

## Outline of the Hong Kong Stock Exchange Rule Changes to Complement New Sponsor Regulations

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On July 23, 2013, the Stock Exchange of Hong Kong Limited (the Exchange) published amendments to the rules governing the listing of securities on the exchange (the Listing Rules) and issued additional guidance to complement the new sponsor regulations introduced by the Securities and Futures Commission (SFC) (the Listing Rules and guidance collectively referred to as the Rule Changes).<sup>1</sup>

In addition to setting out the detailed requirements and procedures that must be followed under the new sponsor regime, the Rules Changes are also intended to streamline and clarify the listing application process. The new Rule Changes requirements will apply to listing applications submitted on or after October 1, 2013, except for the requirement to publish a “substantially complete” proof of the draft prospectus or listing document (the Application Proof) on the Exchange’s website upon the submission of a listing application, which will instead take effect for listing applications submitted on or after April 1, 2014.

As these developments occurred with barely a week to spare before the sponsors of listing applications will need to comply with certain of the provisions (namely those relating to the delivery of sponsor engagement letters to the Exchange no less than two months prior to listing applications proposed to be submitted on or after October 1, 2013), there are many issues for interested participants to consider. This memorandum summarizes the Rule Changes relating to applications for listing on the Main Board of the Exchange and their implications for listing applicants, sponsors and other professional parties.

### New Vetting Measures

The key features of the streamlined listing application process include:

- **Publication of an Application Proof**, which should be substantially complete, on the Exchange’s website upon submission of a listing application;
- **An eight-week moratorium** on the resubmission of listing applications initially returned on the grounds that the Application Proofs are not substantially complete (Returned Applications) and the “naming and shaming” of the sponsors and applicants on the Exchange’s website;
- **An accelerated appeal process** in relation to Returned Applications if a listing applicant or its sponsor(s) disagree with the Exchange’s views;
- **A streamlined regulatory commenting process** focusing on major issues such as eligibility, suitability, sustainability, Listing Rules, companies ordinance and securities and futures ordinance compliance, and any material disclosure deficiencies; and

<sup>1</sup> See <http://www.hkex.com.hk/eng/newsconsul/hkexnews/2013/130723news.htm>.

- **Revised sponsors' rules, undertakings and declarations** to complement the new provisions under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct) and simplify areas that previously overlapped.

### Overview of the Rule Changes and New Guidance Letters

**Appointment of Sponsor.** Sponsors are required to be appointed by listing applicants under a written engagement agreement, and the Exchange must be notified of a sponsor's appointment immediately by receiving a copy of the engagement letter. Sponsors also must notify the Exchange if their engagement is terminated, including the reasons why. To help the sponsor meet its requirements under the Listing Rules and the Code of Conduct, the Exchange now requires the listing applicant and its directors to include a number of obligations in sponsor engagement letters, such as the obligation to fully assist the sponsor in the performance of its diligence. A listing application cannot be submitted until at least two months from the date of appointment of the sponsor. For example, any sponsor aiming to submit a listing application in October 2013 will need to submit an engagement letter compliant with the Rule Changes in August. Sponsor banks should review their engagement letter templates to ensure they conform to the requirements under the Rule Changes.

**Publication of "Substantially Complete" Application Proof.** Principal among the Rule Changes is the requirement to publish a "substantially complete" Application Proof on the Exchange's website upon submission of the listing application. As previously rumored, this requirement will be suspended for a six-month period and take effect for listing applications submitted on or after April 1, 2014. The Exchange has made it clear that there would be no further suspensions. Details relating to Returned Applications (including the names of the applicant, its sponsor(s) and return date) will not be published by the Exchange on its website during the suspension period. The Rule Changes introduce the concept of the "Application Proof — Vetting" and the "Application Proof — Publication", with the former being the version of the Application Proof to be reviewed by the Exchange and the latter being the version for publication on the Exchange's website with certain information redacted so as not to constitute a prospectus under the Companies Ordinance.

**Director / Supervisor Confirmation Regarding Application Proof Content.** To ensure that an Application Proof meets the Exchange's standard, directors (or, for PRC issuers, supervisors) now are required to sign and submit written confirmation at the time of the listing application that the Application Proof information is accurate, complete, and not misleading or deceptive.

**Application Proof Exemptions.** Certain listing applicants will be exempt from the public filing requirement or may, on request, have it waived:

- A new applicant that has been listed on a recognized overseas exchange for not less than five years and has a significantly large market capitalization (as determined by the Exchange from time to time) at the time of filing its listing application is entitled to make a confidential filing of its Application Proof.
- The Exchange or SFC may waive or modify the publication requirements for an Application Proof in a spin-off from an overseas listed parent upon application by a new applicant.

**"Three-Day Initial Check."** During the publication requirement suspension period, the Exchange will adopt a "three-day initial check" for listing applications. Any Application Proof that the Exchange or SFC considers not "substantially complete" will be returned, and an eight-week moratorium will apply, meaning that the application cannot be refiled until eight weeks after the initial application. The eight-week period neatly corresponds with the minimum two-month prescribed period of time between appointment of a sponsor and submission of a listing application. This raises the

stakes for sponsors of Returned Applications by giving listing applicants the opportunity to consider switching sponsors for the resubmission with potentially minimal impact on the timetable.

The Rule Changes also set out a new fast-track appeal process in relation to Returned Applications if a listing applicant or its sponsor(s) disagree with the Exchange's views to reject an application, although the Rule Changes were silent on whether successful appeals would result in revision to, or deletion of, the published details of Returned Applications.

The Exchange and SFC will decide whether to continue the practice of the three-day initial check after April 1, 2014, depending on its effect during the transition period. Guidance on the disclosure requirements for substantially completed Application Proofs and the three-day initial check is set out in a newly published Guidance Letter GL56-13, which sets out the information that can still be included in square brackets or omitted at the time of the application. Although not concurrently provided with the Rule Changes, it would seem likely that a practice will develop of submitting a checklist at the time of the listing application that provides the Exchange with cross references to the disclosure in the Application Proof.

**Accelerated Submission.** To speed up the vetting process, the Rule Changes require a number of documents in a "final or advanced" form to be submitted at the time of the listing application instead of in a preliminary form or at a later date, as was previously allowed. These forms include:

- Waiver applications;
- Statement of adjustments;
- Profit forecast memorandum; and
- Letter from the sponsor confirming sufficiency of working capital.

Experts also are required to submit a confirmation that, save for any unforeseen events or necessary updates, there should be no material changes to the contents of their reports after the submission of the listing application (for which the Exchange has provided a suggested form).

**PHIP Posting.** The requirement to post a web-proof information pack on the Exchange's website before a preliminary offering circular (commonly referred to as the "red herring" prospectus) is distributed to institutional or qualified investors will be replaced by the requirement to publish a Post Hearing Information Pack (PHIP). A new Practice Note 22 has been introduced, which details the PHIP content and posting requirements. Further detailed logistical arrangements for the publication of the PHIPs (as well as Application Proofs) are detailed in new Guidance Letter GL57-13. Under the new PHIP requirement, a listing applicant must provide the Exchange with a confirmation from its legal adviser that the required guidance on redactions in the Application Proof and PHIP and inclusion of appropriate warning and disclaimer statements for publication of these documents has been complied with.

**Financial Information to be Included in the Application Proof.** The Exchange also has issued a new Guidance Letter GL6-09A to supersede the existing Guidance Letter GL6-09 on financial information to be included in the Application Proof for applications commencing October 1, 2013. Following is a summary of the GL6-09A requirements:

Assuming trading record period is Year 1, Year 2 and Year 3

Time of Filing	Application Proof: Required Financial Information
<b>Within two months of end of Year 3</b>	<p>Financial information for Year 1, Year 2 and Year 3 in audited or advanced form.</p> <p>If not available, then (i) a sponsor's confirmation beyond reasonable doubt that the applicant will satisfy Main Board Rule 8.05 or other Chapter 3A and PN21 financial standard requirements, (ii) audited financial information for Year 1 and Year 2 and (iii) reviewed financial information for at least a nine-month stub period (vs. the current six-month stub requirement).</p>
<b>After two months from end of Year 3</b>	<p>Audited financials not more than six months old before expected date of listing document.</p> <p>If not available, then (i) a sponsor's confirmation (see above) and the following:</p> <p><u><i>If application is within six months from end of Year 3</i></u> (ii) audited financials of Year 1, Year 2 and Year 3.</p> <p><u><i>If application is more than six months but less than eight months from end of Year 3</i></u> (ii) audited financials of Year 1, Year 2 and Year 3, and (iii) reviewed financial information for at least a three-month stub period.</p> <p><u><i>If application is more than eight months but less than 12 months from end of Year 3</i></u> (ii) audited financials of Year 1, Year 2 and Year 3, and (iii) reviewed financial information for at least a six-month stub period.</p>

\* related MD&A also must be provided with all of the above financial information

**Sponsor's Undertaking and Statement of Independence.** The Rule Changes have combined the wording of the existing sponsor's undertaking (Appendix 17) and sponsor's statement of independence (Appendix 18) into a single document to be filed with the Exchange at the time of the listing application. The Rule Changes have also removed areas of overlap, for example by repealing rules 3A.14 to 3A.16 that were already covered in the Appendix 19 sponsor's declaration. It is noteworthy that the revised Appendix 19 declaration requires sponsors to state their belief that (among other things) the listing document — including the expert sections — contains all information required by legislation and rules and is true, accurate, complete and not misleading.

**New Guidance Letters.** A series of 10 new Guidance Letters effective for applications submitted on or after October 1, 2013 also has been issued. In addition to those outlined above, the additional guidance letters<sup>2</sup> cover topics including disclosure on instances of non-compliance during the track record period, director and senior management disclosure, MD&A disclosure, accelerated application procedures and logistical arrangements.

<sup>2</sup> See [http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/iporq/gl\\_newrg.htm](http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/iporq/gl_newrg.htm).

## Implications of the Rule Changes

Whether the Rule Changes and the new sponsor regime coming into effect on October 1, 2013, will be the watershed moment Hong Kong regulators are hoping for in terms of improving the overall quality of the market and companies seeking to list remains to be seen, as will whether the various measures brought in by the Rule Changes give the Exchange sufficient comfort to live up to its stated objective of ensuring shorter vetting timetables. However, several points are clear:

**Improved Focus on Drafting and Diligence.** The various measures significantly raise the stakes for the reputations of sponsor banks and should result in a greater focus on the quality of diligence and drafting. While the market will be waiting with bated breath for April 1, 2014, to see which sponsor is the first to be publicly named — and shamed — for submitting a Returned Application, it will be of equal interest to gauge the alacrity with which the Exchange is prepared to reject applications (especially if it involves listing division officials effectively second-guessing the judgment of those who know the business best as to what is material for inclusion in the Application Proof).

**Increase in Pre-A1 Submissions.** Given the heightened stakes and the new requirements to submit documents (including waiver applications) in final or near-final form, one potential, unintended consequence of the Rule Changes is that the practice of pre-A1 submissions or consultations on novel or doubtful points will become more common. Few sponsors or professional parties will be willing to risk their reputations on a difficult judgment call without running it past the Exchange.

**Increased Burden (and cost?) for Listing Applicants.** Listing applicants will need to finalize sponsor appointments (and sponsor fees) at least two months prior to their proposed A1 filing; senior management, and especially directors (and supervisors in the case of PRC issuers), will need to devote genuine time to participating in the drafting process; and issuers should expect the demands on them from sponsors and their advisers to generally increase.

**Now Is the Time for Sponsors to Get Their Houses in Order.** If they have not done so already, sponsor banks should review mandate letter forms and diligence practices and undertake education and training of all staff involved in listing applications to ensure they are familiar with the all new requirements, especially those with respect to listing document/prospectus content requirements.

We would be happy to discuss the Rule Changes with any interested parties and will publish further updates on any further specific guidance and industry practices as they evolve.