DECEMBER 2019 AND JUNE 2020 SUPPLEMENT

Qualification Programme

Module B
Corporate Financing

Hong Kong Institute of Certified Public Accountants
香港會計師公會

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Changes at a glance

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Introduction

This Supplement is to be used in conjunction with the sixth edition of the Learning Pack, and it will bring you fully up to date for developments that have occurred in the period since publication of the Learning Pack and 31 May 2019, the cut-off date for examinable standards and legislation for the December 2019 and June 2020 examinations.

The Supplement comprises a technical update on developments that will be examinable in December 2019 and June 2020 examination sessions that are not currently covered in the Learning Pack. The topics covered are listed on the contents page, and again are covered in chapter order.

In each case the text in the Supplement explains how the Learning Pack is affected by the change, for example whether the new material should be read in addition to the current material in the Learning Pack, or whether the new material should be regarded as a replacement.

Good luck with your studies!

Technical Updates – Learning Pack

Chapter 1	Ethics in business

Added to section 7.4.2 Page 27

The GRI's G4 guidelines were superseded in 2018 by the GRI's Sustainability Reporting Standards. These standards continue to emphasise the need to focus on significant economic, environmental and social impacts, or what substantively influences the assessments and decisions of stakeholders.

The Standards require the following general disclosures:

- Organisational profile
- Strategy
- Ethics and integrity
- Governance
- Stakeholder engagement
- Reporting practice

The organisation should also explain why the topics covered are material, including the boundaries (where the impacts occur and the organisation's involvement in those impacts) and how the organisation manages the topics.

Updated section 7.6 Page 29

7.6 The Environmental, Social and Governance Reporting Guide

Globally, there has been a marked increase in the amount of policy and regulation calling for environmental, social and governance (ESG) reporting. Most countries with policies in this area adopt a combination of laws, listing rules, 'comply or explain' and/or voluntary guidelines to regulate the disclosure of ESG information.

7.6.1 HKEx requirements for ESG reporting

In 2012, the Hong Kong Stock Exchange announced an amendment to its Main Board Listing Rules to include a rule (Rule 13.91) whereby companies were 'encouraged' to produce an ESG report annually, either as a separate report or as part of the annual report.

An Appendix to the Listing Rules included an **Environmental, Social and Governance Reporting Guide.**

On 21 December 2015, HKEx published new requirements for ESG reporting in the 'Consultation Conclusions on Review of the Environmental, Social and Governance (ESG) Reporting Guide'. All companies listed on the HKEx were affected, and the new requirements apply to financial years commencing on or after January 2016.

HKEx believes that the long-term benefits that ESG reporting can bring to issuers, as well as to the quality, sustainability and reputation of the Hong Kong market, outweigh any cost or other disadvantages. It is also seen as important for Hong Kong to align itself with international best practice in this area.

The main changes to the ESG Guide included that issuers are now required to state in their annual reports or ESG reports whether they have complied with the 'comply or explain' requirement, and if not, to give reasons.

The Guide was also re-arranged into two subject areas – (A) Environmental and (B) Social as follows.

Environmental

- Emissions
- Use of resources
- The environment and natural resources

Social

- Employment
- Labour standards
- Supply chain management
- Anti-corruption
- Health and safety
- Development and training
- Product responsibility
- Community investment

The original Guide introduced in 2012 was intended to be the first step in an evolutionary process, with the longer term goal of achieving better and more comprehensive ESG reporting by issuers. The emphasis of the new 2015 requirements is to raise the level of general obligation in ESG reporting, given that there was evidence that many issuers were waiting for the recommended disclosures of the ESG Guide to be upgraded to 'comply or explain' before they began to report.

The 2012 version of the Guide recommended in general terms what the report disclosures should cover, and presented a list of suggested key performance indicators (KPIs). These recommended General Disclosures were upgraded in 2015 to 'comply or explain' with effect from 1 January 2016. It is intended that the requirement for companies to disclose information on their policies in respect of ESG issues, as well as their compliance records with relevant laws and regulations on a 'comply or explain' basis should enhance transparency and raise the overall level of communication.

The KPIs in the Environmental subject area were also upgraded to 'comply or explain', effective for financial years commencing on or after 1 January 2017. The aim of this was to prompt companies to consider how their performance in respect of emissions, waste production and disposal, and use of resources impacts the environment, and how to minimise these impacts and communicate this information to stakeholders.

	ESG reporting guidelines The boards are charged with the responsibility for overseeing ESG risks, so there must be a suitable governance structure in place to keep the board informed of these risks. Effective management systems should be established, including robust systems that can capture data on relevant areas so that management can decide how to deal with the risks that are present. The following Reporting Principles should be applied in the preparation of an ESG report, concerning both the content of the report and how that content is presented: (a) **Materiality** All companies face a range of ESG issues, with varying impacts on the business and its stakeholders. The most significant issues should be given priority. (b) **Quantitative**: KPIs will be used for analysis and decision-making by ESG report users. Companies should therefore establish measurable KPIs and targets wherever possible in their reports, and support them with explanation. (c) **Balance**: The ESG report should provide an unbiased assessment. (d) **Consistency**: The issuer should use consistent methodologies to allow for meaningful comparisons of ESG performance over time. Whilst many issuers publish their ESG information as a part of the annual report, some opt for publishing this information on their websites or in standalone reports. A substantial number of issuers publish ESG information in more than one format. HKEx proposes to continue to allow multiple formats of ESG reporting so as to give issuers the flexibility to issue ESG reports in the form that best suits their circumstances. From the Hong Kong perspective, it is important to maintain appropriate ESG reporting and quality disclosures, so as to match international standards and continue to attract global investors and maintain the city's status.
Added to section 7.6.2 Page 27	In April 2019 the Securities and Futures Commission provided guidance to management companies of SFC-authorised unit trusts and mutual funds on enhanced disclosures for SFC-authorised green or environmental, social and governance funds. The guidance is part of the Strategic Framework for Green Finance aiming to facilitate disclosure and reporting of green-related investment products. The guidance focuses on requiring investment managers to show how they integrate ESG factors into the criteria used in their investment selection process. A green or ESG fund should invest primarily in investments to reflect the particular green or ESG investment focus which the fund represents. Funds should disclose: • A description of the key investment focus • A description of the investment strategies, including ESG principles adopted, investment selection process, any excluded investments and risks associated with the investment theme

Chapter 7	Treasury management

Added to section 1.2 Page 265

Case study: 'One Belt, One Road'

In 2015, the Chinese Government launched the 'One Belt, One Road' (OBOR) initiative, which will involve significant infrastructure investment in over 60 countries in the next decade along the land and sea route of the Medieval Silk Road. Setting up a Corporate Treasury Centre (CTC) overseas has become a priority for companies who are investing in this initiative, in order to manage cash pools, offshore financing, foreign exchange and other key treasury risks. The launch of the OBOR initiative is expected to further enhance international trade and investments across economies in Asia, Europe and Africa, and strengthen the position of Hong Kong as a regional hub for corporate treasury activities.

The initiative aims to further the country's influence and trade links, mainly in Asia and Europe. It proposes the creation of new economic corridors, spanning countries that contain almost two-thirds of the world's population and account for one-third of the world's wealth. OBOR is intended to enable closer connections and new opportunities for trade, investment, economic activities, technological innovation, and the movement of people.

Under OBOR, over the next few decades China plans to build a land-based 'Silk Road Economic Belt' and a 'Maritime Silk Road'. The initiative will involve massive use of concrete, steel, chemicals and metals. Hundreds of thousands of workers and huge use of transport will be also needed to build new power stations, mines, energy projects, roads, railways, airports and container ports.

New sections 1.3–1.5 Page 265

1.3 Technology and the treasury function

There is a variety of technological tools available today to improve the efficiency of treasury operations in such areas as cash management, investment and debt management, and foreign exchange capabilities. Many systems are now integrated with trading platforms and bank portals, and include customised reporting tools.

Inefficiencies and weaknesses that may expose the treasury function to greater risk include the following:

- Duplication of effort, such as the re-input of information
- Tasks which take too long to complete, or are frequently delayed
- Poorly functioning links with older ('legacy') systems or those of other departments
- Management reports incomplete, inaccurate, late or in the wrong format
- Inaccurate cash flow forecasts
- Credit risk not properly identified
- Difficulty in complying with accounting standards

When applied to addressing such difficulties, technology can bring benefits in many areas of treasury management.

- Cash and liquidity management – with improved visibility of cash flows around the business, a greater understanding of pooled cash positions and improved cash flow forecasts can be achieved
- Transactions – speedier settlements, confirmation of deals and timely reporting will result from improved interfaces between trading systems

- Debt management – understanding of the company's debt position in terms of its outstanding loans, mortgages and lease finance
- Greater control over financial risk management – foreign exchange risk, interest rate risk and the management of specific instruments for associated hedging strategies can be more tightly controlled
- General risk management – understanding of exposure limits, credit limits, authorisation levels and the undertaking of scenario and sensitivity analysis should help to reduce risk exposure and ensure compliance with company procedures
- Access controls – resulting in improved security, clear audit trails and tracking of transactions

1.3.1 FinTech

Financial technology (FinTech) is having a big impact on the wider finance environment that the treasury function faces. Impacts on the treasury function include:

- Competitors to banks in providing various services, including investing, lending, money transmission and foreign exchange
- Payments increasingly not being a physical exchange (such as cash or cheque) but a value transfer based on payer, payee and transaction details
- New businesses providing payment security and verification
- Availability of financial advice, driven by algorithms
- Virtual banks without branches, call centres or complex systems
- Availability of risk monitoring capabilities for market and liquidity risks
- Automatic limits monitoring
- Availability of accurate and risk-adjusted valuations of financial instruments
- Flexibility to adapt to new developments, such as enhancement of the Cloud

1.3.2 Blockchain

Blockchain is a digital ledger that allows information to be recorded and shared with a network of individuals. Blockchain uses internet technologies to verify and record transactions. All the information is then available to the participants in the blockchain network. Information blocks cannot be changed once entered without changing all subsequent information blocks, which requires the consent of the participants.

The information is held in a decentralised form, with all elements (nodes) having a copy of the whole blockchain. The decentralised arrangements mean the blockchain data cannot vanish, which would be a risk if it was held in a centralised form.

Blockchain allows organisations providing financial services such as accountants and banks to verify the background and transactions of new clients, which is particularly important for complying with money laundering regulations. It also helps providers of finance to make better-informed decisions about whether they should lend to potential borrowers. Accountants and auditors will be able to verify more easily the transactions underlying financial statements.

Other implications of blockchain technology include:

- Quicker processing of transactions and funds exchanged by banks
- Smart contracts, which have a set of agreed conditions; when these conditions are fulfilled, the contracts are automatically completed
- Allowing the operation of cryptocurrencies

1.3.3 Cryptocurrencies

A cryptocurrency is a digital currency that uses internet technologies to enable online transactions. Cryptocurrencies do not exist in physical form. Bitcoin is a well-known cryptocurrency. Unlike traditional currencies, cryptocurrencies are not controlled by a central bank.

A vital element of cryptocurrencies is the use of cryptography to encrypt the code behind the currencies so that criminals cannot counterfeit them. Cryptocurrencies also make use of blockchain technology, which means that the transactions are verified and recorded on the distributed technology.

As an increasing number of organisations are involved in Bitcoin transactions, other businesses may in time have to develop their financial and IT systems so that they can accept cryptocurrency payments.

However, many experts have warned of the possibility of a collapse in the value of cryptocurrencies, seeing them as speculative bubbles. There were significant falls in the value of Bitcoin during 2017 and 2018.

In February 2018, Hong Kong's Securities and Futures Commission warned a number of Hong Kong exchanges against trading in initial coin offerings. In December 2018, plans for new regulations in Hong Kong were announced, subjecting exchanges and traders to the oversight of the Securities and Futures Commission and requiring investment funds to be licensed if more than 10% of the assets they manage are made up of cryptocurrencies.

1.4 Software as a service

In addition to employing technology in-house, there is growing use of software as a service (SaaS). SaaS solutions employ internet technology and remote servers, enabling users to access software online from anywhere, using a device with an internet connection. The software does not need to be installed on hardware in the company's offices. There are several advantages to this for a treasury function:

- It could remove the need for an internal IT capability
- The supplier is responsible for all updates and maintenance, so the user gets access to these as part of its subscription fee
- Costs can be adjusted according to the company's own requirements (for example, number of transactions or number licensed users).

1.5 Cyber security

In general, cyber attacks will target money, or information (such as credit card details). A firm's systems may also be targeted as an entry to another firm that it has dealings with. It is therefore critical that all firms are aware of the potential cyber risk, and to put appropriate measures in place.

As the use of technology increases exponentially, new weaknesses are identified and the overall level of cyber threat increases. Cyber threats can include the following:

- Stealing of confidential data/information
- Fraudulent payments
- Denial of service attacks – flooding a server with information requests so that it crashes
- Ransomware – malware that blocks system access, or disrupts it until a ransom fee is paid

It is important to identify the most critical company information, data and processes that may come under attack, so that cybersecurity efforts can be prioritised and appropriate policies developed. Companies need to ensure that processes that attract cybercrime, such as payment processing, are reviewed and controls embedded including segregation of duties, enforcement of approval limits and daily reconciliations. As well as appropriate technical measures (such as encryption and anti-virus software), cybersecurity policies should take account of human factors:

- Directors must understand the effects that a cybersecurity breach could have – strong corporate governance and clear policies must be in place
- The Board should be aware of the guidance issued by government agencies, and all employees trained in cyber and information security
- There should be appropriate restrictions around sensitive data, and the company should have clear computer use policies
- Insurance policies should cover the effects of a cyber breach
- Incident response plans should be in place, well-rehearsed and understood

Updated section 2 Page 266

2 Hong Kong as a centre for treasury operations

2.1 Locating corporate treasury activities

International companies operate in an environment of multiple currencies, regulatory and interest rate regimes, in areas such as obtaining capital, managing liquidity, managing risk and processing transactions. An increasing number are using corporate treasury centres (CTC) to simplify and centralise their treasury activities. As discussed in Section 1 above, the functions of a centralised CTC can include carrying out intra-group financing activities and providing other corporate treasury services and transactions. The CTC thus plays an important role in supporting the cash management and funding of international business activity.

There are many factors to consider when deciding where to locate a CTC.

- Tax rates
- Bilateral tax treaties
- Quality and availability of staff
- Language abilities
- Government incentives
- Market liquidity
- Proximity to support staff (bankers, lawyers, consultants, accountants)
- Jurisdiction stability
- Rule of law

Having been undermined in the past by existing tax rules, the attractiveness of Hong Kong as a regional hub was addressed with the amendment of its Inland Revenue Ordinance in the 2015/16 Budget. The objective of this amendment was to attract multinational and Mainland corporations to centralise their treasury functions in Hong Kong and make it more competitive with other regional financial centres such as Singapore.

Under the amended Ordinance, in order to be a qualifying corporate treasury centre it must be a separate legal entity solely dedicated to the conduct of one or more of the following corporate treasury activities:

- Carrying on an intra-group financing business
- Providing corporate treasury services
- Entering into corporate treasury transactions

The Ordinance contained two key tax concessions for qualifying corporate treasury centres which came into effect from 1 April 2016:

- Interest expenses related to intercompany borrowings are tax deductible, (provided that the corresponding interest income is taxed outside Hong Kong at the same or a higher rate). Companies making intercompany transfers within the same group through Hong Kong will not suffer a tax penalty for doing so.
- Additionally, profits tax for qualifying treasury activities undertaken by corporate treasury centres were halved, from the regular Hong Kong corporate tax rate of 16.5% down to 8.25%. Companies need to set up a separate legal entity to encompass all their treasury activities in order to benefit from this new 8.25% tax rate, but unlike in Singapore there is no need to apply to get approval for corporate treasury centre status. The 8.25% tax rate applies automatically when the tax return is submitted.

Qualifying corporate treasury services include the following:

- Managing cash and liquidity
- Processing payments to vendors or suppliers
- Managing relationships with financial institutions
- Providing corporate finance advisory services
- Advising on the investment of funds
- Managing investor relations
- Providing guarantees, performance bonds and other credit risk instruments
- Providing advice on the management of interest rate risk
- Providing assistance in mergers and acquisitions
- Providing advice in regard to accounting policies, treasury policies and regulatory requirements
- Providing operational advice on the treasury management system
- Undertaking economic or investment research and analysis

Qualifying corporate treasury transactions include the following:

- Transactions related to the provision of guarantees, performance bonds, standby letters of credit or other credit risk instruments
- Transactions investing the funds of the corporation in deposits, certificates

of deposit, bonds, notes, debentures, money market funds and other financial instruments

- Transactions entered into for the purpose of hedging interest rate risk, foreign exchange risk, liquidity risk, credit risk and commodity risk – including foreign exchange contracts, forward or futures contracts, swaps and options
- Transactions involving factoring or forfaiting activities

Case study: COSCO Shipping

China COSCO Shipping Corporation Ltd (COSCO) is a large state-owned enterprise involved in a range of shipping-related activities, including the maintenance and management of container terminals, transport solutions, financing and ship building and repairs.

Hong Kong is its most significant location outside China, as it is an important centre for obtaining additional capital for the investment activities generated by the Chinese government's 'One Belt, One Road' initiative.

Hong Kong is a vital centre for COSCO's cash management and financing activities as it represents a mature financial market with a good local understanding of Chinese companies.

COSCO's treasury centre in Hong Kong undertakes a range of activities.

- International payments – global treasury management and supplier payments
- Cash management – cash pools set up in various countries, with excess cash centralised in Hong Kong
- Foreign exchange management – to manage and reduce foreign exchange risk
- Debt financing – bonds, syndicated loans and ship leasing
- Equity financing – several subsidiaries of COSCO have listed in Hong Kong

The network of prominent banks in Hong Kong, with access to their suite of products, services and technology, is another key factor in the attractiveness of Hong Kong as a corporate treasury centre for international companies such as COSCO.

(Source: *'Corporate Treasury Centres in Hong Kong – Case Studies'*, Invest Hong Kong and Hong Kong Monetary Authority, October 2016)

2.2 Cybersecurity in Hong Kong

Hong Kong has not introduced stand-alone cybercrime or cybersecurity legislation, but the Telecommunications Ordinance, Crimes Ordinance and Theft Ordinance were amended to include computer-related criminal offences. These include:

- unauthorised access to any computer;
- misuse of a computer program or data;
- making false entries in banks' books of accounts by electronic means;

- obtaining access to a computer with the intent to commit an offence or with dishonest intent; and
- unlawfully altering, adding or erasing the function or records of a computer.

In addition, the Hong Kong Government supports a number of organisations dedicated to responding to cyber threats. The Hong Kong Police Force established the Cyber Security and Technology Crime Bureau, responsible for handling cybersecurity issues and incidents of computer crime.

As regulators, both the Securities and Futures Commission (SFC) and the Hong Kong Monetary Authority (HKMA) have issued circulars on cybersecurity risk. In 2016, the HKMA announced the 'Cybersecurity Fortification Initiative', undertaken in collaboration with the banking industry. This includes a Cyber Resilience Assessment Framework which comprises three stages:

(a) Inherent risk assessment – an assessment of the level of inherent cybersecurity risk and categorising it into 'low', 'medium' or 'high';

(b) Maturity assessment – an assessment determining whether the actual level of cyber resilience matches the level of inherent risk; and

(c) Intelligence-led Cyber Attack Simulation Testing – a test of cyber resilience by simulating real-life cyber attacks. Institutions with an inherent risk level assessed to be 'medium' or 'high' are expected to conduct this testing.

In May 2017, the SFC issued a circular alert on ransomware threats in the securities industry. In such attacks, files are maliciously encrypted and a ransom is requested in order to recover them. In its circular, the SFC emphasised that all licensed corporations should be alert to cybersecurity threats, and implement measures to address the risk of cyber attack. The following preventive measures are listed:

- Apply the latest security update to computers and network devices
- Install and properly set up a firewall for connecting devices to the internet
- Perform offline backup
- Do not open links and attachment in suspicious emails
- Do not connect any device to the office network before proper verification of the security
- Ensure that anti-virus software is installed and kept updated

Licensed corporations are expected to take actions to critically review and assess the effectiveness of their cybersecurity controls, and they are expected to report any major cybersecurity incident to the SFC.

2.3 Development of Greater Bay Area

The attractiveness of Hong Kong as a location for corporate treasury centres will also be influenced by the development of the Greater Bay Area. A key part of the Greater Bay Area plan (linking Hong Kong, Macao and nine other Chinese cities) is enhanced financial connections. The plan aims to enable cross-border treasury management and settlement arrangements for trade and investment.

The development of the Great Bay Area could have many implications for treasury activities, including the following:

- Being able to open PRC bank accounts in Hong Kong

- Availability of cross-border branches
- Being able to make cross-border payments electronically
- Expanding the functions of offshore accounts
- Enhanced availability of capital through encouragement of investment by institutional investors in capital markets
- Broader use of cross-border lending by banks
- Companies being able to issue Renminbi bonds cross-border
- Greater availability from banks of Renminbi spot/forward trading and derivatives, also development of new commodity and other risk management products
- Access to new cross-border insurance products
- New specialised financial services in areas such as ship finance, financial technologies and transport leasing

Planned support for financial services and treasury activities includes:

- Promotion of mutual financial markets access
- Development of a network service platform for cross-boundary economic and trade cooperation
- Development of a new international trade centre and a settlement platform for trade in goods
- Support for Mainland enterprises establishing capital operation and corporate treasury centres in Hong Kong
- Encouragement of cross-border acquisitions, mergers and other enterprises
- Measures to promote the control of financial risks, strengthening responsibilities and taking action against illegal acts

Chapter 8 Working capital management

Amendment to section 7.6 Example: Settlement discounts

Page 312

A company has annual credit sales of $30m, with two months being the usual credit period given to customers. Not all customers, however, adhere to the policies as evidenced by the actual receivables ageing record as follows:

Actual credit terms	% of customers
2 months	60
3 months	40

Average collection period is therefore = $(2 \times 0.6) + (3 \times 0.4) = 2.4$ months

The company's management decide to offer a 15% discount for payments made within 14 working days (assuming one year = 350 working days) of the invoice being raised. It is estimated that 80% of customers will take the discount and the remainder will use the existing credit terms of two months.

If such a scheme is offered to customers, sales will increase by 20% (at a contribution margin of 30%) and bad debts will be reduced from 10% to 6% of credit sales. The company requires a 25% per annum return on investment.

Is implementation of the early settlement discount scheme worthwhile in financial terms?

Without discount	$m	*With discount*	$m
Contribution earned			
$30m × 30%	9.00	$30m × 1.2 × 30%	10.80
Costs			
Discount given			
N/A	0.00	$30m × 1.2 × 0.8 × 15%	(4.32)
Bad debts			
$30m × 10%	(3.00)	$30m × 1.2 × 6%	(2.16)
Cost of working capital invested			
$30m × 2.4/12 × 25%	(1.50)	$30m × 1.2 × 0.8 × 14/350 × 25%	(0.29)
		$30m × 1.2 × 0.2 × 2/12 × 25%	(0.30)
	4.50		3.73

The company should not adopt the early settlement discount scheme, as it results in a net decrease in benefits of $0.77 million.

Amendment to section 7.10

Page 316

(d) Taking out export credit cover/insurance or means of export finance, factoring or forfaiting house to reduce default risk.

New section 8.1
Page 317

8.1 Supply chain finance

Supply chain finance, or reverse factoring, is when a supplier sells invoices to the bank for a discount, once the customer has approved the invoices and the supplier has selected which of the approved invoices to sell. The supplier is paid earlier, and the customer can pay later, improving the working capital of both. In exchange for the fee from the supplier, the bank is relying on one customer, generally with a good credit rating and who has approved the invoices, rather than a group of customers as would be the case with factoring.

As the customer, rather than the supplier, initiates the process and bears the risk, the discount is lower than it would be if the supplier initiates the process. As soon as the supplier receives the money, its position is protected and the bank has to obtain the money owed from the customer. The bank should obtain some reassurance from the customer's credit rating and should also have credit protection insurance.

The arrangement allows the customer to settle many or all suppliers with one financier, which eases supplier management. Relations with suppliers should be better as their liabilities are settled sooner. The arrangement can often result in suppliers extending credit periods. The process of reverse factoring can also be made more efficient by using Fintech to establish a platform and digitalise business transactions.

Chapter 9 **Types and sources of finance**

Amendment to section 5.4.3

Page 355

The annual payment = $100m/3.890 = $25.707m

Chapter 15	Regulatory environment
Update to section 1.1 Page 575	To highlight its new role as a standalone market for small and medium sized companies, the Growth Enterprise Market was renamed "GEM" with effect from 15 February 2018.
Update to section 3.2.3 Page 586	The Corporate Governance Code was strengthened in January 2019 to reflect concerns about the role and contribution of Independent Non-Executive Directors (INEDs). New requirements included greater disclosure on the identification process of possible INEDs and providing assurance that possible INEDs will be able to devote sufficient time to the board if the new directorship will be their seventh or more listed company directorship. There is also a requirement to state how new directors would contribute to the diversity of the board, as well as the perspectives, skills and experience that they can contribute. Issuers will be required to disclose their board diversity and nomination processes. Diversity is defined as including, but not limited to, gender, age, cultural and educational background, and professional experience.
Update to section 6.3.2 Page 594 para (e)	**Minimum requirements for listing on the Main Board** (e) With effect from 15 February 2018, at the time of the expected date for admission to listing, the minimum expected market capitalisation was increased to HK$500,000,000 from HK$200,000,000 and the expected market value of the securities held by the public must be at least HK$125,000,000. (At least 25% of the company's total number of issued shares must be held by the public at all times. Not more than 50% of the number of shares held by the public at the time of listing can be beneficially owned by the three largest public shareholders.)
Update to section 6.3.5 Page 595	**Applications for a listing on GEM** With effect from 15 February 2018, the GEM Listing Rules were amended as follows: (a) An increase to the minimum expected market capitalisation of a new applicant at the time of listing from HK$100 million to HK$150 million (b) An increase to the minimum public float value of a new applicant at the time of listing from HK$30 million to HK$45 million (c) An increase to the minimum cash flow requirement for a new applicant from HK$20 million to HK$30 million Accordingly, the table on page 596 has been updated in the following areas:

	Minimum requirements for listing	
	Main Board	**GEM**
Type of company	Large and well-established companies that meet the Main Board's requirements.	Small and medium sized companies that meet the GEM's requirements.
Financial requirement	Must pass one of three tests	Must pass a financial test
	Profits test: Profit of at least HK$20 million in its most recent financial year and at least HK$30 million in aggregate in the two preceding years.	• No profit requirement • Market capitalisation of at least HK$150 million at the time of listing. • Positive cash flow from operating activities of at least HK$30 million in aggregate for the two preceding financial years.
	Market capitalisation/ revenue/cash flow test • Market capitalisation of at least HK$2 billion • Revenue of at least HK$500 million for the most recent audited financial year • Positive cash flow from its operating activities of at least HK$100 million in total for the most recent three financial years.	
	Market capitalisation/revenue test • Market capitalisation of at least HK$4 billion • Revenue of at least HK$500 million for the most recent audited financial year	
Minimum market capitalisation for shares	See financial requirements – at least HK$500 million at the time of listing. At least HK$125 million (25%) to be held by the public.	At least HK$150 million at the time of listing. At least 25% (subject to a minimum of HK$45 million) to be held by the public.

	Methods of offering shares for a new listed company	Company may not list by means of a placing only.	A mandatory public offering requirement of at least 10% of the total offer size.

Update to section 6.3.6 Page 597

Transfers from GEM to the Main Board

The amendments to Listing Rules also include new arrangements for transfers from GEM to the Main Board.

- The removal of the streamlined process for a transfer of listing from GEM to the Main Board
- The mandatory sponsor requirement, where a sponsor must be appointed at least two months before the submission of a listing application
- The requirement of the issuance of a 'prospectus-standard' listing document

New section 6.3.7 Page 597

6.3.7 Listing regime for companies from emerging and innovative sectors

The HKEx has changed its Listing Rules to allow for weighted voting rights (WVR) structures and the listing of pre-profit/pre-revenue companies in the biotech industry. This comes in response to concern that the HKEx was not sufficiently open to new economy companies, illustrated by the decision of Chinese company Alibaba to choose the New York Stock Exchange for its listing in 2014. The aim is to create a listing regime that will boost Hong Kong's attractiveness and competitiveness versus other major global listing venues, particularly in respect of attracting new economy companies.

With effect from 30 April 2018, amendments have been made to the Listing Rules to implement the proposals of the '*Consultation Conclusions Paper on a Listing Regime for Companies from Emerging and Innovative Sectors*' (published on 24 April 2018).

The HKEx has also proposed appropriate investor safeguards, recognising the potential risks associated with pre-profit/pre-revenue firms and those with WVR structures. The amendments are summarised below.

(a) **Permit listings of biotech companies that do not meet any of the Main Board financial eligibility tests**

The HKEx offers guidance on the listing eligibility for pre-profit/pre-revenue biotech companies that produce pharmaceuticals, biologics, and medical devices. Manufacturers of other biotech products will be considered on a case by case basis.

Since such issuers will not meet any of the financial eligibility tests of the Main Board, they potentially carry additional risks to investors. These issuers will therefore be subject to high standards, in line with the Main Board requirements. Accordingly, there are detailed eligibility and suitability criteria for determining appropriate applicants, a higher market capitalisation requirement, enhanced disclosure requirements and restrictions on fundamental changes of business.

(b) **Permit listings of companies with WVR structures**

For WVR issuers, safeguards include limits on WVR power and rules to protect non-WVR holders' right to vote, in addition to enhanced corporate governance requirements. An applicant will be required to demonstrate that it is eligible and suitable for listing with a WVR structure, by reference to a number of characteristics, including the nature of the company and the contribution of the proposed WVR beneficiaries.

(c) **Establish a new secondary listing route for China and international companies that wish to secondary list in Hong Kong**

The HKEx aims to strike a balance between facilitating listings of innovative companies that are primarily subject to regulation overseas, and providing appropriate investor protection.

Chapter 16	Financial markets
New section 3.1.5 Page 610	**3.1.5 Virtual banks in Hong Kong** A virtual bank is a bank that primarily delivers retail banking services through the internet or other forms of electronic channels rather than physical branches. As of April 2019, the Hong Kong Monetary Authority had granted four licences for virtual banking. The authority sees development of virtual banking as key to maintaining Hong Kong's position as a financial centre. Virtual banking is seen as driving Fintech and innovation, and also promoting new customer experiences and financial inclusion. One of the new banks, SC Digital, planned to offer a suite of retail financial services, and the ability to open accounts and use financial services on-the-go. New bank Livi VB planned to make the most of technologies such as AI, blockchain, big data and smart risk modelling in offering flexible solutions for customers. The Banking Ordinance requires virtual banks to have a physical presence in Hong Kong, even if they do not operate physical branches. Their owners must be supervised by a recognised authority in Hong Kong or elsewhere. Virtual banks will be expected to comply with the same supervisory requirements as conventional banks, although some requirements will be adopted for virtual banks' business model. The Banking Ordinance lays stress on the banks having a credible business plan for profitability in the medium-term. The Hong Kong Monetary Authority would be concerned if the virtual bank established its market share initially by bearing substantial losses and straining its risk management. As well as managing important risks such as credit, liquidity and interest rate risks, virtual banks must have appropriate procedures to manage technology risks. Controls must be fit for purpose. The adequacy of planned IT governance and systems must be independently assessed. Virtual banks must inform customers of customers' responsibilities for maintaining security when using virtual banking services.
Added to section 8.7.1 Page 619	In 2018 some Hong Kong funds saw a significant inflow despite the overall situation for hedge funds in Asia being poor.

New Section 8.7.2 Regulatory approach to hedge funds Page 619	The management company of a hedge fund must have the competence and expertise, including at least two members having at least five years' relevant experience. To be authorised, the hedge fund would be generally expected to have at least US$100 million total amount of assets. The fund must have a set of clearly defined investment and borrowing parameters. It must disclose the types of financial instruments, the diversification or concentration of investments or strategies, leverage and risk implications. Risk management and control systems must include a due diligence process for the selection of funds and ongoing monitoring processes of fund managers. A hedge fund's financial report must include details of exposures, the top five underlying funds or long and short positions held by the fund, and details of the number of underlying funds or aggregate positions.
Chapter 18	**Mergers and acquisitions**
Amendments to section 3 **Page 665**	First paragraph In Hong Kong, the SFC requires that the management of a listed company performs the necessary due diligence, prior to any merger or acquisition. The purpose of this due diligence exercise is to determine that the information about the target company to be acquired is correct, accurate and properly disclosed. During this process, the parties need to determine that all critical issues have been identified and that key assumptions used in the investment proposal are accurate. Fourth paragraph The process of due diligence is usually carried out by a team whose members have expertise in various relevant functional areas. Those team members are usually employees of the professional firm carrying out the engagement unless a particular expertise is needed that cannot be found within the firm. The team will request documents from various departments within the target company being assessed, which will assist in obtaining the desired information and reaching the desired goals.
Chapter 20	**Business failure and insolvency**
New sections 5.3.2 – 5.3.4 Page 724	**5.3.2 Development of the Z-score model** Variations of the Z-score model have been developed. A version for private companies (Z1 or Z') reflects that they do not have a market value for their share capital. A version was also developed for emerging markets and non-manufacturing industrial companies (Z2 or Z''). The Z'' version omitted the sales/total assets ratio, which was very sensitive to the industry and the country. In addition, interpretations of the original model have been developed as a result of average Z-scores worldwide getting lower, with increased availability of bond market finance. The model has therefore been developed to match Z-score ratings with bond rating equivalents, which change constantly and therefore help keep the assessment updated. The link with the bond market also helps the assessment of the probability of default, based on the incidence of default for the equivalent bond ratings. The most significant problem with using bond ratings worldwide is that the bond ratings are derived from American data.

5.3.3 Z' model for private companies

$Z' = 0.72X_1 + 0.85X_2 + 3.11X_3 + 0.42X_4 + 1.00X_5$

Ratio

Where: X_1 = working capital/total assets
X_2 = retained earnings/total assets
X_3 = earnings before interest and tax/total assets
X_4 = book value of equity/total liabilities
X_5 = sales/total assets

The following table is used to assess the scores for this model:

Z-Score	Prediction
Less than 1.23	High probability of financial distress
1.23 to 2.9	Caution required
Above 2.9	Safe company

5.3.4 Z'' model for emerging markets and non-industrial companies

Ratios X_1 - X_4 are as for Z', with X_5 omitted.

For emerging markets, the formula is $Z'' = 3.25 + 6.56X_1 + 3.26X_2 + 6.72X_3 + 1.05X_4$

The following table is used to assess the scores for this model:

Z-Score	Prediction
Less than 1.1	High probability of financial distress
1.1 to 2.6	Caution required
Above 2.6	Safe company

For non-industrial companies the formula is $Z'' = 6.56X_1 + 3.26X_2 + 6.72X_3 + 1.05X_4$

The following table is used to assess the scores for this model:

Z-Score	Prediction
Less than 1.23	High probability of financial distress
1.23 to 2.9	Caution required
Above 2.9	Safe company

Amendments to Index. Please replace the Index with the one in the following pages.



Index

Note: **Key Terms** and their page references are given in **bold.**

A

B

C

D

E

F

G

H