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# Reduction Of The Minimum Shareholder Requirement For The Market Capitalisation/Revenue Test From 1,000 To 300 Effective 1 February 2011

## Introduction

Hong Kong Exchanges and Clearing Limited ("**HKEx**") published Consultation Conclusions on 21 January 2011 regarding proposed changes to the Market Capitalisation/Revenue Test under the Listing Rules for the Main Board. HKEx published a consultation paper on 10 September 2010 seeking views on a proposed reduction of the minimum shareholder requirement for the Market Capitalisation/Revenue Test from 1,000 to 300 shareholders. Following the receipt of eleven responses from assorted market practitioners, all of whom supported the proposals, HKEx has elected to adopt the changes outlined in the Consultation Paper and Conclusions. The Consultation Paper and Conclusions are available to view in full on the HKEx website at [*here*](http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2010092.pdf) and [*here*](http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2010092.pdf) respectively.

 The changes have been implemented through the amendment of the relevant listing Rules and are effective from 1 February 2011. The opportunity has also been taken by HKEx to redraft the Listing Rules affected by the changes in more accessible language.

## Background To The Reforms

Following a 2008 review by an outside consultant of the quality and competitiveness of the Listing Rules, HKEx decided to undertake an examination of the eligibility requirements for Listing Applicants. The Consultation Paper of September 2010 was published as part of this process.

## Previous Regulatory Framework

An applicant for listing on the Main Board can choose between three different listing eligibility tests; the Profits Test (MB Listing Rule 8.05(1)), the Market Capitalisation/Revenue/Cash Flow Test (MB Listing Rule 8.05(2)), or the Market Capitalisation/Revenue Test (MB Listing Rule 8.05(3). Under the former two tests, the Listing Rules demand the distribution of shares to a minimum of 300 shareholders. However the difference between the previous regulatory framework and that which is about to come into force is that under the Market Capitalisation/Revenue Test (MB Listing Rule 8.05(3)), the obligation imposed by the Rules was for a distribution to 1000 shareholders.

Additionally, exclusively under the Market Capitalisation/Revenue Test, an applicant can use the waiver available via MB Listing Rule 8.05A and list with a shorter trading record period than three years, conditional upon directors and management having sufficient levels of experience.

## Background To The Reform

The Consultation Paper outlined three key reasons why HKEx wished to reduce the minimum shareholder requirement for the Market Capitalisation/Revenue Test from 1,000 to 300 shareholders:

1. This test imposes a more burdensome obligation than that of the Profit Test and the Market Capitalisation/Revenue/Cash Flow Test, both of which require distribution to at least 300 shareholders. The feedback from market practitioners was that the increase of this number to 1,000 for the third test acted as a hindrance to listing for those applicants with a large market capitalisation and revenues, but who could not secure sufficient retail investor interest. The obstacles placed in the way of applicants by the enhanced shareholder requirement are aptly demonstrated by the fact that from 2004-2009, only ten companies out of 352 (3%) listed under the Market Capitalisation/Revenue Test.
2. As applicants seeking to list under the Market Capitalisation/Revenue Test may have higher risk investment profiles, they are not suitable candidates for large scale retail investor interest. Such applicants are not required to be profitable or have a minimum cash flow and are permitted to have a track record of under three years duration, factors which may discourage retail investors. In such circumstances, as one respondent noted, it is hardly appropriate to require such applicants to attract a higher level of retail investor interest than those applicants availing of the other two tests.
3. An open market and desirable level of retail investor participation is already ensured by the large public float requirement of the Market Capitalisation/Revenue Test (at least HK$1 billion) and a minimum requirement for 300 rather than 1,000 shareholders.

## The New Regulatory Framework

As discussed above, under the new system applicants for listing who opt to use the Market Capitalisation/Revenue Test will now be required to have at least 300, as opposed to 1000, shareholders. This change in the regulatory structure will be achieved via the Exchange removing MB Listing Rule 8.05(3)(f) and making a consequential amendment to MB Listing Rule 8.08(2).

## Respondent Query On Ascertaining Actual Number Of Shares Distributed

Two respondents to the Consultation Paper raised concerns regarding the difficulty of calculating the actual distribution of shares in accordance with the minimum shareholder requirement. Their unease stemmed from the fact that a large number of investors submit an initial public offering application through their brokers or bank. Subsequently, their shares are registered under the name of Hong Kong Securities Clearing Company Nominees Limited ("**HKSCC Nominees Limited**") and held in electronic form in the Central Clearing and Settlement System.

The result of this is that all shares applied for in such a manner are held in the name of HKSCC Nominees Limited, which led the respondents to question whether this made the identification of the individual shareholders problematic. One market practitioner suggested that the number of shareholders who should be counted for the purpose of the minimum shareholder requirement were those individuals who had been successfully allotted and issued shares.

However, HKEx responded in the Consultation Conclusions that as regards the minimum shareholder requirement, they preferred to rely on the sponsor’s proper application of the due diligence process and its statement of the number of investors (i.e. beneficial shareholders) who are recipients of shares at the time of listing. As no problems have been recorded with this practice, HKEx state that they do not intend to clarify the Rules any further.

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