INVESTOR EDUCATION CENTRE
投資者教育中心

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Investor Education Centre response to HKEX consultation:

A listing regime for companies from emerging and innovative sectors

The Investor Education Centre (IEC) would like to submit comments to the consultation concerning proposed amendments to the Listing Rules to facilitate the listing of companies from emerging and innovative sectors, subject to appropriate safeguards.

As an organisation dedicated to improving financial literacy in Hong Kong, IEC arms retail investors with the necessary knowledge to assist with all forms of financial decision making including safeguarding their investment in stocks. We understand that there are mixed reactions to allowing the listing of pre-revenue and pre-profit biotech companies on the Main Board, and introducing the weighted voting rights (WVR) structure. While there will be additional safeguards and disclosure requirements in place to protect investors (along with stringent regulator supervision), we consider investor education an important means to also increase investor protection.

The broad media coverage on the listing regime and potential technology IPOs ahead, has probably captured the attention of many institutional and retail investors. While the proposed amendments to the Listing Rules will offer investors opportunities to invest in technology and biotech companies, these investors will also become exposed to a different set of risk factors. In consideration of the likely knowledge gap retail investors will have regarding the "new economy" and the WVR structure, we are concerned that retail investors may not get a clear picture of the risk-return tradeoff, and may tend to overvalue these companies but underestimate the associated risks. Investor education is important and essential to close the knowledge gap.

We are particularly concerned about uninformed or vulnerable retail investors. Some older investors face significant challenges across various economies as is highlighted in a recent report from IOSCO ("Senior Investor Vulnerability" available at iosco.org).

We have appreciated working directly with HKEX colleagues in the past to educate investors on distinct issues (e.g. Stock Connect). Since April 2016 the IEC has created a consumer brand known as The Chin Family. Awareness and trust of the Chin Family is high amongst HK adults and we'd encourage HKEX to work directly with IEC to use The Chin Family channels to educate the public on the issues covered in this consultation, if they progress to market.

We would welcome a discussion with HKEX as you go through the process of examining consultation submissions. We have drafted some initial 'education' themes for issues covered in this consultation in Appendix A attached.

Yours sincerely

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Appendix A

Biotech companies

Biotech is a hot sector but in fact not so many people understand it. Retail investors who are new to the sector and lack the expertise in biotech have to tread carefully. They should be aware of the following issues when they consider investing in biotech companies.

- Valuing biotech companies – The biotech sector is unique, and biotech companies cannot be valued purely based on conventional financial metrics such as revenue and profit. Retail investors who are often less resourceful and knowledgeable than sophisticated investors should consider if they have the capability to make informed judgement calls based on other information such as R&D costs, stages of development of core products as well as patents granted or recognition received. All of these factors require some expertise in the biotech industry.
- Business failure – Retail investors should recognise the relatively low survival rates of biotech companies. Shareholders will end up losing part of or possibly all their investment if a company goes out of business. Vulnerable investors such as retirees should think carefully if they can take on such risk.

Issuers with WVR structure

In contrast with the "one share, one vote" principle, the WVR structure aims to protect the controlling shareholding of some key individuals who are usually the founders or key management of the company by allowing them to have enhanced voting power over other shareholders. While it is tempting to invest in some good quality and high growth innovative companies, we would like to bring out the risks inherent in the WVR structure so that retail investors can see a more balanced picture.

- Reducing voting power – voting power of retail shareholders can become impotent as the founders or key management theoretically can out vote ordinary shareholders on every corporate action except a few key matters prescribed in the Listing Rules.
- Risks relating to corporate governance – The WVR structure may undermine accountability of key management as they are insulated from the threat of removal and losing control of a business even when they are not acting in the best interest of the company and shareholders. This structure may reduce the role of the board of directors and hamper its ability to execute its fiduciary responsibility to shareholders.
- The term "new economy" is not well-defined. The term embraces a range of companies claiming to be innovative and therefore investors should seek to understand the subsector the company is operating in before committing to an investment in that company's stock.
- Moreover, retail investors should understand that companies from the "new economy" can also choose not to opt for listing with the WVR structure.

<u>*About IEC*</u>

Established in 2012 and supported by the Education Bureau and all four financial regulators, the Investor Education Centre (IEC) is an organisation dedicated to improving financial literacy in Hong Kong.