

# ACUMINOUS

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## SUSPENSION OF TRADING AND DELISTING OF LISTED COMPANIES

The Stock Exchange of Hong Kong Limited (the “**Exchange**”) under the auspices of the Securities and Futures Commission (the “**SFC**”) have recently taken a more stringent regulatory approach on listed companies in difficulties, financial or otherwise, by implementing several important changes to the Rules Governing the Listing of Securities on the Exchange (the “**Listing Rules**”).

The following changes are part of a series of “initiatives” introduced by the Exchange and the SFC. The Exchange claimed that the purpose of all these amendments are to establish a fair, orderly and informed market by delisting listed companies that are in their view unsuitable for continued listing. With the wide discretion of the Exchange, listed companies should be aware of the substantial risks they are exposed to.

Meanwhile, the Listing Rules have been amended to reduce rights of review previously available to listed companies. The newly tightened delisting framework means suspended companies must act promptly towards resumption to avoid delisting. With the introduction of the fixed period delisting criterion and the streamlined review structure, main board listed companies may be delisted after a trading suspension of 18 continuous months if they fail to timely remedy or address the Exchange’s concerns and resume trading. From our experience, however, 18 months may not be sufficient to engineer and implement a successful resumption proposal.

### Listed companies with disclaimer or adverse audit opinions

In the past, trading in the securities of a listed company would be suspended if it failed to publish periodic financial information within the time frame imposed by the Listing Rules. Under the new regime proposed by the Exchange, listed companies will also be at risk of being suspended if the auditor has issued, or has indicated that it will issue, a disclaimer of opinion or an adverse opinion on the listed company’s preliminary results announcement or its financial statements for the financial years commencing on or after 1 January 2019.

Trading in the securities can only be resumed once the listed company has:

1. addressed the issues giving rise to the disclaimer or adverse opinion; **and**
2. provided comfort that a disclaimer or adverse opinion in respect of such issues would no longer be required; **and**
3. disclosed sufficient information for investors to assess its updated financial positions.

### Suitability for continued listing

Listed companies will now be at risk of being deemed unsuitable for continued listing. There is a real likelihood that a listed company will be suspended and eventually delisted if the Exchange considers it to have unsuitability issues given their wide discretion. The suspended listed company will be given only a limited period to address and remedy **all** the concerns and if the listed company fails to address those concerns within the limited time frame, the Exchange will proceed to cancel its listing.

The following areas are factors, we call them the “unsuitability concerns”, which the Exchange will consider when determining the listed company’s suitability for continued listing.

#### 1. Sufficiency of operations

Rule 13.24 of the Listing Rules (“**Rule 13.24**”) requires listed companies to maintain a sufficient level of operations or assets of sufficient value to warrant the continued listing of their securities or otherwise the Exchange would suspend these listed companies on extreme cases. Any of the following could, in the opinion of the Exchange, be deemed as non-compliance of Rule 13.24 and these listed companies could be delisted:

- (1) the assets do not generate sufficient revenue and profits to support a continued listing. In these cases, the listed companies are not operating substantive businesses, and the value of the businesses is minimal, if any;
- (2) the listed company has been operating at a very small scale and incurring losses for years; and
- (3) a very low level of operating activities and revenue.

#### 2. Cash companies

A company whose assets consist wholly or substantially of cash or short-dated securities is considered to be unsuitable for listing. The definition of "short-dated securities" in the Listing Rules has been revised to include investments that are easily convertible into cash. As there is no prescribed quantitative threshold in the Listing Rules which defines what amounts to a cash company, any listed company with substantial liquid investments and cash may be deemed as a cash company. Once a listed company is considered to be a cash company, its application for resumption of trading will be difficult.

#### 3. Suitability issues concerning directors or persons with substantial influence

The Exchange considers a listed company to be unsuitable for continued listing if an individual who has been involved in incidents which may raise serious doubt as to their character or integrity and their ability to act honestly in good faith, e.g. involvement in fraud, theft or other types of dishonesty, is in the view of the regulators, able to exert control or substantial influence over the listed company’s operation and management irrespective of whether the individual ceases to be a director.

#### 4. Material breach of the Listing Rules

Any listed companies which persistently fail to comply with the Listing Rules will be deemed to be unsuitable for continued listing. For example, failure to publish audited financial statements within the required time period would normally be deemed as a material breach.

#### 5. Inability to disclose material information

Listed companies have various general and specific continuing disclosure obligations under the Listing Rules (including, among others, disclosure of inside information required to be disclosed under Part XIVA of the SFO and periodic financial statements). If a listed company engages in arrangements, transactions, or businesses which impose secrecy obligations (e.g. state secret), thereby prohibiting the listed company from disclosing material information to the market, or providing necessary information to its auditors for finalizing their reports, it might lead to the Exchange raising concerns on the listed company’s suitability for continued listing.

#### 6. Non-compliance with laws and regulations

The Exchange considers any breaches of laws and regulations, whether intentional, systemic or repeated, by a listed company a matter of utmost concern and would adversely affect its suitability for listing.

## 7. Business structure

A listed company should ensure that its business structure or arrangements can adequately safeguard its assets and shareholders' interests, failing which the Exchange may consider the listed company no longer suitable for listing. This would be highly relevant to listed companies relying on contractual-based arrangements or structures to indirectly own and control any part of their businesses. The Exchange may consider a listed company unsuitable for continued listing if it does not directly own the operating company but relies solely on structured contracts to control the operating company while enjoys the economic benefits derived.

## 8. Excessive reliance on key customer/supplier or controlling/ substantial shareholder

The Exchange may also deem a listed company unsuitable for listing if there is excessive reliance on a single major customer / supplier. It 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 listed company's financial condition.

## 9. Fraud

There are cases in which a listed company is no longer considered suitable for listing if it is found that its published financial statements were based on fraudulent accounts with material 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 listed company failed to explain or reconcile.

## 10. Material internal control failures

The Exchange will likely consider any listed companies with material internal control failures unsuitable for continued listing. For example, failures 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.

## 11. Failure to provide information to the Exchange

The Listing Rules require listed companies to provide the Exchange with all relevant information requested. The Exchange will deem listed companies unsuitable for listing if they are unable to comply with the requests.

## 12. Trade or economic sanctions

A listed company may be deemed unsuitable for listing if the exposure to sanction risks due to its new business / activity will materially affect the its business, operations or assets.

### **Fixed period delisting criterion**

In August 2018, the new fixed period delisting criterion became effective and the Exchange is now able to delist a main board company after a continuous trading suspension of 18 months, and 12 months for GEM board companies. Suspended companies will now have to act promptly towards resumption in averting a potential delisting. The Exchange has also amended Rule 6.10 which specifies its power to publish a delisting notice and allow the company a limited period of time remedy the relevant matters to avoid delisting, or delisting a company immediately.

## Changes in review structure of Listing Committee decisions

Under the new proposal which will become effective shortly, the pre-existing two-tier review structure for decisions of material significance (e.g. (i) rejection of a new applicant's listing application solely on the ground of unsuitability for listing; (ii) cancellation of listing; and (iii) imposition of certain disciplinary sanctions) made by the Listing Committee will be abolished. These decisions will now be subject to only **one level of review**.

Previously, suspended companies in difficulties had been given sufficient time to resurrect or rescue their business in averting a potential delisting. With the new proposal, delisting decisions will become final within a much shorter time span and the time allowed to attempt any corporate rescue has effectively been shortened.

## Conclusion

The new amendments clearly indicate the Exchange's determination to delist listed companies which are deemed to be unsuitable for listing in their opinion. With the introduction of the fixed period delisting criterion and the streamlined review structure, the Exchange will be able to delist listed companies much quicker. The new stringent approach clearly means more listed companies could potentially be delisted as they fall prey to unsuitability concerns. Stakeholders of listed companies in difficulties or in doubt are better advised to engage experienced professionals to address the unsuitability concerns at an early stage to avert falling into the delisting dead end.

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