

## **HKEx GUIDANCE LETTER**

**HKEx-GL17-10 (May 2010) (Updated in September 2011, March 2014 and August 2015)**

<b>Summary</b>	
<b>Subject</b>	<b>Guidance for Chapter 21 companies</b>
<b>Listing Rules</b>	<b>Rules 21.04; 21.14(1); 21.14(3); 21.14(5)</b>
<b>Author</b>	<b>IPO Transactions Team</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.*

### **Purpose**

1. This letter sets out guidance on:
  - the minimum board lot and subscription size, market capitalisation, number of shareholders, and offering document in restricted marketing cases;
  - considerations for listing investment companies;
  - qualifications of directors, investment managers/ investment advisers; and
  - conflicts of interest where the investment company's executive directors/ investment managers/ investment advisers also manage other third party funds.

### **Restricted Marketing**

2. Rule 21.14(1) provides that the Exchange must be satisfied that there is not likely to be significant public demand for the securities of the investment company.

Rule 21.14(3) provides that the Exchange has to be satisfied that adequate arrangements have been made to ensure that the securities of the investment company will not be permitted to be marketed to the public in Hong Kong.

However, the provision does not prohibit marketing to professional investors in Hong Kong.

Rule 21.14(5) provides that the Exchange reserves the right to impose a minimum investment and/ or minimum board lot size if it deems it necessary by the nature of the investment company.

Rule 21.04 provides that the qualifications for listing contained in Chapter 8 apply, except for rules 8.05, 8.06, 8.07, 8.08(1), 8.09, 8.10 and 8.21 and save as otherwise

agreed with the Exchange.

#### *Minimum Board Lot Size and Subscription Size*

3. Main Board and GEM Rules currently do not have mandatory requirements on the minimum board lot size for listing applicants. However, the Exchange has a practice of requiring a minimum board lot size of HK\$2,000 at the time of listing for general listing applicants. This takes into account the minimum transaction costs for a securities trade.  
([http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/listpp/eppguid/documents/d\\_t\\_a.doc](http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/listpp/eppguid/documents/d_t_a.doc))
4. In the case of restricted marketing, to ensure that the securities of an investment company are not marketed to the public except to professional investors, the investment company must:-
  - (a) generally have a board lot size and subscription size of at least HK\$500,000 for its securities. The Exchange will consider individual circumstances and adjust the minimum board lot and subscription size as it sees appropriate (***Revised in September 2011***).
  - (b) demonstrate that the intermediaries involved in selling securities for and on their behalf, should as part of their “know your client” procedures under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission<sup>1</sup>, satisfy themselves that each placee is a professional investor as defined in Schedule 1 of Securities and Futures Ordinance (cap. 571); and
  - (c) demonstrate that other aspects of the offering structure are acceptable to the Exchange.

#### *Market Capitalisation and Shareholder Spread*

5. Rule 8.08(2) is designed to establish a broad base of shareholders that will help the development of a potentially “deeper” market to ensure subsequent liquidity. Hence an investment company, like any company seeking a listing under Chapter 8, must demonstrate that there is sufficient interest in the securities to be offered to justify a listing. The minimum number of shareholders is therefore 300 for an investment company, irrespective of whether the offer is under restricted marketing, unless a waiver is granted (***Updated in August 2015***).
6. Although investment companies under restricted marketing are not subject to the market capitalisation requirement in Rule 8.09, their market capitalisation effectively must not be less than HK\$150 million (a minimum subscription size of HK\$500,000 per placee with a minimum of 300 placees).

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<sup>1</sup> See also the Consultation Conclusions issued by the SFC in February 2011 on the Consultation Paper issued in October 2010 on the evidential requirement under the Securities & Futures (Professional Investor) Rules. The Securities and Futures Commission (“SFC”) concluded that the assessment of a professional investor will adopt a principles-based approach whereby firms may use methods that are appropriate in the circumstances to satisfy themselves that an investor meets the relevant assets or portfolio threshold.

### *Registration of a Prospectus by an Investment Company (Added in September 2011)*

7. Investment companies with restricted marketing under Rule 21.14 must not issue a listing document that constitutes an offer to the public. But, it may be marketed to professional investors. Accordingly, an offering document under restricted marketing should not require the registration of a prospectus. Investment companies under restricted marketing and sponsors should ensure that the offer does not amount to a public offer. In case, the investment company requests the Exchange to register a prospectus, it must provide the Exchange with a submission from its sponsor and legal adviser as to why it considers the offering document is a prospectus.
8. If an investment company intends to offer shares in connection with a collective investment scheme (“CIS”) to the public, both the CIS and the CIS listing document will be subject to SFC authorisation<sup>2</sup> and the requirements under Chapter 20 of the Listing Rules.

### **Other Considerations for Listing (Added in September 2011)**

9. The Exchange will consider the investment company’s:
  - (a) risk control and compliance measures to ensure compliance with its investment objective and policies as well as applicable laws, rules and regulations, and to review its investment portfolio and monitor its portfolio risk;
  - (b) purpose in raising funds and rationale for listing; and
  - (c) process, which must be clearly articulated, to identify and assess potential investments.

### **Qualifications of Directors, Investment Managers/ Advisers (Added in September 2011)**

10. Rule 21.04(1) provides that the Exchange must be satisfied:

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- (i) A listing document which is a prospectus under the Companies Ordinance (*Retitled as the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) with effect from March 2014*) must be registered in accordance with the Companies Ordinance (*Updated in March 2014*).
- (ii) The Exchange’s power to authorise the registration of a prospectus derives from the Securities and Futures (Transfer of Functions-Stock Exchange Company) Order (“**Transfer of Functions Order**”).
- (iii) The Exchange’s power under the Transfer of Functions Order is limited and it does not permit the Exchange to authorise the registration of a prospectus in relation to an offer of interests in a collective investment scheme (“**CIS prospectus**”) unless:
  - 1) it does not involve an offer to the public, i.e. which does not come within section 103(1)(b) of the Securities and Futures Ordinance (“**SFO**”); or
  - 2) if offered to the public, the offer is exempted from the operation of section 103(1)(b) of the SFO by virtue of any exemption other than section 103(3)(h) of the SFO, e.g. 103(3)(k) of the SFO (i.e. an invitation to professional investors).
- (iv) SFC reserves the power to authorise the registration of a prospectus under the Companies Ordinance (*Retitled as the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) with effect from March 2014*) concurrently with the Exchange (*Updated in March 2014*).
- (v) SFC has the power to authorise a CIS under section 104 of the SFO, and the issue of a CIS offer document to the public under section 105(1) of the SFO.

- as to the character, experience and integrity of the directors of any investment company, its management company and/ or its investment adviser (if any) and the fitness and competence of each of them; and
  - that the executive management committee has had satisfactory experience in the professional management of investments on behalf of third party investors.
11. There is no explicit standard for measuring the fitness and competence of any person who acts as an investment company's director or investment manager/ adviser. The Exchange ordinarily expects a high standard of integrity and competence from those who are responsible for giving investment advice to an investment company.
12. Information to facilitate the Exchange to assess whether Rule 21.04(1) is satisfied includes:
- (a) their years of experience in professional management of investments on behalf of third party investors and/ or providing investment advisory services to professional/ institutional investors;
  - (b) the types and geographical coverage of the investments they managed;
  - (c) the fund sizes (including investment objectives and policies) and performance during the period under their management which should essentially be comparable to the proposed size of the investment company to enable the Exchange to appraise their experience in managing third party funds;

Performance indicators such as the net asset value of the managed funds; their absolute performance; and their relative performance compared to that of other major managed funds and relevant indexes should be disclosed.

In one case, the Exchange did not consider the investment company's executive directors and the investment manager's directors suitable nominees for their posts where:

- the size of the portfolios previously under these persons' management was much smaller than the company's;
  - some portfolios had a limited track record; and
  - the portfolios had generally recorded negative returns and underperformed compared to their respective benchmarks.
- (d) their roles and responsibilities in the present and past job positions, and how their work experience would help them perform their current roles in the investment company and/ or its management company taking into consideration the performance of the funds managed;
  - (e) details of their licences, academic and professional qualifications, including the year they were obtained and the granting institutions;
  - (f) any breaches of laws, rules and regulations in the relevant industry which have bearing on their integrity and/ or competence.

The Exchange will carefully examine the explanations given for non-

compliances. Explanations like negligence or inadvertence reflect on a person's experience and competence in handling third party funds, although the Exchange takes into account when the non-compliances occurred and what experience the person has gained since then.

For non-compliances related to integrity (e.g. market manipulation, failing to act in the best interest of clients on execution of orders), inexperience is not generally an acceptable explanation.

13. The information referred to in paragraph 12 must be disclosed in the listing document. The Exchange may not approve the persons taking up the relevant positions in the investment company if the information is not available.
14. The sponsor must confirm to the Exchange, with basis, the suitability of the persons proposed to be investment company's executive directors, investment managers/ advisers.

### **Conflicts of Interest (*Added in September 2011*)**

15. Potential conflicts of interest arise where an executive director is also a director/ senior managing member of the investment manager; or where an investment manager manages both the investment company's funds and other funds.
16. Under these circumstances, the investment company must demonstrate a satisfactory internal control mechanism to deal with conflict situations .

This includes:

- (a) each executive director/ investment manager/ adviser must demonstrate that he is able to devote sufficient time and resources to look after the investment company's affairs;
- (b) each conflicted person must maintain the confidentiality of the information of the investment company and other funds managed by him in accordance with the standards under any professional codes to which he is subject;
- (c) the listing document must disclose a fair process for allocating investment opportunities between the investment company and the other funds managed by each conflicted person in a timely and equitable manner:

Where the investment manager manages funds other than the investment company's

- (i) the investment manager should have sufficient staff to serve the investment company and compliance officers to perform daily review of order allocation to ensure that all orders are allocated fairly under its internal control measures;
- (ii) the investment manager must disclose to the investment company's board of directors any potential investment opportunities and ensure that the investment company is given the opportunity to decide whether to participate in those investments before entering into those investments on behalf of other clients or on its own account;

- (iii) if the investment company and the investment manager's other clients are interested to participate in the same investment and the available investment is insufficient to satisfy these demands, the investment company should allocate the investment to the investment company and other clients on a pro-rata basis depending on the respective subscription requests.

When deciding the subscription size of any investment for the investment company and other clients, the investment manager/ adviser must consider factors such as current weighting of assets, risk parameters, market outlook, constraints of investment exposure and the financial resources available to the investment and other clients.

Where an investment company's director also manages other third party funds:

- (iv) the number of conflicted directors must not be so excessive as to paralyse the decision making process of the investment company;
  - (v) each conflicted director must before entering into any transaction disclose to the investment company's board of directors the potential investment opportunities; and must abstain from voting on decisions whether to invest in those transactions;
  - (vi) the independent non-executive directors (INEDs) must participate in the board meetings to assist the non-conflicted directors to make decisions in conflicted situations;
  - (vii) the INEDs must have sufficient expertise and knowledge in running an investment management business on behalf of third parties; and
  - (viii) the non-conflicted directors and the INEDs collectively must have sufficient experience and knowledge to ensure the proper function of the board of directors. They must be able to seek independent advice from external legal counsel or other professionals to assist them in arriving at investment decisions.
17. The sponsor must confirm to the Exchange that the potential conflicts of interest are satisfactorily managed to ensure the smooth running of the company's affairs and the interests of shareholders are not compromised as a result.

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