

## Hong Kong Proposes Rules to Combat Backdoor Listing - Part 2

To address concerns about backdoor listings and shell activities in Hong Kong, the Stock Exchange of Hong Kong Limited (**HKSE**) recently published (i) a consultation paper proposing to tighten the Listing Rules on reverse takeover, continuing listing criteria and others (the [Consultation Proposals](#)); and (ii) a

guidance letter on listed issuer's suitability for continued listing (GL96-18).

We have examined the new guidance letter GL96-18 in our earlier [Update](#) and we will discuss HKSE's Consultation Proposals in this article.

### Consultation Proposals at a Glance

In curbing recent increase in the trading and the creation of "shell" companies, the Consultation Proposals seek to amend the Hong Kong Listing Rules in the following areas:

ENHANCING CONTINUING LISTING CRITERIA TO DETER SHELLS ACTIVITIES, 12-MONTH TRANSITION <sup>i</sup> FOR COMPLIANCE	
<b>Sufficient operations</b>	issuer must carry out a business with a sufficient level of operations <u>and</u> (previously "or") have assets of sufficient value to support its operations to warrant its continued listing
<b>Cash Companies</b>	issuer (other than "investment company") may be regarded as not suitable for listing if assets consist wholly or substantially <sup>ii</sup> of cash and/or <u>short-term investments</u> , which definition is extended to include investments readily realisable or convertible to cash; listed securities; bonds, bills or notes of less than one year to maturity; and advances to third parties (save for trade receivables in ordinary course of business) repayable within one year
TIGHTENING THE TRANSACTIONS UNDER THE "PROVISIONS TO DETER CIRCUMVENTION OF NEW LISTING REQUIREMENTS" TO REGULATE BACKDOOR LISTING, NO TRANSITION PERIOD	
<b>Reverse takeovers (RTO)</b>	<ul style="list-style-type: none"> <li>the six "principle-based test" assessment criteria set out in guidance letter GL78-14<sup>iii</sup> codified with modifications</li> <li>transactions/arrangements (proposed and/or completed) in reasonable proximity or otherwise related within a <u>three-year</u> period deemed as a series of arrangements</li> <li>aggregation period under the "bright-line test" extended from 24 months to <u>36</u> months</li> <li>deemed new listing – <u>both</u> acquisition targets and enlarged group suitable for listing</li> </ul> <p><i>Please see below further discussion on RTO Rules</i></p>

<b>Extreme transactions</b>	<ul style="list-style-type: none"> <li>the “extreme very substantial acquisition” requirements under guidance letter GL78-14<sup>iii</sup> codified with modifications</li> <li>Extreme Transaction rules (new requirements) apply if issuer under same control for not less than three years and the transaction would not result in change in control <u>OR</u> issuer operating a principal business with substantial size (with annual revenue or total asset value of HK\$1billion or more) after the transaction(s)</li> <li><u>both</u> acquisition targets and enlarged group suitable for listing</li> <li>appointment of <u>financial adviser</u> who is required to conduct due diligence on target(s) and submit a declaration</li> </ul> <p><i>Please see below further discussion on Extreme Transactions</i></p>
<b>Restriction on disposals</b>	<ul style="list-style-type: none"> <li>no material disposal (or distribution in specie) of existing business <u>at the time of or within 36 months</u> after a change in control, unless the remaining group or the assets acquired from incoming shareholder meet the new listing requirements</li> <li>HKSE may apply this rule to a material disposal where there is a proposed or intended change in the single largest substantial shareholder</li> </ul>
<b>Large scale issue of securities</b>	<ul style="list-style-type: none"> <li>a large scale issue of securities <u>for cash to acquire and/or develop a new business</u><sup>iv</sup> may be considered as a means to circumvent new listing requirements (normally not applicable if less than half (50%) of the issuer’s assets would consist of cash as a result of the issue)</li> </ul>
<b>ENHANCING RULES FOR BETTER PROTECTION OF INVESTORS, NO TRANSITION PERIOD</b>	
<b>Significant distribution in specie</b>	<ul style="list-style-type: none"> <li>significant distributions in specie of unlisted assets (<u>amounting to a very substantial disposal</u>) must be approved by independent shareholders (controlling shareholders and their respective associates abstaining from voting) with at least 75% of the votes for and not more than 10% of the votes against the resolution</li> <li>a reasonable cash alternative should be offered</li> </ul>
<b>Securities transactions</b>	<ul style="list-style-type: none"> <li>securities transactions <u>not</u> considered of a revenue nature unless carried out by group members that are subject to the supervision of prudential regulators (i.e. banking company, insurance company or securities house)</li> <li>details of each securities investment representing <u>5% or more</u> of issuer’s total assets must be disclosed in annual reports</li> </ul>
<b>Financial performance guarantee acquired</b>	<ul style="list-style-type: none"> <li>mandatory disclosure on any <u>subsequent change</u> (by way of announcement) and the <u>outcome</u> (in annual report) of any financial performance guarantee of a target acquired by issuer in a notifiable or connected transaction</li> </ul>

i. Transition period commences from the effective date of the amendment.

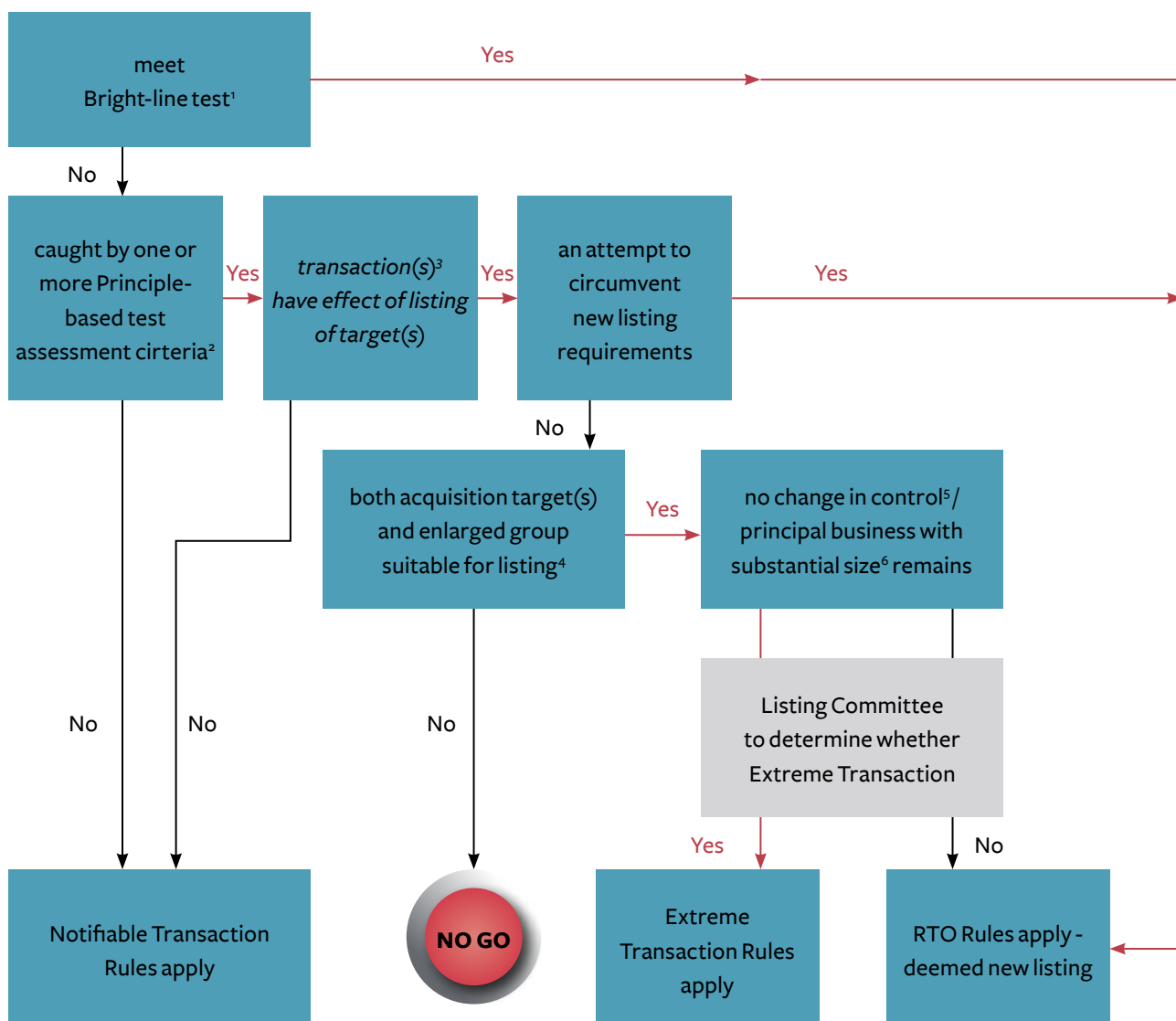
ii. The expression of *wholly or substantially* is understood as meaning *in the main* or *as of the greater part*. A company with less than half (50%) of its assets being cash as a result of a fundraising would not normally be regarded to have assets consisting wholly or substantially of cash. See HKSE’s guidance letter [GL84-15](#).

iii. See HKSE’s guidance letter [GL78-14](#).

iv. The proposed rule would apply where funds raised are used to develop a new business through future acquisitions, in addition to greenfield operations as described in HKSE’s guidance letter [GL84-15](#), which will remain as guidance to explain circumstances under which HKSE would apply the restriction.

## The Revised RTO Rules and Extreme Transaction Rules

We set out below in the form of a flowchart our analysis of the possible application of the revised rules on RTO and Extreme Transactions from a reading of the Consultation Proposals. This is not a substitute for a formal advise.



### NOTES

1. The *bright line test* refers to two specific forms of RTOs: (a) an acquisition (or a series of acquisitions) of assets constituting a very substantial acquisition involving a change in control; or (b) very substantial acquisition(s) of assets (individually or in aggregate) from the new controlling shareholder and its associates within 36 months following a change in control.
2. The *principle based test* gives HKSE broad discretion to deem an acquisition to be a new listing if, in the opinion of HKSE such acquisition constitutes an attempt to achieve a listing of the assets to be acquired and a means to circumvent the new listing requirements.

A new assessment criterion is proposed to replace the current “issue of restricted convertible securities” criterion, namely any *change in control or de facto control* of issuer after taking into account:

- i. any substantial change in the board and key management;
- ii. any change in single largest substantial shareholder; and

iii. any issue of restricted convertible securities (with a conversion restriction mechanism to avoid triggering a change in control under the Takeovers Code) to vendor as acquisition consideration.

Other assessment criteria remain unchanged including:

- a. size of the acquisition targets relative to that of issuer;
  - b. nature and scale of issuer's business;
  - c. any fundamental change in issuer's principal business;
  - d. quality of the acquisition targets; and/or
  - e. any series of arrangements (historical, proposed or intended) within a three-year period to list the acquisition targets.
3. HKSE may regard acquisitions and other transactions or arrangements (proposed or completed) as a series if they take place in a reasonable proximity to each other (which normally refers to a period of three years or less) or are otherwise related.
  4. For a RTO or Extreme Transaction, both the acquisition targets and the enlarged group must be suitable for listing; the acquisition targets (and in certain RTO, each target) must meet the track record requirement; and the enlarged group must meet all the new listing requirements. Waiver from management/ownership continuity requirement may be granted in certain Extreme Transactions.
  5. Issuer must demonstrate that it has been under the control of a large business enterprise for not less than three years, and the transaction forms part of a business restructuring and would not result in a change in control.
  6. The Extreme Transaction classification would not be available if issuer demonstrates "shell" like characteristics. As general guidance, "a principal business with substantial size" may include a principal business with annual revenue or total asset value of HK\$1 billion or more, excluding any revenue or assets not attributable to issuer's original principal business e.g. any significant investments or surplus cash, and any revenue or assets attributed to a newly acquired or developed business.

## Contact Us

For inquiries related to this Legal Update, please contact the following persons or your usual contacts with our firm.

### Jacqueline Chiu

Partner

T: +852 2843 2447

E: [jacqueline.chiu@mayerbrownjms.com](mailto:jacqueline.chiu@mayerbrownjms.com)

### Jeckle Chiu

Partner

T: +852 2843 2245

E: [jeckle.chiu@mayerbrownjms.com](mailto:jeckle.chiu@mayerbrownjms.com)

### Chester Wong

Partner

T: +852 2843 4273

E: [chester.wong@mayerbrownjms.com](mailto:chester.wong@mayerbrownjms.com)

---

Mayer Brown JSM is part of Mayer Brown, a global legal services organisation, advising many of the world's largest companies, including a significant proportion of the Fortune 100, FTSE 100, CAC 40, DAX, Hang Seng and Nikkei index companies and more than half of the world's largest banks. Our legal services include banking and finance; corporate and securities; litigation and dispute resolution; antitrust and competition; employment and benefits; environmental; financial services regulatory and enforcement; government and global trade; intellectual property; real estate; tax; restructuring, bankruptcy and insolvency; and private clients, trusts and estates.

OFFICE LOCATIONS AMERICAS: Charlotte, Chicago, Houston, Los Angeles, Mexico City, New York, Palo Alto, San Francisco, Washington DC

ASIA: Bangkok, Beijing, Hanoi, Ho Chi Minh City, Hong Kong, Shanghai, Singapore, Tokyo

EUROPE: Brussels, Düsseldorf, Frankfurt, London, Paris

MIDDLE EAST: Dubai

TAUIL & CHEQUER ADVOGADOS in association with Mayer Brown LLP: Brasília, Rio de Janeiro, São Paulo

Please visit [www.mayerbrownjms.com](http://www.mayerbrownjms.com) for comprehensive contact information for all our offices.

This publication provides information and comments on legal issues and developments of interest to our clients and friends. The foregoing is intended to provide a general guide to the subject matter and is not intended to provide legal advice or be a substitute for specific advice concerning individual situations. Readers should seek legal advice before taking any action with respect to the matters discussed herein.

Mayer Brown is a global services provider comprising legal practices that are separate entities, including Tauil & Chequer Advogados, a Brazilian law partnership with which Mayer Brown is associated (collectively the "Mayer Brown Practices"), and affiliated non-legal service providers, which provide consultancy services (the "Mayer Brown Consultancies"). The Mayer Brown Practices and Mayer Brown Consultancies are established in various jurisdictions and may be a legal person or a partnership. Details of the individual Mayer Brown Practices and Mayer Brown Consultancies can be found in the Legal Notices section of our website.

"Mayer Brown" and the Mayer Brown logo are the trademarks of Mayer Brown.

© 2018 Mayer Brown. All rights reserved.

Attorney Advertising. Prior results do not guarantee a similar outcome.