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Ernst & Young
27/F, One Taikoo Place
979 King's Road
Quarry Bay, Hong Kong

安永會計師事務所
香港鰂魚涌英皇道979號
太古坊一座27樓

Tel 電話: +852 2846 9888
Fax 傳真: +852 2868 4432
ey.com

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BY HAND AND BY EMAIL

Corporate and Investor Communications Department
Hong Kong Exchanges and Clearing Limited
8th Floor, Two Exchange Square
8 Connaught Place
Central
Hong Kong

Dear Sirs,

Consultation Paper on GEM Listing Reforms

Ernst & Young is pleased to respond in this letter to the request of The Stock Exchange of Hong Kong Limited for feedback on the captioned Consultation Paper. Terms used in this letter shall have the same meanings as in the Consultation Paper.

We welcome the Exchange's efforts to encourage and facilitate SME listings and to consider GEM's positioning, market perception and viability as an alternative to the Main Board.

Set out below are our overall observations and comments on some of the key proposals.

Overall observations

It is unclear whether the current proposals will in isolation revive GEM as there are many intertwined issues to consider and deal with. However, we would like to applaud the Exchange for its efforts to engage with a broad range of stakeholders to hear their concerns regarding GEM and develop proposals to address those concerns, to also solicit views from Mainland Institutional SME Investors as to how the GEM Listing Rules could be improved and to put forward proposals from different perspectives.

Liquidity is the key. The HKEX will have to work with the Hong Kong Government and the SFC to improve GEM liquidity.

It is encouraging to have noted that the Government announced on 29 August the establishment of the Task Force on Enhancing Stock Market Liquidity ("Task

Force") to comprehensively review factors affecting stock market liquidity and make improvement proposals to the Chief Executive. The Task Force comprises members from the financial services sector, relevant government officials, as well as representatives from financial regulators and the HKEX. It is stated in the announcement that the Task Force will holistically review key internal and external factors affecting market liquidity, including the listing regime, market structure and trading mechanism and that it will put forward specific recommendations on such matters as strengthening the competitiveness and sustainable development of Hong Kong's stock market, and promoting it to issuers and investors in strategic markets. In the Chief Executive's 2023 Policy Address ("Policy Address") delivered on 25 October, the Chief Executive said that the Task Force had submitted its report and that he had accepted the Task Force's recommendations. A number of measures will be implemented, including the reduction of the rate of stamp duty on stock transfer from the current 0.13% to 0.1% of the consideration or value of each transaction payable by buyers and sellers respectively, the legislative procedures of which is targeted to be completed by the end of November.

The Chief Executive also mentioned a number of measures to deepen financial co-operation in the Greater Bay Area, including co-establishing the Shenzhen-Hong Kong Financial Co-operation Committee with the Shenzhen authorities in the first half of 2024. The committee will advise and offer suggestions in various areas including bolstering mutual access to the financial markets. This, coupled with the HKEX's Memorandum of Understanding signed with the BSE on 29 June for building long-term cooperation in support of cross listings and the HKEX's collaboration with overseas markets, should pave the way for any anticipated cross-trading programmes which may hopefully benefit GEM issuers and investors.

Changing the GEM Listing Rules alone may not be sufficient to increase the attractiveness of GEM and therefore the market perception of GEM. We understand that the Consultation Paper only deals with part of the jigsaw (i.e., the GEM Listing Rules) in the grand scheme of reviving GEM. We hope the more coordinated reform this time can finally put GEM on the right track. Bringing the stamp duty rate to pre-2021 level should help boost market liquidity in the short term; however, it is doubtful whether this will benefit GEM. The concept of market makers on GEM (similar to that for London's Alternative Investment Market) was explored back in 2006 but the HKEX stated in its Consultation Paper on the Growth Enterprise Market in July 2007 that it believed that "changes to the trading mechanism would not fundamentally improve the liquidity of the stocks. Changes to the trading mechanism could provide more scope for market abuse, which would not be in the interests of investors and therefore proposed no change to the trading mechanism on GEM, which is the same as that of the Main Board". We understand that the regulators are mindful of the need to strike a balance between facilitating capital raising opportunities for issuers and protecting the interests of investors. Previous GEM reforms have not achieved the regulators' intentions of reviving GEM. Perhaps it is time to consider a bolder move, such as introducing market makers for GEM and exploring the exemption of stamp duty on GEM share transfer.

New streamlined transfer mechanism

We agree that a streamlined mechanism should be introduced to enable qualified GEM issuers to transfer their listing to the Main Board without the need to appoint a sponsor or publish a "prospectus-standard" listing document, thereby avoiding all the difficulties and expenses associated with a full listing process. A streamlined transfer mechanism should encourage issuers to list on GEM rather than to wait to apply for listing on the Main Board directly.

Track record requirements

One of the proposed requirements for a streamlined transfer of listing from GEM to the Main Board is the publication of financial results for three full financial years as a GEM issuer prior to the transfer (instead of only one full financial year commencing after the date of its initial listing on GEM). The Exchange proposes that a streamlined transfer applicant demonstrates that there has been, throughout its three-year financial track record period, (a) ownership continuity and control, and (b) no fundamental change in its principal business; and explains that these continuity requirements help substantiate the rationale for the removal of sponsor due diligence and publication of a "prospectus-standard" listing document for a streamlined transfer.

We are of the view that three full financial years is too long - applicants might as well wait to list on the Main Board as it may take even longer to get listed on the Main Board by first becoming a GEM issuer. As such, the proposed streamlined transfer mechanism with a three-year wait may hardly increase the attractiveness of GEM as a stepping-stone to the Main Board. We suggest keeping the current one-year requirement. The due diligence standards for a new listing on GEM are no different from those for a new listing on the Main Board. With a one-year wait, GEM issuers eligible for the streamlined transfer would have gone through the stringent listing exercise just the year before and been subject to the continuing scrutiny of the regulators and the market for at least a year.

In fact, when the Exchange first introduced the streamlined transfer mechanism in 2008, it changed its proposal of requiring GEM issuers to have listed on GEM for at least two years to one year. It is quoted in paragraphs 88 to 90 of the

Consultation Conclusions on the Growth Enterprise Market issued in May 2008 that:

"One respondent articulates its objection in the following terms: Imposing a two-year listing and good behaviour record requirement would 'penalise' a GEM company which, for example, meets all the Main Board entry requirements but has not been listed on GEM for two years. Such a company will have to wait for one more year to get listed on the Main Board if it is first listed on GEM (which requires a two-year track record); if in fact it is able to satisfy Main Board listing requirements with a three-year track record after waiting for a year. The Exchange has considered this submission and agrees with the rationale behind it. It was not our intended policy to set up an artificial barrier to make it more difficult for issuers preferring to use the second board as a relatively short-term stepping-stone towards reaching the Main Board as its ultimate aim, vis-à-vis those opting for a direct route to the Main Board. If the original proposal of a two-year waiting period on the GEM is maintained, in effect the total period under assessment and scrutiny would be four years, given that the new admission criteria require two years of operating cash flow plus another two years' listing status. The Exchange therefore concurs with the underlying arguments of the respondents to reduce the waiting period from two years to one year, rendering the total period of financial scrutiny and regulatory assessment three years in total - that is, two years before the GEM listing and one year post-listing. This total period of approximately three years would also accord with the trading record period requirements of the Main Board."

It takes time for GEM liquidity to improve, so positioning GEM as a stepping-stone for the Main Board may have a more instant effect on the appeal of GEM as a listing venue.

Daily Turnover Test and Volume Weighted Average Market Capitalisation Test

The Exchange sets out the rationale for proposing the captioned tests for streamlined transfer applicants in paragraphs 122, 123 and 129 of the Consultation Paper:

"The proposed Daily Turnover Test aims to help ensure that the market capitalisation of a transferee, at the time of its listing on the Main Board, is supported by a minimum level of daily turnover over the Reference Period. We also note that a trading volume based requirement is currently in place for a transfer of listing from the BSE to the STAR Market and the ChiNext Market. For such transfer, a transferee must have at least 10 million shares as accumulated trading volume for consecutive 60 trading days prior to board approval for the transfer announcement. Our proposed liquidity based qualification is therefore in line with the approach taken by the BSE."

"The proposed Volume Weighted Average Market Capitalisation Test (when combined with the proposed Daily Turnover Test) helps mitigate the risk that the minimum market capitalisation is met by a valuation which is inflated or distorted by a limited number of trades when trading turnover is low and helps identify companies with a valuation based on adequate investor demand as targets for the new streamlined transfer mechanism."

The Exchange acknowledges in paragraph 124 of the Consultation Paper that "a high Minimum Daily Turnover Threshold may give greater confidence that the test meets its aims, as set out above. However, we have also noted, from recent cases, that some transfer applicants may have lower liquidity in their shares but still be suitable for transfer to the Main Board. For this reason we seek market views on the appropriate Minimum Daily Turnover Threshold". Instead of choosing between two absolute amounts as the Minimum Daily Turnover Threshold, we wonder whether the test should be set to take into account the fact that GEM is a rather illiquid market (the liquidity of which will hopefully improve over time after the reform), e.g., as the lower of HK$X and Y% of the trading volume of GEM as a whole. This may help address the perceived disparity between the treatment of a rather liquid GEM issuer who fulfilled Main Board eligibility tests but whose trading was restricted in an illiquid market and a rather illiquid existing Main Board issuer who barely had any trading - the former having to go through the full listing process once again in order to be able to list on the Main Board after failing to use the streamlined transfer mechanism. The Exchange may expand Tables 2 and 3 on page 37 of the Consultation Paper to reach a trading volume percentage appropriate for the purpose.

"Reference Period" is defined as the 250 trading days immediately preceding the transfer application and until the commencement of dealings in the applicant's securities on the Main Board. Paragraph 137 of the Consultation Paper states that a streamlined transfer application will be processed by the Listing Division and approved by the Listing Committee. The definition of the Reference Period suggests that the tests will still go on after the in-principle approval of the Listing Committee and therefore there is uncertainty as to whether the streamlined transfer mechanism can be used until the transfer actually happens. We suggest that the line be drawn either at the time of the transfer application or at the time of the Listing Committee hearing.

New alternative eligibility test

In principle, we agree to introduce an alternative financial eligibility test targeting high growth enterprises that are heavily engaged in R&D activities. This may hopefully attract technology and research driven growth companies from the new economy in Hong Kong, the GBA and beyond to come to list on GEM, providing an alternative listing route for companies that are not eligible for listing on the Main Board under Chapters 8, 18A or 18C of the Main Board Listing Rules.

We note that the Exchange proposes a minimum revenue threshold to help ensure that (a) the GEM listing applicant has fully commercialised its products and/or services; and (b) its revenue growth over the track record period is meaningful. The Exchange expects a GEM listing applicant to have fully commercialised its products and/or services to mitigate the higher risk of corporate failure to which such applicant would be subject if it had yet to do so and was unable to secure sufficient external funding to support its operations. These are all legitimate reasons as far as investor protection is concerned. Whether companies that can fulfil such proposed requirements would choose, amongst other listing venues, to list on GEM, a rather illiquid market, is another issue. These companies have their business models tried and tested but are underfunded in terms of their ability to grow and deliver on market opportunities. The most probable ultimate goal for these companies is to list on the Main Board - this again emphasises the importance of a streamlined transfer mechanism that does not impose a lengthy waiting period and is not too stringent as to the liquidity thresholds, so that these companies may choose to list on GEM as a stepping-stone to the Main Board.

The Policy Address mentioned measures to promote the development of green and sustainable finance in Hong Kong, including the launch of a dedicated proof-of-concept subsidy scheme for green Fintech in the first half of 2024, providing early-stage funding support for pre-commercialised green Fintech. The HKEX may play a role in such support scheme to facilitate the listing of green Fintech on GEM upon commercialisation.

Removal of mandatory quarterly reporting requirement and alignment of periodic reporting timeframes with Main Board

We agree to align GEM's periodic reporting requirements with those for Main Board issuers. Removing quarterly reporting as a mandatory requirement for GEM issuers should help address stakeholders' concerns regarding the compliance costs of a GEM issuer. As GEM is no longer a market for early-stage pre-revenue companies, the original rationale at the time of launch of GEM for imposing mandatory quarterly reporting and shorter periodic reporting timeframes upon GEM issuers is less relevant.

Reduction of post-IPO lock-up period for controlling shareholders

We agree to reduce the post-IPO 24-month lock-up period imposed on controlling shareholders of GEM issuers to 12 months to align with Main Board requirements. A prolonged lock-up period for controlling shareholders reduces the attractiveness of a GEM listing and hinders newly listed GEM issuers' business development by potentially imposing a delay on a post-listing issue of securities for fundraising purposes. The shortening of lock-up period to 12 months will also bring the Exchange's requirements generally in line with the majority of the Selected Overseas Junior Markets.

Should you have any questions on the above comments, please do not hesitate to contact our Professional Practice Partner in Hong Kong, [redacted]

Yours faithfully,

[redacted]

Certified Public Accountants
Hong Kong