

### **Concept Paper – New Board**

I welcome the idea of introducing the New Board and I wish to express my general views in this letter **on an anonymous basis**. These views only reflect my opinions but not the opinions of Troutman Sanders or its other partners.

#### 1. Eligibility – New Economy

It seems that both the New Board PRO and New Board PREMIUM are only open to applicants engaging in “New Economy” industries. It is rare that an international stock exchange is limited to particular industries, and thus references to the experience of other stock exchanges may not be available. The Stock Exchange will have to formulate its own rules that screen out the “Old Economy” companies but are also considered fair by the public.

The New Board rules may give guidelines on what industries are considered as “New Economy”, and such guidelines may have to be updated from time to time. The more difficult issue seems to be a business with both New Economy and Old Economy elements, e.g. a business that engages in a traditional industry but delivers its products/ services in an innovative way or offers to its customers benefits which are not currently available.

Because of such “New Economy” eligibility, it may also be necessary to require a potential applicant to seek the Stock Exchange’s clearance before submitting its application even though its business is apparently of a New Economy type. This avoids a listing applicant wasting its resources to put together a listing application which is rejected for reason of eligibility.

I suggest that the eligibility of all applications be considered by an independent screening committee of the Stock Exchange (i.e. not the staff of the Stock Exchange). In order to establish public recognition and confidence in the committee, the committee may include academics as well as practitioners in different New Economy industries. The committee members are expected to have the necessary knowledge to assess the innovative elements of an applicant's business to qualify as "New Economy". It is not necessary to include a lot of investment bankers, lawyers or accountants as they may not be the best persons to assess whether a particular industry is a "New Economy" industry at the prevailing time. Making such screening process compulsory will allow the screening committee to accumulate experience in differentiating New Economy businesses from Old Economy businesses so that different applications can be screened with relatively consistent criteria. If the screening process is optional, such purpose cannot be achieved.

The eligibility screening process should be a relatively straight-forward one and does not require a long submission from an applicant. Further, there should be measures to protect the confidential information and business secrets disclosed by any applicant.

The down-side of such screen process is the existence of subjective judgment. But that down-side exists any way if the New Board is limited to particular industries – the New Economy industries.

2. Transfer from New Board PRO to New Board PREMIUM or the Main Board

The purpose of listing on the New Board PRO may well be to raise equity finance for future business development when the business is still at its initial stage. When such development bears fruit to the extent that the company fulfils the Main Board financial criteria, the company may wish to "upgrade" its listing status to New Board PREMIUM or even the Main Board. These two boards allow participations by retail investors (i.e. a broader investor base) and are more-recognized.

The Stock Exchange may consider (a) whether such board transfer is available and (b) if so, the procedures. If the transfer is not available or the procedures are cumbersome (e.g. listing document and full due diligence by financial adviser are required), it may undermine the purpose of the New Board PRO of fostering New Economy companies. But if the transfer is relatively easy, then the New Board PRO may encounter those problems of the GEM Board which the Stock Exchange intends to tackle in the latest consultation paper. Therefore, there is a balance to strike between these two concerns.

If transfer is allowed, there should be some basic conditions such as (a) the company has been listed on the New Board PRO for at least 3 years, (b) there is no substantial change in either its control or its business nature in the last 3 years (as confirmed by a financial adviser) and (c) it has fulfilled the 3-year profits requirements of the Main Board. A Transfer should not be allowed if the company has substantially changed its business nature in the last 3 years, because such change might suggest the company is still at a rather unstable stage and is therefore more suitable to remain on the New Board PRO.

3. Avoid creating shell companies

Because companies on both the New Board PRO and the New Board PREMIUM are expected to engage in New Economy industries, the leadership and entrepreneurship are of primary importance. It is hard to imagine why a substantial change in ownership or management is appropriate within a short period of time after listing. Such a change might suggest the company is being sold as a shell company.

Therefore, the Stock Exchange may consider restricting change of control in a New Board listed company within the first 3 years of listing. The restriction may cover control of control or a “potential” change of control arising from transfers of shares and convertible securities, issue of new shares and issue of convertible securities. Even if convertible securities (e.g. convertible bonds, warrants) will not result in immediate change of control in terms of voting rights, they may pave the way to a change of control.

However, the restriction should not suffocate the normal fund raising – something which is essential for companies at its early stage of development. The key is whether there is a change of control and management associated with the fund raising.

4. Disclosure and investor education

A listing applicant with a weighted voting rights structure should prominently disclose its listing documents the risks associated with such a structure, e.g. it is not easy to replace the leaders who hold super voting rights. The Hong Kong retail investors are not used to weighted voting rights structures and therefore such prominent disclosure is necessary. The Stock Exchange may also consider assigning a particular starting number or pre-fix to the stock code of each company with a weighted voting rights structure so that the investors who deal in the shares of such company on the open market also know it carries a weighted voting rights structure.

Due to the accelerated delisting mechanisms, it is necessary for an applicant to disclose prominently in its listing document the higher risks of delisting. The Stock Exchange should also strengthen investor education in that regard.

The principle of “let the buyers be aware” should be more adopted for the New Board, and it may not be necessary for the regulators to over-protect those who invest in companies on the New Board. It is because investing in such type of company inherently carries higher risks than investing in a Main Board or GEM listed company, and such risks are commensurate with the potentially higher returns.

Please let me know if you have any questions.

Yours faithfully,

