisions (see above);
- Opinion Letter of Supplementary Amendments (see above);
- Regulatory Guidelines Relating to the Document Submission and Vetting and Approval Procedures for Share Issuance and Overseas Listing by Joint Stock Companies (see above);
- Notice of the State Council on Further Strengthening Administration of Share Offering and Listing Overseas (“国务院关于进一步加强在境外发行股票和上市管理的通知”) (1997年6月20日) promulgated on 20 June 1997 (“Red Chip Guidelines”);
- Notice on Certain Issues Concerning the Implementation of the “Notice of the State Council on Further Strengthening Administration of Share Offering and Listing Overseas” (“中国证券监督管理委员会关于落实国务院‘关于进一步加强在境外发行股票和上市管理的通知’若干问题的通知(一)”) promulgated on 27 February 1998 (as the implementation measures of Red Chip Guidelines);
- Notice of the Ministry of Finance Concerning Issuing the Provisional Regulations on Accounting Firm’s Provision of Auditing Services for the Overseas Listed Companies in Mainland China. (“财政部关于印发《会计师事务所从事中国内地企业境外上市审计业务暂行规定》的通知”) promulgated by the Ministry of Finance on 26 May 2015 and effective on 1 July 2015;
- Supervisory Guidelines Concerning Overseas Listed Shares, Documents to be Submitted for Listing and Vetting Process (“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 and effective on 1 January 2013 (simplified procedures for small and medium sized companies);



- Notice of China Securities Depository and Clearing Corporation Limited Concerning Issuing Detailed Measures on Registration and Custody of Non-overseas Listed Shares of Overseas Listed Companies (“中国证券登记结算有限责任公司关于发布《境外上市公司非境外上市股份登记存管业务实施细则》的通知”) promulgated and effective on 2 April 2007;
- Notice of the State Administration of Foreign Exchange on Issues Concerning the Foreign Exchange Administration of Overseas Listed Companies (“国家外汇管理局关于境外上市外汇管理有关问题的通知”) promulgated by the State Administration of Foreign Exchange on 31 December 2014 and effective on the same date;
- Opinions on Further Standardising the Operation and Deepening the Reform of Overseas Listed Companies (“中国证券监督管理委员会关于进一步促进境外上市公司规范运作和深化改革的意见”) promulgated by State Economic and Trade Commission and CSRC in March 1999 (the Opinions call for reform of overseas listed companies in accordance with the following principles: separating companies from the State, restructuring to reduce connected transactions and avoid competition, empowering the board of directors decision-making, raising the standard of senior management, strengthening the supervisory committee, giving full support to company secretary, providing an incentive system for senior management, and increasing the economic competitiveness of the company by scientific management. It is an attempt to turn SOEs from a communist mode into a capitalistic mode for overseas listing);
- Report on Questions Concerning Overseas Public Offering and Listing of Domestic Enterprises (“关于境内企业到境外公开发行股票和上市存在的问题的报告”) promulgated by CSRC on 9 April 1993 (central message: CSRC approval is required for overseas listing);
- Letter Relating to Overseas Share Offering and Vetting and Listing Approval of Domestic Enterprises (“关于境内企业到境外公开发行股票和上市审批程序的函”) promulgated by CSRC on 4 February 1994 (other than reiterating that CSRC’s approval is required for listing overseas, the Letter focuses on PRC lawyers to ensure that they will directly discuss with CSRC to determine whether approval is required before issuing a legal opinion on the issue. Failure to do so is fraudulently misrepresenting the

public, and CSRC will treat non-compliance as committing securities fraud);

- Notice on Several Issues Concerning Standardising Overseas Listing of Subordinated Enterprises of Domestically-Listed Companies (“关于规范境内上市公司所属企业到境外上市有关问题的通知”) promulgated by CSRC on 10 August 2004 (additional requirements for overseas listing of subordinated enterprises);
- 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” ZhengJianFaXingZi [1999] No. 126 (证监发行字[1999]126号) (hereinafter the Guidelines for Listing on the Hong Kong GEM) approved by the PRC State Council on 6 September 1999, promulgated by the CSRC on 21 September 1999. Please see Section 1.1 of Chapter 3 for details.
- Supplementary Regulations of the Ministry of Finance Concerning the Notice of Allocating the Profits of Overseas Listed Pilot Enterprises that have implemented the Shareholding System (“财政部《关于境外上市的股份制试点企业利润分配问题的通知》的补充规定”) promulgated by the Ministry of Finance on 1 January 2001 and effective on the same date; and
- Letter issued by CSRC regarding the Notice Period of General Meeting to Overseas Shareholders by Overseas Listed Companies (“中国证券监督管理委员会海外上市部关于到境外上市公司向境外上市外资股股东发出会议通知信函时间的函”) promulgated by CSRC on 26 April 1995 and effective on the same date.

### ¶2-300 Companies on GEM Board: Pre-listing Preparation and Consideration

Listing a company can create many new opportunities for a company but it creates a whole new set of challenges and can significantly affect how a company operates. An IPO is a huge task and to delist may be costly and complicated and the listing rules require a continuing set of obligations such as disclosure and corporate governance requirements which must be complied with after listing. It is important that the leadership of an issuer is committed. The timing of listing is critical. The overall market strength, industry economic conditions, market's opinion of the IPO, and technological changes also impact and may determine the success of the IPO.

### **¶2-310 Getting Ready and the Timetable**

A normal listing (ordinary shares or depository receipts) on HKEx takes approximately five to six months to complete. Normally, for foreign incorporated issuers, an issuer has to ensure that HKEx will accept its domicile jurisdiction, which is a process of comparing the jurisdiction of the issuer with the Hong Kong jurisdiction. Mainland Chinese companies and other overseas companies for which the requirements for listing have been laid down in the Listing Rules are normally accepted for listing; therefore, it is highly unlikely that the HKEx Listing Committee will reject such a company based on jurisdictional issues. The HKEx Listing Division will usually begin considering the listing application once it is submitted.

However, the issuer is usually advised to have an orderly plan for an IPO one or two years before beginning the process of listing. Such time is for the company to prepare and to ensure it will perform and act like a public company.

### **¶2-320 Financial Information**

Accurate budgeting and forecasting is essential for a listing, and the issuer should set up a team to advise on this matter. The company should understand its market share, prepare realistic budgets and updated forecasts, and explain any differences which arise. During an IPO, underwriters will frequently ask for financial projections and they will compare a company's historical performance to its past budgets. Budgets and forecasts are important tools for research analysts once the company is listed.

### **¶2-330 Management Team**

The issuer should also build up its management team with professionals who have public company experience in finance, development, operations and marketing. They should all share the long-term goal of the issuer led by a visionary CEO and preferably a CFO who has previous IPO experience. This management team must also satisfy the management continuity of two financial years before listing as required by the Listing Rules (see below).

The issuer should also start appointing independent members to their board of directors and establish audit, remuneration and nomination committees. Furthermore, the issuer should familiarise itself with corporate governance principles and practices.

## ¶2-340 Appointment of Professionals

Prospective issuers should establish good relationships with investment bankers, law firms, accounting advisers, and auditors. This not only builds its credibility, but also enables it to choose its IPO team.

The issuer has to identify IPO team members such as its sponsor, underwriter(s), law firms (from both Hong Kong and the PRC), compliance adviser, independent financial adviser (“IFA”, if applicable), accounting adviser, auditor, valuer, receiving banker and financial printer.

Creating a positive image is also important for the public offering, and it takes time. The issuer may hire a public relations firm to maintain positive external communication with the public and shareholder relationship. It also needs to maintain a good relationship with the company and institutional investors who will buy the issuer’s shares, and people who can influence others whether to buy their shares such as financial analysts, stockbrokers, and financial reporters from the press and industry-related magazines/journals.

## ¶2-350 Cost Implications

Hong Kong’s listing fees are relatively low. The initial listing fee, the annual listing fee and the subsequent issue fee of GEM are set out in Appendix 9 of the GEM Rules.

### Initial Listing Fee

Monetary value of the equity securities to be listed (see sub-paragraph (c) below)	(HK\$M)	Initial listing fee	(HK\$)
Not exceeding	100		100,000
Not exceeding	1,000		150,000
Over	1,000		200,000

*Source: Rule 1(1)(a) of Appendix 9 of the GEM Rules*

The initial listing fee should be calculated by reference to the proposed maximum value of the maximum number of equity securities to which the listing application relates.<sup>11</sup>

<sup>11</sup> Rule 1(1)(c) of Appendix 9 of the GEM Rules.

The initial listing fee is not refundable.<sup>12</sup>

### Annual Listing Fee

The annual listing fee is stated in Appendix 9 of the GEM Rules as follows:

	<u>Nominal value of listed equity securities</u>	<u>Annual listing fee</u>
	(HK\$M)	(HK\$)
Not exceeding	100	100,000
Not exceeding	2,000	150,000
Over	2,000	200,000

*Source: Appendix 1(2)(a)(i) of Appendix 9 of the GEM Rules*

Annual listing fees shall be payable in advance in one instalment. The fee shall be payable within seven days of receiving a debit note and in the case of a new applicant, before dealings in the relevant securities commence. Regardless of the day of the month on which the securities are listed, the annual listing fees will be calculated from the first day of that month and pro rata payment in respect of that month is not permitted.<sup>13</sup>

Where an issuer has shares which have a nominal value of less than HK\$0.25, then the nominal value of each share shall be deemed to be HK\$0.25 for the calculation of the annual listing fee. If listed issuers whose shares cease to have a nominal value subsequent to their date of listing (the “no-par event”), the nominal value per share that was used to calculate the annual listing fees immediately before the no-par event (the “notional nominal value per share”) shall be used to calculate the annual listing fees from the no-par event. If an issuer conducts a subdivision of shares after the no-par event, the notional nominal value per share shall be adjusted accordingly, subject to a minimum of HK\$0.25 (e.g. if an issuer conducts a 2-for-1 subdivision, and the notional nominal value per share was HK\$1, the nominal value per share used to calculate annual listing fees from the subdivision will be HK\$0.50).<sup>14</sup> If issuers whose shares have no nominal value on

<sup>12</sup> Rule 1(1)(b) of Appendix 9 of the GEM Rules.

<sup>13</sup> Rule 1(2)(b)(i) of Appendix 9 of the GEM Rules.

<sup>14</sup> Note 1 of Rule 1(2)(a)(i) of Appendix 9 of the GEM Rules.

their date of listing, the nominal value per share shall be deemed to be HK\$0.25 for calculating annual listing fees.<sup>15</sup>

Annual listing fees shall not be refundable.<sup>16</sup>

If an issuer transfers its listing from GEM to the Main Board during a term in respect of which the annual listing fee has been pre-paid, the portion pre-paid in respect of the remainder of the year in which the listing is transferred will be refunded. The amount to be refunded will be 1/12 of the total pre-payment for each full calendar month remaining in the 12-month period to which the pre-payment relates. Regardless of the day of the month on which the listing is transferred, the annual listing fee will not be refunded in respect of that month.<sup>17</sup>

### Subsequent Issue Fee

If a listed issuer makes a subsequent issue of equities, a subsequent issue fee shall be calculated in accordance with the following table.

Monetary value of the equity securities to be issued (see sub-paragraph (e) below)		Subsequent issue fee
	(HK\$M)	(HK\$)
Not exceeding	5	5,000
	10	10,000
	100	25,000
	1,000	50,000
Over	1,000	75,000

Source: Rule 1(3)(a) of Appendix 9 of the GEM Rules

Apart from the initial listing fee, annual listing fee and subsequent issue fee, other fees include a transaction levy, trading fees and brokerage.

In addition to payment to the HKSE, the cost of listing also involves charges incurred for the services provided by various professional parties. With an IPO, an issuer needs to consider the legal and underwriting costs. In terms of legal costs, listing in Hong Kong is comparable with the UK, while the underwriting costs Hong Kong is comparable with the US. The fees charged will vary greatly

15 Note 2 of Rule 1(2)(a)(i) of Appendix 9 of the GEM Rules.

16 Rule 1(2)(b)(i) of Appendix 9 of the GEM Rules.

17 Rule 1(2)(b)(iv) of Appendix 9 of the GEM Rules.

depending on, for example, the complexity of the listing exercise and the size of the share offer.

Professionals which may be involved in the listing application include the following non-exhaustive list of personnel:

- sponsors;
- reporting accountants;
- legal advisers;
- valuers;
- underwriters/placing agents;
- printers; and
- public relation agents.

### **¶2-360 Reorganisation and its Considerations**

A restructuring is done to rationalise the corporate structure, improve efficiency and profitability, and implement corporate governance principles. The process will usually add value to the company and is an added benefit of the listing process. A good restructuring can also help the company develop a clear and justifiable business strategy that can be understood by international and institutional investors.

Assuming that the enterprise is not a shareholding company, the first step is to set up a joint-stock limited company which will be the IPO issuer.

Pre-listing restructuring often involves the following: spinning off non-core activities which are not relevant to the group's principal business; merging subsidiaries and other companies under its control which share similar functions; splitting-up large subsidiaries with different divisions and functions into separate subsidiaries; restructuring the group of companies to create a holding company; "ring-fencing" any risky or non-profit generating business, and if possible, excluding it from the group; winding-up companies which do not serve any meaningful functions; and liaising with tax advisers to enhance tax efficiency of the group structure.

Reorganisation involves many issues that may affect the listing application:

- continuity of management;
- continuity of trading record;
- competition issues and connected transactions;



- land use rights; and
- issues relating to minority shareholder protection (if any).

In addition to the above issues, the following matters should also be taken into consideration for reorganisation of PRC companies:

- approval of the PRC Government; and
- possible “*ultra vires*” issue relating to the “scope of business” obligations in the articles as set forth in Article 12 of the PRC Company Law.

An issuer’s PRC lawyer needs to seek clearance of the above issues, and they may need to issue legal opinions on them. They may also need to issue a legal opinion on the reorganisation itself. All the above issues will be discussed in more detail below and in the next few chapters.

The restructuring plan therefore includes the following:

- valuing the assets,<sup>18</sup>
- auditing the group’s accounts;
- ascertaining the number of shares to be owned by the State (if any, particularly significant for PRC companies) and the shareholding structure after listing;
- determining which assets to be kept or disposed, and the appropriate packaging for listing;
- obtaining necessary government approvals;
- drafting various legal documents including a reorganisation agreement and the Articles of Association; and
- a proposal dealing with land and intellectual property issues.

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18 For property activities, property valuations are required unless the property interest (as described by the rules) has a carrying amount below 1% of the applicant’s total assets. The total carrying amount of property interests not valued must not exceed 10% of the applicant’s total assets. Summary disclosure in the listing document is allowed if the market value of a property interest as determined by the valuer is less than 5% of the applicant’s total property interests that are required to be valued; for non-property activities, property valuations are only required if the carrying amount of a property interest is or is above 15% of the applicant’s total assets. Property activities do not include holding properties for its own use. See Main Board Rule 5.01 A & B and GEM Rule 8.01A & B.



Other than legal considerations, a PRC State-owned enterprise may also need to take into consideration various non-productive elements of the issuer as well as the pension funds of their employees. Previously, under China's centrally planned system, the State-mandated companies were required to provide for the welfare of the retired employees and their amount can be rather impressive. It is important that restructuring takes into account of the liability relating to such retired or soon to-be-retired employees.

Restructuring is also a great opportunity to revisit all the connected transactions and a good reorganisation will minimise the number of connected transactions after it has been implemented. Certain connected transactions may need shareholder's approval, or else the issuer needs to obtain a waiver from the HKSE and disclose them in the prospectus. In either case, the disclosure and waiver requirements related to connected transactions create significant extra work for the management and IPO team so there is an incentive to minimise them. A full discussion of connected transactions can be found in Chapter 4.

It is also important to ensure that any sale of share for the sake of reorganisation does not involve any unlawful financial assistance by the issuer for the acquisition of its own shares. Relevant sections regarding financial assistance can be found in the *Companies Ordinance*. The new *Companies Ordinance (Cap 622)*, which took effect on 6 March 2014, has relaxed the financial assistance provisions and financial assistance is allowed if the issuer satisfies a solvency test and obtains requisite board and/or shareholder approvals.

## ¶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>19</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>20</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 the PRC.<sup>21</sup> Since then, many changes have taken place in 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>22</sup>
- under the 1992 Notice,<sup>23</sup> SPC is to prepare a development plan for the securities industry after considering the plans and

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19 The 1992 Notice, para 1.1.

20 The 1992 Notice, para 1.2.

21 The 1992 Notice, para 1.3.

22 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 municipals 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 number of bureaucratic ministries. CSRC therefore devoted most of its time to explore listing mainland companies in Hong Kong.

23 The 1992 Notice, para 1.3.

proposals made by the SCSC. The 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. In 2003, after the government restructuring, it was renamed the National Development and Reform Commission (“NDRC”);

- SCRES was responsible for drafting regulations for trial shareholding enterprises as well as organising and coordinating related matters.<sup>24</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. 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. SETC has been amalgamated with SPC and was later separated under different names. It was once called the Production Office in the early 1990s, and subsequently, SETC in the late 1990s. It has also taken up some functions from SCRES. In the 2003 reorganisation, it was abolished, and its function was split between the newly created State-owned Asset Supervision and Administration Commission (“SASAC”) and the super-ministry, the Ministry of Commerce.

The objective of SASAC is to fully realise the government’s role as investor and owner by separating the government’s functions as investor and owner of state assets from its function as public manager of society as a whole. SASAC only has authority over a specific list of enterprises. To date, the list includes 196 firms, comprising all the large, central government-controlled firms. The main responsibilities of SASAC are to monitor these enterprises’ operations financially and operationally. Among other things, they will approve major decisions of these

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<sup>24</sup> The 1992 Notice, para 1.3.

enterprise operations, like the issuance of new securities and restructuring of the enterprises;

- PBOC was once in charge of the examination and approval, as well as the overall administration of securities, and would report to the SCSC.<sup>25</sup> Such power has been taken away from it. With the creation of the China Banking Regulatory Commission in the 2003 restructuring, it was stripped of most, if not all, of its financial regulatory functions. PBOC mainly concentrates on its role and functions as the Central Bank in the PRC, and is responsible for the issue of treasury bonds;<sup>26</sup>
- MOF will be in charge of the overall administration of registered accountants and accounting firms. However, whether an auditing firm may engage in the securities-related business will be decided by CSRC instead;<sup>27</sup>
- the Shanghai and Shenzhen Stock Exchanges are administrated by their respective local governments but supervised by CSRC. They undertake the normal functions performed by most other stock exchanges, such as regulating the activities of their members and approving securities for listing; and
- local enterprises require the examination and approval at the provincial level, or by departments authorised by the Municipal People's Government, together with the enterprise's department-in-charge.

The 1992 Notice emphasised the role of self-regulation by the securities industry in establishing a securities system with Chinese characteristics. However, self-regulatory bodies such as China Securities Association and Stock Exchange Executive Council<sup>28</sup> are not relevant when it comes to enterprises seeking listing abroad.

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25 The 1992 Notice, para 1.3.

26 The (Amended) Law of the People's Bank of China of the PRC promulgated by the Sixth Session of the Standing Committee of the NPC on 27 December 2003.

27 The 1992 Notice, para 1.3.

28 The 1992 Notice, para 1.4 Self-regulatory bodies include China Securities Association ("CSA") and the Stock Exchange Executive Council ("SEEC"). Founded in August 1991 and licensed by both PBOC and CSRC, CSA strengthens the professional management and coordination of its members; conducts research and training; establishes trading rules; lobbies the PRC Government on behalf of its members; and liaises among various government bodies, issuers, traders and investors. SEEC was set up in March 1989 as a private organisation to advise CSRC and to create a nationwide treasury bond trading system, STAQ, which was established on 5 December 1990.

For listing of shares in Hong Kong, the main regulatory bodies are the SFC and HKSE (under the HKEx) in Hong Kong, and the enterprise has to fulfil the requirements set out in the Main Board Rules or the GEM Rules, depending on which exchange the enterprise prefers to be listed. In the PRC, CSRC is the main regulatory body and the listing of an enterprise overseas requires its approval.<sup>29</sup> The restructuring of a PRC enterprise may need approval from SDRC. The registration of restructured Chinese enterprises may require the approval of the State Administration of Industry and Commerce (“SAIC”), which is also responsible for issuing business certificates, evidencing that a company has a “legal person” status.<sup>30</sup> The enterprise also needs to seek approval from the relevant industry regulator. For example, when China Eastern Airlines and China Southern Airlines applied for listing, approvals were obtained from the Civil Aviation Administration of China, and when People’s Insurance Company of China and China Insurance Co. Ltd sought H-share listing in Hong Kong, approvals were required from the China Insurance Regulatory

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SEEC has participated in the planning and establishment of the Shanghai and Shenzhen Stock Exchanges and has taken an active part in the drafting of many laws such as the Securities Law and the Company Law. SEEC has been developed into a holding company, integrating financial investment, media, consultation, training and high-tech matters.

- 29 See Special Regulations, Article 2. Red Chip companies also need to seek the approval of CSRC, or they may need to file relevant information to CSRC for registration. According to the Notice promulgated by State Council Concerning Further Strengthening Administration of Share Offering and Listing Overseas (20 June 1997 *Guojia* [1997] No. 21, effective as of the same day) (commonly known as “Red Chip Guidelines”), any PRC invested but foreign registered enterprise which owns assets in the PRC shall require the approval from provincial government, or the relevant supervising authorities under the State Council. For those that own assets in the PRC less than 3 years, listing abroad is not allowed unless they are examined and approved by CSRC, and after listing, the shares owned by PRC entities shall be filed to CSRC for registration (the Guideline, para 2). Any restructuring of PRC invested and foreign registered enterprises shall also be approved by the provincial government or any supervising authorities under the State Council and examined by CSRC and other state planning authorities (the Guideline, para 3). Backdoor listing of such enterprises is not allowed (the Guideline, para 4).
- 30 Administrative Regulation on Company Registration of the PRC promulgated by the State Council as Decree No. 156 on 24 June 1994 and effective on 1 July 1994, Article 3. SAIC also co-handles the licensing of commodities brokerage firms, as well as the supervision of commodity trading, together with the CSRC. It also approves project-financing deals and registers currency traders.

Commission. If the enterprise concerned falls within the list of enterprises under the SASAC, approval of SASAC is also required.<sup>31</sup>

Enterprises relating to foreign trade and economic cooperation may need approvals from the Ministry of Commerce. Any tax relief or tax exemption enjoyed by the H-share companies may need approval from the State Administration of Taxation. If the listing application involves foreign exchange matters, approval from the State Administration of Foreign Exchange (“SAFE”) may be required.

If the listing involves transfer of State assets, “Measures for the Administration of State-owned Asset Valuation”<sup>32</sup> requires asset valuation be conducted. The State-asset regime is governed by the State Asset Administration Bureau which has been taken over by the Ministry of Finance. Valuation is also required when the enterprise that seeks listing has properties in the PRC. Chapter 8 of the GEM Rules governs the establishment of title in the PRC, and it requires a valuation report to show whether the relevant party has vested legal title to the relevant property. For land-related issues, approval may be required from the Ministry of Land and Resources, which was formerly known as the State Land Bureau.

Due to the number of approvals possibly required for listing, the HKSE has published the Guidelines for the Legal Opinion on PRC Approval Issues in connection with New Listing Applications. Under the Guidelines, the HKSE may ask an issuer or its sponsor for a legal opinion from a law firm registered in the PRC and certified by the Ministry of Justice and CSRC as being qualified to engage in securities matter to produce a legal opinion that no governmental or regulatory authority is required for the listing of the issuer’s shares on the HKSE; if any approval is required, then such approval will be obtained.

According to Rule 25.16(5) of the GEM Rules, PRC companies which apply to be listed on the GEM need to submit legal opinions to the HKSE by PRC lawyers (authorised by the relevant authority in PRC) to advise on securities laws, confirming the due incorporation and legal person status of the PRC issuer as a joint stock limited

31 Civil Aviation Administration of China is a ministry of the State Council responsible for national civil aviation affairs, and the China Insurance Regulatory Commission is an institution directly under the State Council to formulate insurance-related laws and regulations, oversee insurance business operation, and promote insurance industry reforms and restructuring.

32 The measure was promulgated by the State Council as Decree No. 91 on 16 November 1991, Art 3.



company under the PRC law, and the proposed issuer has obtained all relevant regulatory approvals in PRC as required for the issue and listing contemplated by the PRC. CSRC also issued the Guidelines on Approval and Supervision of Domestic Enterprises Applying for Listing on the Growth Enterprise Market in Hong Kong on 21 September 1999. Under the guidelines, CSRC's approval for listing on the GEM in Hong Kong requires, among other things, a legal opinion issued by a PRC law firm (which is qualified to practice securities law) on whether the listing candidate has complied with relevant laws and policies, and whether the listing candidate has committed any significant breach of the law during the previous two years.

After restructuring and before listing, the issuer also needs to register as an overseas company under Part 16 of the *Companies Ordinance (Cap 622)* in Hong Kong.

## ¶2-400 GEM Listing Requirements of the HKSE

When it was established in November 1999, GEM was envisioned to be an alternative market to the Main Board by providing capital formation opportunities for growth companies. In order to achieve this objective, GEM did not require a profit record, revenue or any standard financial requirements. Instead, the companies were required to have had active business pursuits for at least 24 months prior to the listing application (or for 12 months if certain conditions related to size and public shareholding are met). The implication was that GEM was operating under the buyer's beware philosophy. Because of its nature, the risks of investing in such companies were much higher, but GEM provided the venue for start-up companies which had great growth potential but yet to prove themselves a means to raise funds. Early on, GEM was particularly attractive to technology companies and it was very successful in the first two years. However, due to the technology bubble burst in 2000 – 2001, many GEM stocks subsequently decreased in value and some companies experienced great losses and/or long periods of suspension, making their shares illiquid. Because of this loss of confidence, there was a review of GEM in 2005, culminating to a public consultation in 2007 and a change of rules and direction in 2008.

During the public consultation in 2007, three options were considered:

- (1) turning GEM as the second board;
- (2) merging GEM with the Main Board; and
- (3) turning GEM into something similar to AIM in London.

As far as the second option was concerned, most market practitioners did not support the merger. As for the third option, AIM relies on market and market intermediary self-discipline. Instead of increasing centralised regulation or reducing oversight, AIM shifts it to the private sector through enhancing the role of the gatekeepers. The role of the sponsor (or nomad/nominated adviser) in London is essential for the integrity of AIM. Although Hong Kong is in a continuous process to strengthen the sponsor regime to improve corporate governance, whether the sponsors in Hong Kong can function as well as their London counterparts is yet to be seen. Another difference is that Hong Kong also has a larger retail market than London and therefore the role of the regulators is more important. In view of the above, both HKEx and SFC thought that it was not ready for the AIM model.

As a result of the 2007 consultation, GEM will restructure in such a way to make it into a second board, a stepping stone for companies to be listed on the Main Board. Due to the change of policy and direction, GEM Rules were revised to reflect such a change.

For instance, instead of having a no profit requirement, new admission requirements for GEM are largely in line with the Main Board but less stringent. A history of profit is now required while active business pursuits are no longer necessary because of the profit requirements. The positive cash flow from operating activities in the ordinary and usual course of business before changes in working capital and taxes paid is required and should be at least HK\$20 million in aggregate for the two financial years immediately preceding the issue of the listing document. The operating cash flow requirement means the GEM is no longer a listing venue for start-up companies.

Terms like initial management shareholders and significant shareholders which were initially unique with the GEM Board are no longer used and instead the more familiar “controlling shareholders” as used in the Main Board are used whenever appropriate. The admission process is also streamlined to provide a more efficient means for GEM companies to be listed on the Main Board.

The following table shows the difference in entry requirements between the GEM Rules as at 2001 and the GEM Rules as at 2013. These Rules reflect the differences between GEM as a fundraising platform for start-ups and GEM as a stepping stone for the Main Board and shows the development of GEM Rules. Effective from 15 February 2018, GEM has again repositioned itself as a fundraising platform for small and mid-sized companies. Please refer to Chapter 3 for details.



## ¶2-500 Development of GEM Rules up to 2013

	As at 2001 <sup>33</sup>	As at 2013
Incorporation (for H-share companies only)	<ul style="list-style-type: none"> <li>duly incorporated in the PRC as a joint stock limited company</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>
Suitability for listing	<ul style="list-style-type: none"> <li>suitable for listing in the opinion of the HKSE</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>
Active Business Pursuits <sup>34</sup>	<ul style="list-style-type: none"> <li>24-month minimum active business pursuit period<sup>35</sup> (by showing that the new applicant has a substantial or potential business because it has spent the last 24 months prior to the listing making substantial progress in building up that business) – may reduce to 12 months if certain size and public following requirements are met<sup>36</sup></li> </ul>	<ul style="list-style-type: none"> <li>no requirement.</li> </ul>

33 All the amendments from the Joint Announcement on the Market Consultation and Changes to the Rules governing the Listing of Securities on the Growth Enterprise Market published on 21 July 2001 became effective on 1 October 2001. The 2001 amendments are some of the major amendments that affect the entry requirements of GEM.

34 “Active business pursuits” means a new applicant must demonstrate that, throughout the required period immediately preceding the date of submission of the listing application, it has, either by itself or through one or more of its subsidiaries, actively pursued one focused line of business under substantially the same management and ownership as existing at the time of the application for listing, and must make a statement of active business pursuits in the listing document providing both qualitative and quantitative information, in a reasonable level of detail, about the activities and performance of the issuer during that required period.

35 GEM Rule 11.12(2)(a) which was repealed on 1 July 2008.

36 GEM Rules 11.12(2) & (3) which were repealed on 1 July 2008.

	As at 2001	As at 2013
	<ul style="list-style-type: none"> <li>a shorter period of active business pursuit for infrastructural, mineral resource exploitation companies and companies that meet certain turnover, asset or market capitalisation criteria but not less than 12 months.<sup>37</sup></li> </ul>	
Focused Business	<ul style="list-style-type: none"> <li>actively engaged in one focused business by devoting its attention towards advancing one core business rather than two or more disparate businesses that may compete for their attention;<sup>38</sup></li> </ul>	<ul style="list-style-type: none"> <li>no requirement.</li> </ul>
Business Objectives	<ul style="list-style-type: none"> <li>profit forecast optional;</li> <li>must state business objectives and how to achieve them after listing;</li> <li>must report on achievement of objectives in the first two annual reports after listing;</li> <li>explain the use of proceeds in detail by reference to its business objectives; and</li> </ul>	<ul style="list-style-type: none"> <li>profit forecast optional;</li> <li>must state business objectives and how to achieve them after listing;</li> <li>must report on achievement of objectives in the first two annual reports after listing;</li> <li>explain the use of proceeds in detail by reference to its business objectives; and</li> </ul>

<sup>37</sup> GEM Rule 11.12(1) & Note 6 to GEM Rule 11.12 which were repealed on 1 July 2008.

<sup>38</sup> GEM Rule 11.12(3) which was repealed on 1 July 2008.

	As at 2001	As at 2013
	<ul style="list-style-type: none"> <li>accountant reports of two full financial years (covering at least 24 months of active business pursuits or 12 months if the active business pursuit is allowed to be shortened to 12 months);<sup>39</sup> the latest financial period reported on by the reporting accountants must not have ended more than six months before the date of the prospectus.</li> </ul>	<ul style="list-style-type: none"> <li>accountant reports of two full financial years; the latest financial period reported on by the reporting accountants must not have ended more than six months before the date of the prospectus.</li> </ul>
Open Market	<ul style="list-style-type: none"> <li>minimum percentage of securities in public hands will be:</li> <li>the higher of HK\$30 million and 25% for GEM applicants with MC not exceeding HK\$4 billion;</li> <li>the higher of HK\$1 billion and 20% for GEM applicants with MC over HK\$4 billion;<sup>40</sup></li> </ul>	<ul style="list-style-type: none"> <li>at least HK\$30 million in public hand (at the time of listing); and</li> <li>25% of the issued share capital to be held by the public, or 15–25% of the issued share capital if MC<sup>41</sup> more than HK\$10 billion;</li> <li>where there is one or more than one class of securities other than the class of securities for which listing is sought, 25% of the issuer's total issued capital should be held by the public and the class of securities for which listing is sought must not be less than 15% of the issuer's total issued share capital;</li> </ul>

39 GEM Rule 11.10 and Note to GEM Rule 11.10 were amended on 1 July 2008.

40 GEM Rule 11.23(1) which was repealed on 1 July 2008.

41 Abbreviation for market capitalisation.

	As at 2001	As at 2013
	<ul style="list-style-type: none"> <li>• special requirement for issuers which commenced dealings before 1 October 2001;<sup>42</sup></li> <li>• if there are existing issued securities of the PRC issuer:<sup>43</sup> <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:               <ul style="list-style-type: none"> <li>• 25% of total issued capital if MC is HK\$4 billion or less;</li> <li>• the higher of (i) HK1,000 million in public hands and (ii) 20% if MC to be at least HK\$4 billion.</li> </ul> </li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• no additional requirement for issuers which commenced dealings before 1 October 2001;</li> <li>• if there are existing issued securities:           <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:               <ul style="list-style-type: none"> <li>• 25% of total issued capital; or</li> <li>• not less than 15% having MC not less than HK\$30 million.</li> </ul> </li> </ul> </li> </ul>
Profit Requirements	<ul style="list-style-type: none"> <li>• none other than "a business of both substance and potential"<sup>44</sup></li> </ul>	<ul style="list-style-type: none"> <li>• positive operating cash flow to be at least HK\$20 million in aggregate for the latest two financial years.</li> </ul>

42 GEM Rule 11.23(2) which was repealed on 1 July 2008.

43 GEM Rule 25.08 which was repealed on 1 July 2008.

44 GEM Rules 11.12(3)(d) Note 3 (repealed 1 July 2008).

	As at 2001	As at 2013
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>
Market Capitalisation	<ul style="list-style-type: none"> <li>HK\$30 million (HK\$46 million in effect)<sup>45</sup></li> </ul>	<ul style="list-style-type: none"> <li>at least 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>46</sup></li> </ul>	<ul style="list-style-type: none"> <li>a minimum shareholder spread of 100 public shareholders (as a guideline);</li> <li>not more than 50% owned by three largest public holders.</li> </ul>

<sup>45</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>46</sup> GEM Rule 11.22 which was repealed on 1 July 2008.

	As at 2001	As at 2013
Shareholding Requirements for initial management shareholders	<ul style="list-style-type: none"> <li>• 12-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>47</sup>),<sup>48</sup></li> <li>• six months for initial management shareholders with no more than 1% shareholding in the GEM listed issuer.<sup>49</sup></li> </ul>	<ul style="list-style-type: none"> <li>• ownership continuity and control for the most recent financial year;</li> <li>• latest two financial years under the same management;</li> <li>• controlling shareholders cannot sell shares for six months (for 12 months any pledge/charge must be disclosed);</li> <li>• for the next six months, controlling shareholders can sell shares but should retain control; and</li> <li>• no fundamental change of business 12 months after listing.</li> </ul>

<sup>47</sup> GEM Rule 13.15(2) which was repealed on 1 July 2008.

<sup>48</sup> GEM Rule 13.16(1)(a) which was repealed on 1 July 2008 (placed in escrow with an escrow agent with 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.

<sup>49</sup> GEM Rule 13.16(1)(b) which was repealed on 1 July 2008 (placed in escrow with an escrow agent with all his relevant securities). Also see GEM Rule 13.16(2) for disposal of any direct or indirect interest in his relevant shares 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.

	As at 2001	As at 2013
Free Transferability	<ul style="list-style-type: none"> <li>freely transferable (securities accepted by HKSCC as eligible for deposit, clearance and settlement in CCASS)</li> </ul>	<ul style="list-style-type: none"> <li>the same</li> </ul>
Underwriting and offering mechanism	<ul style="list-style-type: none"> <li>free to decide the offering mechanism provided full disclosure; and</li> <li>100% placing allowed, underwriting not compulsory.</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>
Business Competition	<ul style="list-style-type: none"> <li>independence of issuer from controlling shareholders not required; and</li> <li>possible but full disclosure required</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>
Property-related Matters	<ul style="list-style-type: none"> <li>establishment of long-term titles for substantially major portions of its PRC properties;</li> <li>appropriate evidence of title for substantially major portions of its properties not situated in the PRC.</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>
Process Agents	<ul style="list-style-type: none"> <li>for PRC issuer, it must appoint one process agent and receiving agent</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>
Authorised representative	<ul style="list-style-type: none"> <li>two</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>
Register of Shareholders	<ul style="list-style-type: none"> <li>Register maintained in Hong Kong or other place approved by the HKSE and transfers to be registered locally</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>
Sponsor	<ul style="list-style-type: none"> <li>must appoint one or more sponsors</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>

	As at 2001	As at 2013
Compliance Adviser	<ul style="list-style-type: none"> <li>at least two-full-financial years after listing</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>
Directors and Supervisors	<ul style="list-style-type: none"> <li>the board of directors collectively responsible for the management and operations of the issuer;</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>
	<ul style="list-style-type: none"> <li>every director and supervisor must satisfy the HKSE that he has the character, experience and integrity and is able to demonstrate a standard of competence commensurate with his position as a director or supervisor.</li> </ul>	
Independent Non-executive Directors	<ul style="list-style-type: none"> <li>at least three;</li> <li>at least one with appropriate professional qualifications or accounting or related financial management expertise.</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>
Company Secretary	<ul style="list-style-type: none"> <li>has the requisite knowledge and experience to discharge the functions of the secretary of the issuer and who possesses the qualifications prescribed under the GEM Rules</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>
Qualified Accountant	<ul style="list-style-type: none"> <li>must be a qualified accountant and a fellow or associate member of the Hong Kong Society of Accountants or a similar body of</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>



	As at 2001	As at 2013
	accountants recognised by that Society for the purpose of granting exemptions from the examination requirement for membership of that Society	
Audit Committee	<ul style="list-style-type: none"> <li>establishment of an audit committee comprising non-executive directors only and a minimum of three members, at least one of whom is an INED with appropriate professional qualifications or accounting or related financial management expertise.</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>
Mandatory Provisions for Articles of Associations	H-share companies only: <ul style="list-style-type: none"> <li>Appendix 3, Part C of Appendix 11</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>
Arbitration	H-share companies only: <ul style="list-style-type: none"> <li>resort to arbitration</li> </ul>	<ul style="list-style-type: none"> <li>the same.</li> </ul>
Special Companies	<ul style="list-style-type: none"> <li>special rules for project<sup>50</sup> and natural resource exploitation<sup>51</sup> companies</li> </ul>	<ul style="list-style-type: none"> <li>special rules for project and mineral companies;</li> <li>identical rules between Chapter 18A of the GEM Rules and Chapter 18 of the Main Board Rules regarding mineral companies.</li> </ul>

<sup>50</sup> GEM Rule 11.14(1).

<sup>51</sup> GEM Rule 11.14(2) was amended on 3 June 2010 to change natural resource exploitation companies into mineral companies with an additional Chapter 18A, Practice Note 4 and Appendix 18 to deal with mineral companies.

## ¶2-600 Primary and Secondary Listings

Primary listing refers to cases where the HKSE is the primary location where the listing applicant's securities will be traded. Secondary listing refers to cases where a listing applicant's securities have already been traded on another exchange. A primary listing is one that results in the company becoming fully subject to the Listing Rules i.e. the GEM Rules in the context of listing on GEM, while for a secondary listing, the company is principally regulated by the rules and authorities of the jurisdiction where it is primarily listed. The applicant must be recognised by the HKSE to have a strong reputation for requiring high shareholder protection and corporate governance standards. Further, a secondary listing applicant must have a "centre of gravity" outside Greater China (see para. 11 and section 5 of the 2013 Joint Policy Statement).

Subject to minor differences, the entry requirements for secondary listings are essentially the same as those for a primary listing because secondary listing does not mean that the issuer can have lower qualifications. However, concessions may be granted for continuing obligations if the primary listing venue or the corporate law in the home jurisdiction offer equal protection for shareholders. Similarly, the listing process and documentary requirements are similar although governed by different sections of the Listing Rules, so listing preparation takes similar time although initial listing fees for secondary listing are significantly cheaper in the Main Board i.e. 25% of primary listing,<sup>52</sup> subject to HKEx to increase the fee if most of the trading takes place in Hong Kong. As an alternative, a PRC company can opt for a dual-primary listing where it is subject to both full requirements in Hong Kong and those of another jurisdiction. In such a case, the ongoing HK compliance cost depends on the regulatory waivers obtained from the HKSE and differences in compliance requirements between the listing venues between Hong Kong and the home jurisdiction.

Secondary listing is usually for companies with large capitalisation and long track record of regulatory compliance and it usually seeks secondary listing to raise more funds and increase visibility aboard. Secondary listing is therefore not for GEM and it is not allowed although dual listing is allowed on GEM.

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52 Rule 11(2) of Appendix 8 of the Main Board Rules. Secondary listing is not allowed for GEM.