

**HKEX GUIDANCE LETTER**  
**HKEX-GL96-18 (June 2018)**

<b>Subject</b>	<b>Guidance on listed issuer’s suitability for continued listing</b>
<b>Listing Rules and Regulations</b>	<b>Main Board Rules 2.03, 2.06, and 6.01(4) GEM Rules 2.06, 2.09 and 9.04(4)</b>
<b>Related Publications</b>	<b>HKEX-GL68-13 and GL68-13A</b>

**Important note:** *This letter does not override the Listing Rules and is not a substitute for advice from qualified professional advisers. If there is any conflict or inconsistency between this letter and the Listing Rules, the Listing Rules prevail. You may consult the Listing Department on a confidential basis for an interpretation of the Listing Rules or this letter.*

**I. Purpose**

1. This letter provides guidance on the general approach relating to the Exchange’s assessment of the suitability of a listed issuer or its business for continued listing. Guidance on factors about the suitability of an applicant for listing is set out in our Guidance Letters GL68-13 and GL68-13A.

**II. Concept of “suitability for listing”**

2. The Exchange, as frontline regulator of listed issuers, has a statutory duty under the Securities and Futures Ordinance (**SFO**) to ensure, as far as reasonably practicable, an orderly, informed and fair market for the trading of securities. In discharging this duty, the Exchange acts in the interest of the public, having particular regard to the interest of the investing public.
3. MB Rule 8.04 / GEM Rule 11.06 provides that both the issuer and its business must, in the opinion of the Exchange, be suitable for listing. MB Rule 6.01(4) / GEM Rule 9.04(4) provides that if the Exchange considers a listed issuer or its business no longer suitable for listing, it may direct a trading halt or suspend dealings in the listed issuer’s securities or cancel the listing of these securities.

4. MB Rule 2.06 / GEM Rule 2.09 states that suitability for listing depends on many factors. Compliance with the Rules may not of itself ensure a listed issuer's suitability for continued listing. The Exchange has a broad discretion to interpret and apply the concept of suitability for the purpose of maintaining market confidence with reference to the currently acceptable standards in the market place. It will pay particular regard to the general principles for listing under MB Rule 2.03 / GEM Rule 2.06, which include ensuring:
  - all holders of listed securities are treated fairly and equally;
  - keeping investors and the public fully informed of material factors which might affect their interests; and
  - directors acting in the interests of shareholders as a whole.
5. Suitability is a broad and flexible concept that applies in a wide range of circumstances. The suitability criterion provides the Exchange with discretion to meet its regulatory objectives and its obligations to act in the best interest of the market as a whole and in the public interest. It is not possible or desirable for decisions on suitability to be subject to "bright line" criteria, or to seek to reduce the requirements of suitability to a list of "pass-fail" requirements.
6. In an IPO application, the listing applicant must satisfy the Exchange that it and its business are suitable for listing. This is a basic condition that must be met before the listing of its equity securities is approved. Once listed, the issuer must ensure that it and its business continue to be suitable for listing.
7. The Exchange may cancel a listing where the suitability issues are fundamental to the general principles for listing and are beyond remedy, or the listed issuer fails to demonstrate a reasonable prospect of addressing the issues and resuming trading within a reasonable period of time.
8. This Guidance Letter sets out examples of situations where the Exchange may question an issuer's suitability for continued listing. The Exchange's assessment on the suitability for continued listing of a listed issuer is on an individual basis and in light of all pertinent facts whenever it deems appropriate. Where there are concerns that an issuer has suitability issues, the Exchange has discretion to suspend trading in the securities of the issuer, and give the issuer a reasonable period to address such concerns and take appropriate remedial action. If the issuer fails to address such concerns within the reasonable period, the Exchange may cancel its listing.

### **III. Guidance**

#### **A. Issuers with “shell” characteristics**

9. In Guidance Letter GL68-13A, the Exchange noted a number of newly listed issuers whose controlling shareholders either changed or gradually sold down their interests shortly after the regulatory lock-up period following listing. It questioned whether these issuers’ listing applications were driven by the perceived premium attached to the listing status rather than the development of their underlying business or assets. These issuers, when identified by potential buyers, would invite speculative trading and create opportunities for market misconduct (e.g. market manipulation or insider trading) and unnecessary volatility in the market post listing. The Guidance Letter raised concerns about the suitability for listing of those applicants whose size and prospects do not appear to justify the cost or purpose associated with a public listing. The media commonly refer to these activities as “shell creation”.
  
10. Similarly, the Exchange noted a number of listed issuers whose controlling shareholders had sold down their interests, and/or the issuers had undertaken a series of actions that led to a diminution of their original businesses and the operation of new businesses. For example, the issuers disposing of or winding down their principal businesses; the existing management of the company resigning; and the issuers establishing or acquiring new businesses unrelated to their original businesses. These new businesses may have a very low barrier to entry and/or can be easily established and discontinued without significant costs, may be asset-light or the assets may be highly liquid or marketable. They share some of the characteristics described in paragraph 1.4 of Guidance Letter GL68-13A, for example, pure trading business with a high concentration of customers; asset-light businesses where a majority of the assets are liquid; and a superficial delineation of business from the parent.

11. In certain individual cases, it is unclear whether these new businesses have substance and are sustainable in the longer term; are operated commercially with the proper infrastructure, processes and controls normally associated with businesses in those industries; are managed by officers with expertise in the business; and the size of the operation and the level of activities are sufficient to support the costs associated with a listing. These issuers may have market capitalizations disproportionate to the size and prospects of their businesses, and may be “blue sky companies”<sup>1</sup> susceptible of speculative activities and market manipulation. This raises similar concerns about the impact of such activities on the orderliness, quality and reputation of the market. The Exchange has concerns that in these individual cases, the issuers may be carrying on these activities for the purpose of maintaining a listing status rather than genuinely operating and developing the new business. The media commonly refer to these activities as “shell maintenance”.
12. The Exchange noted that certain types of businesses, such as proprietary securities trading, money lending and indent trading may be employed in these circumstances as they can be operated in a manner that fit the characteristics described in paragraph 11 above. Where, based on the specific facts and circumstances, the business models employed by these listed issuers exhibit such characteristics, there may be questions about their suitability for continued listing. For example, the Exchange may question an issuer’s suitability for continued listing if there is a concern that the issuer’s money lending business, being a material part of its business, is not a business of substance having regard to its business model, operating scale and history, source of funding, size and diversity of customer base, loan portfolio and internal control systems. Where the Exchange becomes concerned that a material part of the company or its businesses is no longer suitable for listing, it may suspend the trading in the company’s securities and request the company to address its concerns (see paragraph 8).
13. It should be noted that an assessment of the suitability of an issuer or its business(es) for continued listing must be made case by case, based on the specific business model employed by the issuer and the particular facts and circumstances of that issuer. For the avoidance of doubt, it is the specific business model adopted by issuers, and not the specific type(s) of business themselves cited in paragraph 12 above, that may render the company or business unsuitable for listing.

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<sup>1</sup> “Blue sky companies” are those where public investors have no or little information about their business plans and prospects, leaving much room for the market to speculate on their possible acquisitions. These activities create opportunities for market manipulation. See Listing Decision LD35-2012.

## **B. Prolonged suspension**

14. The Rules require the duration of any trading suspension to be for the shortest possible period. This ensures the proper functioning of the market and prevents shareholders and other investors from being denied reasonable access to the market. The directors of a suspended issuer are obliged to take adequate action for the issuer to remedy the issues resulting in the suspension and resume trading as soon as practicable. This fulfills their undertakings given to the Exchange to procure the issuer to comply with the Rules.
15. If an issuer fails to remedy the issues resulting in the suspension, the trading suspension will be prolonged. This would deprive shareholders from trading their shares and/or realizing their investments in the market. The issuer's suitability for continued listing will become an issue when, for example, the issuer fails to demonstrate a reasonable prospect of remedying the issues and resume trading within a reasonable period of time, or its directors become uncontactable by the Exchange or otherwise fail or refuse to respond to the Exchange's enquiry as to the resumption plan or its progress. This will not prejudice the Exchange's right to consider an issuer no longer suitable for listing on the basis of the underlying issues causing the trading suspension themselves or other reasons as it considers appropriate.

## **C. Other instances of non-suitability**

### **(1) Suitability issues concerning directors or persons with substantial influence**

16. Directors of a listed issuer are, collectively and individually, responsible for the issuer's management and operations.
17. An individual may not be suitable to be a director if an incident involving him raises a serious doubt as to his character or integrity and his ability to fulfill his duty to act honestly, in good faith and for a proper purpose<sup>2</sup>. A non-exhaustive list of examples include: involvement in fraud, theft or other types of dishonesty (such as false accounting, bribery, conspiracy to defraud, misappropriation of funds, money laundering and provision of false and misleading testimony to regulators), or breach of securities law, rules or regulations (either personally or through the company of which he is or was a director). This assessment is on a case-by-case basis.

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<sup>2</sup> See MB Rules 3.08 and 3.09 / GEM Rules 5.01 and 5.02.

18. If a director is no longer suitable to act as director, the retention of office by the director is prejudicial to the interests of minority shareholders. If he is also a person being highly likely to be able to exert control or substantial influence over the issuer's operation and management, the concern about the company's suitability for continued listing would exist irrespective of whether he ceases to be a director.

**(2) Material breach of the Rules**

19. Listed issuers must comply with the requirements under the Listing Rules. Persistent failure to comply with the Rules in a material manner prevents the operation of a fair, orderly and informed market for the trading of securities and undermines the interests of investors. This raises a serious concern about whether the issuer is suitable for continued listing.
20. For example, the Rules require listed issuers to publish audited financial statements at regular intervals, enabling shareholders and potential investors to appraise their current financial position. Failure to publish the required financial statements will result in a trading suspension of the issuer's shares. An issuer's continued failure to rectify the breach would deprive shareholders and potential investors of (i) the financial information to appraise the issuer's position, and (ii) reasonable access to the market for trading their shares and/or realizing their investments in the market. This calls into question whether the issuer remains suitable for listing.

**(3) Inability to disclose material information**

21. To keep shareholders and potential investors fully informed of material factors which might affect their interests<sup>3</sup>, listed issuers have various general and specific continuing disclosure obligations under the Rules (including, among others, disclosure of inside information required to be disclosed under Part XIVA of the SFO and periodic financial statements).
22. If an issuer engages in arrangements, transactions, or businesses which impose secrecy obligations (e.g. state secret), thereby prohibiting the listed issuer from disclosing material information to the market, or providing necessary information to its auditors for finalizing their reports, this would deprive shareholders and potential investors of the information necessary to make an informed investment decision. This gives rise to the issue of suitability for continued listing.

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<sup>3</sup> MB Rule 2.03(3) / GEM Rule 2.06(3).

**(4) Non-compliance with laws and regulations**

23. Listed issuers should comply with applicable laws and regulations at all times. Intentional, systemic and/or repeated breaches of laws and regulations by a listed issuer may affect its suitability for listing. The concern may not only be about a lack of management integrity (in the case of intentional breaches), but also about a lack of competence or capacity, borne out by systemic or repeated breaches, even if not deliberate.
24. Relevant factors for an assessment of an issuer's suitability for listing on this basis include:
- The nature, extent and seriousness of the breaches.
  - The reasons for the breaches, whether they were intentional, fraudulent, or due to negligence or recklessness.
  - The impact of the breaches on the issuer's operation and financial performance.

For example, an issuer may be considered no longer suitable for listing if the non-compliance leads to revocation of a licence or permit which is a prerequisite for or essential to the continued principal business operations of the issuer.

**(5) Trade or economic sanctions**

25. Reference is made to Listing Decision LD76-2013 on the Exchange's assessment on the suitability for listing of listing applicants with businesses in countries (**Sanctioned Countries**) subject to trade or economic sanctions imposed by governments such as the United States, the member states of the European Union and Australia.
26. A listed issuer may become exposed to sanction risks due to its new business / activity which is sanctionable by law or a change in law or regulation which makes its existing business become sanctionable. Its suitability for continued listing would become an issue in extreme cases where, for example, (i) the sanction risks and sanctions imposed have materially undermined the issuer's business and the issuer does not have sufficient operations or assets required under the Rules to maintain a listing status; or (ii) the sanction risks to investors and the Exchange (including related companies) are significant.

**(6) Business structure**

27. A listed issuer should ensure that its business structure or arrangements can adequately safeguard its assets and shareholders' interests, failing which the Exchange may consider the issuer no longer suitable for listing.
28. As an example, reference is made to our Guidance Letter GL77-14, setting out guidance on the use of contractual-based arrangements or structures by listed issuers to indirectly own and control any part of their businesses. Under such arrangements, the issuer does not directly own the operating company, relying solely on structured contracts to control the operating company and enjoy the economic benefits derived from it. Given the inherent risks associated with such arrangements to the issuer's interests, the Exchange may consider an issuer adopting such arrangements unsuitable for continued listing unless such arrangements are in strict compliance with the conditions set out in Guidance Letter GL77-14.

**(7) Gambling**

29. Listed issuers which engage in gambling business will be considered unsuitable for listing unless they satisfy the requirements set out in our Guidance Letter GL71-14 on "*Gambling Activities Undertaken by Listing Applicants and/or Listed Issuers*".

**(8) Excessive reliance on key customer/supplier or controlling/substantial shareholder**

30. Excessive reliance on a single major customer / supplier may raise serious concerns on whether the business model is viable and sustainable, particularly if any change of the arrangements with, or the loss of, such customer / supplier would result in material impact on the issuer's financial condition. If the transactions are fundamental to the issuer's business, this may further give rise to a concern over the issuer's ability to carry on its business independently and, if the degree of dependence is excessive, this would translate into a concern on suitability for continued listing.
31. For example, if the issuer's supply and sales are both dominated by the controlling shareholder (or its associates), and the transactions become the issuer's sole or primary source of revenue, there is a serious concern that the issuer would be a captive company merely serving the controlling shareholder. In this context and, in such circumstances, it is questionable whether the business remains viable and sustainable without these transactions. Lack of transparency on the controlling shareholder's operational and financial position restricts the public shareholders and potential investors of the issuer from properly assessing the issuer's position. In these circumstances, the issuer may be considered no longer suitable for continued listing.



**(9) Fraud**

32. There are cases where an issuer is considered no longer suitable for listing if it is found that its published financial statements were based on fraudulent accounts with significant overstatement of profits, or false documents (e.g. invoices, sales records), or there existed serious discrepancies among different sets of books and accounts which the issuer failed to explain or reconcile. In these circumstances, shareholders and potential investors are deprived of the necessary financial information for making an informed assessment of the issuer and there is a serious question over the management integrity.

**(10) Material internal control failures**

33. Listed issuers should maintain a sound system of internal controls over their financial, operational and compliance matters to safeguard their assets and protect the interests of shareholders<sup>4</sup>. There are cases where an issuer fails to (i) provide sufficient evidence to support the completeness and accuracy of its financial statements in material respects (leading to a disclaimer audit opinion), (ii) prevent or detect corporate misconduct such as misappropriation of assets or funds, or (iii) timely disclose material information to shareholders and potential investors. This may result from significant internal control failures, and is detrimental to the interests of shareholders and the fair, orderly and informed market for trading of securities. In these circumstances, the issuer may be considered unsuitable for continued listing.

**(11) Failure to provide information to the Exchange**

34. The Rules require listed issuers to provide the Exchange with information requested by the latter to protect investors, ensure the smooth operation of the market or verify compliance with the Rules. Compliance with this requirement is essential to the Exchange performing its statutory duty of maintaining an orderly, informed and fair market.
35. An issuer's suitability for continued listing may be called into question in an extreme case where without the issuer providing the required information to the Exchange, there is a serious concern about whether an orderly, informed and fair market can be maintained.

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<sup>4</sup> Paragraph C2 of Appendix 14 to the MB Rules / Paragraph C2 of Appendix 15 to the GEM Rules.