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## Capital Markets Quarterly Update

HONG KONG

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## TOPICAL ISSUES

## New Regulations on IPO Sponsors

## QUICK READ

On 12 December 2012, SFC published its “*Consultation Conclusions on the regulation of IPO sponsors*” (**Sponsor Consultation Conclusions**) to confirm certain reforms on two major areas:

(a) the regulatory regime for sponsors’ conduct; and (b) the legislative amendments relating to sponsors’ liability. The new regulatory requirements will apply to listing applications ***submitted on or after 1 October 2013***.

## MAJOR REFORMS

The major reforms adopted are:

AREAS	KEY REFORMS
Prospectus liability	<p>The CO should be amended to clarify that sponsor firms have statutory criminal and civil liabilities for defective prospectuses.</p> <p>For criminal liability, prosecution should bear the burden of proving that a sponsor firm knowingly or recklessly approved a prospectus containing an untrue statement (including an omission) which was materially adverse from an investor’s perspective.</p>
Publication of application proof of prospectus	<p>An advanced proof of the prospectus submitted with the listing application will be published on the HKEx website.</p>
Reliance on expert reports	<p>Although a sponsor is not expected to re-perform the work of an expert, it should exercise professional scepticism about an expert’s work and it should therefore act proactively when assessing expert reports. In particular, it should:</p> <ul style="list-style-type: none"> <li>critically review the expert opinion against the totality of its knowledge of the listing applicant and its industry sector to ensure that the overall disclosure to the public is coherent and consistent; and</li> </ul>



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AREAS	KEY REFORMS
	<ul style="list-style-type: none"> <li>ensure that the scope of the expert's work adequately covers the reliability of the information provided to the expert. If not, the sponsor should request the scope to be expanded, seek assistance from a qualified person or extend its scope of due diligence.</li> </ul> <p>At the time of issue of a prospectus, the sponsor should not believe unreasonably that the information in the expert report is untrue, misleading or contains any material omission.</p>
Management discussion and analysis of financial performance and condition (MD&A)	A sponsor should work closely with the management of the listing applicant and its other advisers to produce a relevant, adequate and comprehensible MD&A. In particular, the sponsor should consider material matters relating to the listing applicant's historical and future financial performance, exceptional items or unusual accounting treatments.
Appointment	A listing applicant should appoint a sponsor at least two months before submission of its listing application. A sponsor should notify HKEx when it is formally appointed, regardless of whether a listing application has been submitted.
Sponsor fees	Sponsor fees should be specified in a sponsor's engagement letter and be based solely on its role as a sponsor.
Co-operation from financial adviser	IPO financial adviser should fully co-operate with, and should not adversely affect, the sponsor in discharging its duties.
Notification to regulators	A sponsor should notify the regulators under specified circumstances such as when it ceases to act for a listing applicant.

#### CODE OF CONDUCT

The key obligations of sponsors will be specified in a new paragraph 17 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission which will become effective on 1 October 2013. The related amendments to the Corporate Finance Adviser Code of Conduct and the Additional Fit and Proper Guidelines for Corporations and Authorized Financial Institutions applying or continuing to act as Sponsors and Compliance Advisers will also become effective on the same day.

#### WAY FORWARD

HKEx will amend the Listing Rules with a view to bringing the relevant new requirements into force when they become effective.

Also, legislative amendments to the CO will follow a separate timetable.

You may download copies of the Sponsor Consultation Conclusions via the link below:

<http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=12PR132> ♦

## New Guidance on Pre-IPO Investments

On 25 October 2012, HKEx published two guidance letters, “[HKEx-GL43-12](#)” and “[HKEx-GL44-12](#)” to help remove some of the uncertainties surrounding Pre-IPO investments by cataloguing which Pre-IPO

investment terms and which Pre-IPO convertible instruments pricing arrangements are allowed and which ones are not. For more details, please refer to our previous Legal Update “[Pre-IPO Investments: The Dos and Don'ts](#)”. ♦

## PROCEDURES AND WAIVERS

### Granting of Waiver in relation to Despatch of Interim Report

#### QUICK READ

On 12 October 2012, HKEx published a listing decision “[HKEx-LD38-2012](#)” in which it grants a waiver to a listing applicant from strict compliance with the requirement to send an interim report to its shareholders under Rule 13.48(1) of the Listing Rules.

#### BACKGROUND

The listing applicant was a PRC listed company which intended to list on HKEx in September of Year 4.

Its prospectus in relation to its HKEx proposed listing would include an accountants’ report for:

- the three financial years ended 31 December of Year 3; and
- the three months ended 31 March of Year 4.

The listing applicant published its interim results and report for the six months ended 30 June of Year 4 (**Interim Results**) on the website of the PRC stock exchange in August of Year 4. Under the PRC regulatory requirements, it was not required to send a hard copy of its interim report to its shareholders in the PRC.

The listing applicant would include certain specified information (**Specified Information**) on its Interim Results in its prospectus according to the requirements under a relevant listing decision.

#### RELEVANT LISTING RULES

Rule 13.48(1) of the Listing Rules requires an issuer to send to its shareholders an interim report or a summary interim report in respect of the first six months of the financial year within three months after the end of that period.

#### ISSUE

The listing applicant submitted that full compliance with Rule 13.48(1) would not provide any new information to its shareholders but would incur unnecessary costs, given that the relevant financial information for the six months ended 30 June of Year 4 in the interim report would be disclosed in its prospectus.

The issue is whether or not to grant the listing applicant a waiver from strict compliance with the requirement under Rule 13.48(1).

#### LISTING DECISION

HKEx decided to grant to the listing applicant a waiver from strict compliance with the requirement under Rule 13.48(1) in respect of its Year 4 interim report provided that it:

- included the Specified Information in its prospectus;
- was not in breach of its articles or laws and regulations of its place of incorporation or other regulatory requirements, regarding its obligation to publish and distribute interim reports and accounts; and
- included in its prospectus a statement that it would comply with the Model Code for Securities Transactions and Code on Corporate Governance set out in Appendices 10 and 14 to the Listing Rules respectively for the year ending 31 December of Year 4.

You may download copies of the listing decision via the link below:

<http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/Ld38-2012.pdf> ♦

## Granting of Waiver in relation to Filing of IPO Placee Lists

### QUICK READ

On 14 December 2012, HKEx published an updated listing decision “*HKEx-LD48-4*” specifying the conditions which a listing applicant should satisfy for granting a waiver from compliance with the filing of placee lists requirement under the Listing Rules with respect to the IPO shares sold in public offers outside Hong Kong.

### BACKGROUND

The international offering of the listing applicant included a public offering without listing (**POWL**) in Japan.

The Listing Rules require submission to HKEx of a list from each of the placing brokers specifying the details of and the amounts taken up by each placee. The sponsor applied for a waiver from strict compliance with such requirements.

### LISTING DECISION

The normal practice of HKEx is not to require the submission of placee lists in respect of the public offer of shares sold under POWL in Japan and the US provided that HKEx is reasonably satisfied that the investors fulfil the independence requirement under the relevant foreign regulations.

In view of such practice, HKEx approved the current waiver application subject to the satisfaction of the following conditions:

- the shares would be sold in a public offer governed by rules and regulations of the relevant jurisdiction to ensure independence of the investors;
- the listing applicant and sponsor made a demonstrable effort to comply with the placee list requirement in good faith and established that full compliance would not be practicable;
- the sponsor, underwriters or placing brokers would confirm in writing that the non-institutional investors obtaining the shares sold in the public offers are independent of them, the listing applicant’s connected persons or their associates or any existing shareholders of the

listing applicant, including nominee(s) of the foregoing; and

- each placing broker would be required to submit to HKEx a list setting out details of all institutional placees and the number of shares taken up by each of them as required under the relevant Listing Rules<sup>1</sup>.

You may download copies of the listing decision via the link below:

<http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/LD48-4.pdf> ♦

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<sup>1</sup> This condition is newly included in the current case in addition to the three other conditions which have been set out in previous cases.

## DISCLOSURE REQUIREMENTS AND GUIDANCE

### Guidance on Matters in relation to Biological Assets

#### QUICK READ

On 7 December 2012, HKEx published a guidance letter “*HKEx-GL46-12*” to provide guidelines on various matters in relation to biological assets<sup>2</sup>: (a) unrealised fair value gains on valuation for the purpose of the trading record and profit requirements under Rule 8.05(1)(a) of the Listing Rules<sup>3</sup>; (b) disclosure requirements; and (c) due diligence work expected to be performed by sponsors and other professional advisers.

#### BACKGROUND

HKEx considers that sales of biological assets/ agricultural produce<sup>4</sup> are the principal activities in the ordinary and usual course of business of a listing applicant engaging in agricultural activities<sup>5</sup>. The guidelines are specific to listing applicants engaging in agricultural activities in view of the nature of, and inherent risks relating to, the biological assets and their valuation and may not be applicable to other listing applicants.

#### GUIDELINES

The guidelines are summarised as follows:

AREAS	GUIDELINES
Trading record and profit requirements	<p>A listing applicant engaging in agricultural activities should use recorded sales of biological assets/ agricultural produce and profits (excluding any unrealised fair value gains on biological assets) for the purpose of the trading record and profit requirements under the Listing Rules.</p> <p>A listing applicant should consult HKEx as soon as possible to seek appropriate guidance.</p>
Disclosure requirements	<p>Disclosures to be made in the prospectus:</p> <ul style="list-style-type: none"> <li>the group’s results excluding any unrealised fair value gains/losses on biological assets; and</li> <li>the following information regarding biological assets: <ul style="list-style-type: none"> <li>specified information on the valuer;</li> <li>fair value measurement;</li> <li>their significance to the listing applicant’s net asset value;</li> <li>rationale for using and specified information relating to the selected valuation technique;</li> <li>whether the sponsor and reporting accountants are satisfied with such selected valuation technique;</li> <li>limitations on the sponsor’s due diligence and the corresponding actions to address such limitations;</li> <li>sensitivity analysis on material input changes relating to the valuation technique;</li> <li>if a specific valuation method is used, material cash flows used in the fair value measurement and relevant confirmations from the directors and sponsor;</li> <li>details on stock-take, internal controls over physical existence and record keeping;</li> <li>licences/ rights/ permits to carry out the agricultural activities; and</li> <li>appropriate risk factors.</li> </ul> </li> </ul>

<sup>2</sup> Biological asset is defined as a living animal or plant under Hong Kong Accounting Standard 41 – Agriculture (**HKAS 41**).

<sup>3</sup> Rule 8.05(1)(a) of the Listing Rules requires that a listing applicant must have a trading record of not less than three financial years during which the profit attributable to shareholders must, in respect of the most recent year, be not less than HK\$20 million and, in respect of the two preceding years, be in aggregate not less than HK\$30 million. The profit mentioned above should exclude any income or loss of the issuer, or its group, generated by activities outside the ordinary and usual course of its business.

<sup>4</sup> Agricultural produce is defined as the harvested product of the entity’s biological assets under HKAS 41.

<sup>5</sup> Agricultural activity is the management by an entity of the growth, degeneration, production, and procreation and harvest of biological assets for sale or conversion into agricultural produce or into additional biological assets. Such activity covers a diverse range of activities, for example, raising livestock, forestry, annual or perennial cropping, cultivating orchards and plantations, floriculture, and aquaculture (including fish farming). (Source: paragraphs 5 and 6 of HKAS 41).



AREAS	GUIDELINES
Due diligence expected from the sponsors and other professional advisers	<p>More stringent due diligence work should be performed including the following:</p> <ul style="list-style-type: none"> <li>• appointment of an independent qualified valuer to value the biological assets to the satisfaction of the sponsors;</li> <li>• the sponsors and/or other relevant professional advisers should be duly satisfied with the following information regarding the biological assets: <ul style="list-style-type: none"> <li>» their physical existence;</li> <li>» their condition/development status; and</li> <li>» specified disclosures made in the prospectus and accountants' report;</li> </ul> </li> <li>• the sponsor should conduct independent verification on: <ul style="list-style-type: none"> <li>» the listing applicant's licences/rights/permits; and</li> <li>» the listing applicant's operations to ensure compliance with the relevant licences/rights/permits and records maintained by the competent authorities (if any).</li> </ul> </li> </ul>

You may download copies of the guidance letter via the link below:

<http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/Documents/gl46-12.pdf> ♦

## LISTING SUITABILITY AND OTHER LISTING DECISIONS

### Guidance on Satisfying the Trading Record Requirements

#### QUICK READ

On 26 November 2012, HKEx published a guidance letter "HKEx-GL45-12" on matters relating to satisfying the trading record requirements under the Listing Rules.

#### RELEVANT LISTING RULES REQUIREMENTS

Rule 8.05(1)(a) of the Listing Rules requires that a listing applicant must have an adequate trading record. There are two conditions to be satisfied under such requirement:

- **the minimum length of the trading record** – the listing applicant must have a trading record of not less than three financial years; and
- **the minimum amount of profits during such period** – the profit attributable to shareholders must, in respect of the most recent year, be not less than HK\$20,000,000 and, in respect of the two preceding years, be in aggregate not less than HK\$30,000,000. Such profit should exclude any income or loss generated by activities outside the ordinary and usual course of the listing applicant's business.

#### GUIDANCE

The following guidelines in relation to satisfying the trading record requirements are provided:

GUIDELINES	DETAILS
A financial year does not necessarily cover a calendar year or twelve months	<p>Accordingly, the trading record requirement of three financial years does not necessarily refer to a period of three calendar years.</p> <p>E.g., a listing applicant adopts 31 December as its financial year end. If it was only incorporated on 1 April in Year 1, its trading record would cover nine months for Year 1 (from 1 April to 31 December) and 12 months for both Years 2 and 3 (1 January to 31 December for both years). Although there would only be 9 months in Year 1 of the trading record period, it would still be regarded as a full financial year.</p>

GUIDELINES	DETAILS
Preparation activities should not be counted towards satisfaction of the trading record requirement	<p>Only trading activities will be taken into account when assessing whether the trading record requirements have been duly satisfied.</p> <p>Accordingly, where a listing applicant has not yet commenced generating any revenue, the expenses related to preparation activities such as business planning, construction of factory facilities, procurement of raw materials, preliminary negotiations with potential customers or trial production, or ancillary revenue generated outside the ordinary and usual course of business should not be counted towards satisfaction of the trading record requirements.</p>

You may download copies of the guidance letter via the link below:

<http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/Documents/gl45-12.pdf> ◆

## Contractual Arrangements would not Result in Unsuitability for Listing (Further Guidelines)

### QUICK READ

On 5 December 2012, HKEx published a revised listing decision “*HKEx-LD43-3*” to set out further guidelines in relation to the previous version of the listing decision published on 27 August 2012 in which it determines that the legal questions relating to certain contract-based structures arrangements (**Structured Contracts**) would not render the listing applicant unsuitable for listing.

For a summary of the previous version of the listing decision, please refer to the article entitled “*Contractual Arrangements Would Not Result in Unsuitability for Listing (Further Guidelines)*” contained in our previous *Capital Markets Quarterly Update (July to September 2012)*. Please read this article in conjunction with the previous version of the listing decision.

### FURTHER GUIDELINES

A new provision requiring a listing applicant using Structured Contracts for the entire or part of its business to disclose in its prospectus details of any insurance purchased to cover the risks relating to the

Structured Contracts or a prominent disclosure that those risks are not covered by any insurance.

You may download copies of the listing decision via the link below:

<http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/LD43-3.pdf> ◆

## Glossary

IN THIS UPDATE, THE FOLLOWING TERMS HAVE THE FOLLOWING MEANINGS

<b>CO</b>	Companies Ordinance (Cap 32 of the Laws of Hong Kong)	<b>PRC</b>	People's Republic of China
<b>GEM</b>	Growth Enterprise Market operated by SEHK	<b>SEHK</b>	The Stock Exchange of Hong Kong Limited
<b>HK</b>	Hong Kong Special Administrative Region of the PRC	<b>SFC</b>	Securities and Futures Commission
<b>HK\$</b>	Hong Kong Dollars	<b>SFO</b>	Securities and Futures Ordinance (Cap 571 of the Laws of Hong Kong)
<b>HKEx</b>	Hong Kong Exchanges and Clearing Limited (also referring to its subsidiaries, including SEHK, as appropriate)	<b>Takeovers Code</b>	Code on Takeovers and Mergers
<b>IPOs</b>	Initial public offerings	<b>US</b>	United States of America
<b>Listing Rules</b>	Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (Main Board Listing Rules) or Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (GEM Listing Rules) or both, as the case may be		



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