



STRICTLY PRIVATE AND CONFIDENTIAL

16 August 2017

Hong Kong Exchanges and Clearing Limited
12/F, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

Dear Sirs,

Re: New Board Concept Paper

Introduction

1. On 16 June 2017, the HKEx published a consultation paper entitled *Review of the Growth Enterprise Market (GEM) and Changes to the GEM and Main Board Listing Rules issued by the HKEx* (the “**GEM CP**”) and a concept paper with the title of *New Board* (“**NB CP**”). In the GEM CP, the HKEx argued, among other things, that GEM should abandon its “stepping stone” role to the Main Board and recast itself as the listing platform for established small and mid-sized issuers that meet the requisite financial and track record criteria. We have commented on the GM CP in a separate letter which accompanies this one.
2. By way of the NB CP, the HKEx introduced to the market the concept of a New Board as a new listing platform in addition to the Main Board and GEM. According to the NB CP, the New Board is designed to facilitate listing on the Exchange of (i) companies that have shares with weighted voting rights (“**WVR**”); and (ii) New Economy companies. Accordingly, the New Board comprises two segments, namely:
 - (a) New Board PREMIUM, which is a segment targetting companies that meet all the requirements for a Main Board listing (including being subject to the current sponsor regime) but which have WVR structures. Both professional and retail investors will be able to trade on the Premium segment; and



- (b) New Board PRO, on the other hand, will target start-up companies operating in the new economy with or without WVR structures which do not meet either the Main Board or GEM eligibility for listing requirements. Only professional investors will be able to trade on the PRO segment.
3. Having reviewed the NB CP, we set out for the consideration of the HKEx and the Exchange the following comments in respect of the proposed changes included in the Concept Paper. All capitalised terms not otherwise defined herein shall have the meanings ascribed to them in the NB CP.

Justification for establishing a New Board

4. Relying on a discussion paper entitled *Positioning Hong Kong as an IPO Centre of Choice* issued by the FSDC in June 2014 (paragraph 4.7.4 on page 53 therein), the HKEx argued that the listing regime in Hong Kong, going forward, should follow the examples set by international markets in adopting multiple listing boards or differentiated segments within listing boards to accommodate different types of issuers.
5. According to the NB CP, the current listing regime in Hong Kong has been dominated by (i) issuers from the PRC which maintain a primary listing in Hong Kong (from 2006 to May 2017, the concentration of Mainland issuers has increased from 50.3% of the market capitalisation of companies listed on SEHK to 64%, see Figure 1 on page 10 of the NB CP); and (ii) companies in Hong Kong's low growth sectors, notably in the financial and property sectors which together make up 44% of the total market capitalisation of the Hong Kong market (paragraph 31 on page 11 of NB CP). As a result, the following types of companies, in the view of the HKEx, have found it very difficult to get listed in Hong Kong.
- (a) pre-profit companies;
 - (b) companies with non-standard governance features; and/or
 - (c) Mainland companies that wish to list on the Exchange as a secondary listing venue,
- which, in the HKEx's view, will be remedied by the creation of the New Board.
6. In addition, the HKEx is of the view that with the creation of the New Board, the reputation of the Main Board as the premier listing board in the Hong Kong market can be preserved and enhanced in the following manner. First, since New Economy companies without a business track record or profitability are likely to carry higher risks to investors, the creation of a separate New



Board which caters to these types of companies specifically can thus “ring-fence” the risk associated with such companies and reduce the possibility of those issuers seeking a listing of their shares on the Main Board (paragraph 99 on page 23 of the NB CP). Second, as companies with WVR structures are allowed to list only on the New Board, companies listed on the Main Board are thus free of the entrenchment risks (managers are insulated from the threat of removal) and the expropriation risks (controlling shareholders extracting benefits from their companies at the expense of other shareholders) usually associated with WVR structures (paragraph 103 on page 24 of the NB CP).

Pre-profit companies

7. Companies in high growth sectors such as Biotechnology usually have little or no track record of profitability as they tend to spend their money on R&D of their products which are yet to reach the commercialisation stage, hence return a profit. With no track record of profitability, they are unable to get listed on the Main Board or GEM. By contrast, all three tiers of NASDAQ allow companies without profit or revenue records to list, while LSE’s AIM and Singapore’s Catalist impose no financial or track record criteria (see paragraph 52 on page 52 of NB CP). It is therefore not surprising that the proportion of “pre-profit” issuers listed in the US has climbed from 24% in 1980 to 68% in 2016 (see Figure 6 on page 15 of NB CP). In the past ten years, over 6,000 Mainland companies that did not meet the Profit Requirement (for Main Board) or Cashflow Requirement (for GEM) had been listed on NEEQ, NYSE and NASDAQ. The number of those companies with a minimum market capitalisation of at least HK\$200 million, which is the minimum for Main Board listing, amounted to 1,502 (see paragraph 66 on pages 17-18 of NB CP).

Issuers with WVR structures

8. According to the HKEx in paragraph 58 on page 17 of the NB CP, WVR structures have been prevalent in innovative companies in the technology sector, including such well-known companies as Alphabet and Facebook, which rely heavily on the technical expertise and market knowledge of their owner managers. Compared to ordinary shareholders of the company, those owner managers have arguably got the long-term interests of the company at heart, and they are therefore rewarded with voting control disproportionate to their economic interest in the company under WVR.



9. The listing regime in Hong Kong has historically imposed a de facto ban on companies with WVR structures to get listed on the Exchange. It is argued that this ban will reduce Hong Kong's listing competitiveness when compared to other regimes, say, the US's which permits companies with WVR structures to list there. For example, 33 out of 116 (28%) Mainland companies with primary listings in the US have WVR structures; their combined market capitalisation of US\$561 billion represents 84% of the market value of all US-listed Mainland companies. Their market capitalisation is equivalent to 15% of the entire market capitalisation of the Hong Kong market. Moreover, 18 out of 33 (55%) US-listed Mainland Chinese companies with WVR structures accounting for 84% of market capitalisation are from precisely the information technology industry which is not yet fully represented in the Hong Kong market (see paragraphs 40-41 on pages 13 and 14 of NB CP).

Mainland companies seeking secondary listing in Hong Kong

10. Under the 2013 JPS, companies with a "centre of gravity" in Greater China are prohibited from pursuing a secondary listing in Hong Kong. So Mainland New Economy companies which have been listed in other venues have been unable to seek a secondary listing in Hong Kong. Moreover, the requirement under 2013 JPS for any overseas companies to demonstrate equivalent shareholder protection standards to those in Hong Kong by, e.g. varying the companies' constitutive documents, can be arduous (including having to convene a general meeting to request majority or supermajority shareholder approval for the relevant variations to the constitutive documents) and cost prohibitive. It is argued that this can deter Mainland New Economy companies from pursuing a dual primary or secondary listing in Hong Kong.

Summary of the New Board proposals

11. A summary of the proposed New Board can be found on pages 6-8 of the NB CP.

Comments on the New Board proposals

New Board PRO

- (a) *Unclear definition of eligible companies for listing:-*
12. According to the HKEx proposal, only pre-profit companies with "high growth potential" or New Economy companies can apply to list on the New



Board (paragraph 136 on page 31 of the NB CP). Even with such a relatively innocent statement there are at least three uncertainties. First, as proposed in the NB CP, staff of the Listing Department of the Exchange would be responsible for vetting and approval of the listing applications on New Board PRO, but absent detailed guidelines, it may be hard for them to tell the difference between a high growth company and one that has little growth. The HKEx is recommended to set out in detail in the relevant draft Listing Rules or in the form of a Guidance Letter the benchmarks to be used by the Listing Department to determine whether or not a company is high growth or low growth. This would be helpful to potential applicants and their professional advisers, as well as to staff within the Listing Department, who would be responsible for processing future applications if the New Board PRO proposal is implemented.

13. Second, in paragraph 101 on page 23 of the NB CP, the HKEx conceded that it would be hard to define what New Economy companies were since they might encompass a range of different sectors. The HKEx has provided a non-exhaustive definition of New Economy industries in the NB CP which includes companies in such industries as Biotechnology, Health Care Technology, Internet and Direct Marketing Retail, Internet Software and Services, IT Services, Software, Technology Hardware, Storage and Peripherals. All this looks good on paper but it is worthy of note, however, that there are many companies which may in fact exhibit some but not all of the characteristics of companies in the New Economy industries, as indicatively defined above. For example, companies in the health products industry may as part of their business activities dabble in promoting health care technology. Should such companies be classified as New Economy companies and thus be eligible for listing on the New Board PRO? Or will staff of the Listing Department of the Exchange be required to examine in detail the proportion of the company's business activities which are attributable to New Economy and which are not, and then, based on such findings, come to a conclusion as to whether not the company is a New Economy company? It is highly doubtful if the Exchange would have the time and possesses sufficient resources and manpower to perform such kind of examination, particularly once the New Board is launched and the Exchange is expected to be flooded with applications (we note the reported very positive response to the New Board proposal in a recent seminar held in Cyberport).
14. It is understood that the Exchange intends to develop a set of guidelines for the definition of New Economy industries for the purposes of listing on the New Board companies in those industries. However, given the evolving nature of



technology and the interactive relationship between the old economy and new economy sectors, it is considered highly unlikely that the Exchange can come up with a fixed definition of what constitutes a New Economy company. In the end, the Listing Committee may have to be called upon as an arbiter to exercise the ultimate discretion to determine which companies are eligible to be listed on the New Board PRO.

15. We are of the view that a listing regime that relies on the subjective judgement of regulators to determine which listing applicants are considered to be high growth and New Economy companies would give rise to regulatory uncertainty and could result in inconsistent and unfair decision-making on the part of the regulators.
16. Finally, the quoted statement from NB CP (see paragraph 12) referred to listing on the New Board, but it did not specify which segment the HKEx had in mind. It is clear from the NB CP that the New Board PRO will be restricted to New Economy companies; however, the NB CP was evasive in respect of whether or not access to the New Board PREMIUM segment will be similarly restricted. However, much of the NB CP suggested that the New Board PREMIUM would be available to any company with a WVR structure (or other non-standard governance structure) regardless of the industry in which it operates.
17. The above discussions all point to the need for the HKEx to come up with clear definitions of what types of companies are eligible to seek listing on the New Board PRO. Since the New Board PRO is a new listing regime with some of the normal listing requirements being rendered inapplicable to the listing of New Economy companies (e.g. no financial or track record requirements, participation of only professional investors, no requirement to engage sponsor to performance due diligence), the HKEx should clearly specify which companies are and are not eligible to be so listed – otherwise potential applicants which may be able to take advantage of such concession will not know where they stand. Absent clear definitions of what an eligible company is, access to the New Board PRO may become dependent on the listing applicant passing an imprecise test on its eligibility to get listed. This may result in (i) inappropriate companies being listed on the New Board PRO; and (ii) many listing applicants are determined to be unqualified for listing on the New Board PRO after incurring costs for carrying out a review of their operations and filing listing applications.



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(b) *Concerns over participation of professional investors only:-*

18. Given the higher risks potentially arising from issuers that do not meet the existing financial and track record eligibility requirements of the Main Board or GEM, the HKEx suggested that New Board PRO would be open to professional investors only. Concerns have been expressed that a market comprises entirely professional investors may lack liquidity, which poses greater risks of volatility and may make the market less attractive to issuers (see paragraph 108 on page 24 of the NB CP).

(c) *Unclear extent of due diligence required of eligible companies:-*

19. Since investors in the New Board PRO are proposed to comprise only professional investors, who should be better placed than retail investors to carry out their own analysis of companies seeking a listing on this segment, we therefore agree with the HKEx's suggestion that less onerous due diligence standards would be required of listing applicants on New Board PRO. So instead of sponsors, professional financial advisers with Type 6 licence ("FA") should be engaged to advise on their applications.
20. The HKEx expects that the appointed FAs will exercise their professional judgement to (i) determine the level of due diligence required for the applicants; and (ii) ensure that the listing document provides sufficient information to enable professional investors to make an "informed investment decision" – it is unclear as to the level of liability for issuers (including directors of issuers) under the SFO for material omissions and inaccuracy or misstatement in the listing document, where the standard of disclosure is stipulated as being lower than "prospectus" standard. In addition, the extent of due diligence work required, or expected, of FAs in this context is potentially unclear, and FAs may ultimately decide to carry out sponsor-style diligence in any event to mitigate potential risk of regulators finding that their due diligence was not "reasonable" in hindsight, should any problems arise.

New Board PREMIUM

(a) *Main Board by another name:-*

21. Apart from the following four differences, there is in reality little variance between the New Board PREMIUM and the Main Board (in terms of, e.g. investor eligibility, admission financial requirement, minimum public float value at listing):



- (a) New Board PREMIUM admits New Economy companies as issuers (this point remains unclear – see paragraph 16);
- (b) companies with WVR structures are allowed to list on New Board PREMIUM;
- (c) issuers already listed on NYSE and NASDAQ are waived from the requirement to comply with Hong Kong-equivalent shareholder protection standards; and
- (d) the New Board PREMIUM permits secondary listing of Mainland companies,

questions might be asked as to why there is a need for the New Board PREMIUM if its features are not markedly different from that of the Main Board, apart from the HKEx's desire to (i) attract sizable companies with WVR structures to get listed in the Hong Kong market; and (ii) segregate those issuers to a new listing board with a view to diluting the force of the SFC's criticisms, which were set out in statement issued on 25 June 2015 ("SFC WVR Statement"), of the HKEx's draft proposals for listings on the Main Board of companies with WVR structures.

22. In any event, amongst these above-mentioned four differences, the HKEx seems to be most concerned that the New Board PREMIUM will afford an opportunity to companies with WVR structures to get listed on a new separate listing venue instead of the Main Board. The reasons being: (i) to overcome the de facto ban of listing by such companies on the Main Board; and (ii) to allay the SFC's concerns previously expressed in the SFC WVR Statement that allowing companies with WVR structures to list on the Main Board will, among others, open the floodgates to undesirable listing applicants seeking to entrench the control of their founders. However, notwithstanding the HKEx's attempt to segregate companies with WVR structures to a New Board, the implementation of the WVR structures, as explained in paragraphs below, is still beset with many difficulties.

Implementation of WVR structures

- (a) *Addressing risks inherent in WVR structures:-*

23. Given the entrenchment and expropriation risks associated with WVR structures (see above paragraph 6), the HKEx suggested in paragraph 154 on page 35 of the NB CP that concerns arising from such risks could be addressed by either disclosure or some structural restrictions such as restrictions on the types of persons that can hold WVR, the minimum equity that they must hold



in the company on an ongoing basis and restrictions on the transfer of WVR as well as a potential sunset date on any WVR structures.

(b) *Application of current investor protection regime to issuers with WVR structures:-*

24. The HKEx indicated in paragraph 93 on page 22 of the NB CP that that issuers listed on either segment of the New Board are expected to comply with the post-listing continuing obligations applicable to Main Board issuers, including the connected party transaction rules and super-majority voting by shareholders on fundamental matters. We believe that it may be difficult for the Exchange in designing a compliance framework to cater for issuers with WVR structures. For example, it is not clear how the definitions for a “connected person” and an “associate” in the Listing Rules, or the “control” and “associate” tests in the Takeovers Code would clearly apply to such structures and also whether legislative changes might be needed to the SFO regarding the disclosure of interests in issuers with WVR structures. It is also not clear how to determine whether or not shareholders of a listed company with WVR structures have got a material interest in a transaction which prevents them from voting on such a transaction under Listing Rule 2.15 and Chapter 14A of the Listing Rules.

Linkage between different listing boards

(a) *No fast track migration:-*

25. According to the NB CP in paragraph 127 on page 29 therein, there would be no fast track migration mechanism between the New Board and the Main Board or GEM, or from New Board PRO to New Board PREMIUM. We agree with this view. For a listed company on New Board PRO wishing to list on other platforms to attract retail investors including the NEW Board PREMIUM, GEM and the Main Board, it would have to meet all the admission criteria and other listing requirements of the relevant board (e.g. issuing a prospectus). A requirement to raise additional capital via a public offer may also be imposed. In addition, given the similarities between the New Board PREMIUM and the Main Board (see above paragraph 21) as well as the concerns expressed by the SFC in the SFC WVR Statement over WVR structures, we are of the view that, as a matter of principle, there should not be a fast track migration from the New Board PREMIUM to the Main Board unless the concerns set out in the SFC WVR Statement are all removed.

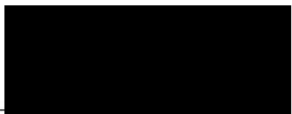


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26. GEM was set up more than 10 years ago, and its popularity with issuers used to be relatively low with low liquidity. SEHK therefore introduced in 2008 the concept of GEM acting as the “stepping stone” to the Main Board and, by way of the GEM Streamlined Process, providing a fast track migration mechanism for GEM-listed companies which, among others, meet the Profit Requirement to transfer their listings to the Main Board. We believe that the proposed creation of the New Board should likewise provide a fast track for different listing boards to migrate to each other. However, as mentioned in the preceding paragraph, we agree that given the lack of participation of retail investors in the New Board PRO, it would be difficult for companies listed on it to transfer their listing to other boards unless the admission criteria of the other boards have been adequately met. Nevertheless, if sizable companies with WVR structures are not allowed to transfer to the Main Board, which is the premier listing venue in Hong Kong, without meeting the requirements in the SFC WVR Statement, which may prove difficult as WVR structures in respect of companies such as Alibaba are not subject to negotiation, then there is a potential risk for the New Board PREMIUM to experience difficulty in attaining critical mass, so that it becomes a “premium” board in its own right. In such circumstances, we have serious doubts as to whether or not sizable companies with WVR structures, absent the opportunity to migrate to the Main Board, will be interested in using the New Board PREMIUM as a platform to get listed in Hong Kong. We should be interested to know whether the HKEx has canvassed major companies with WVR structures on the current structure of the New Board and received feedback on their willingness to consider participating.

Yours faithfully,
For and on behalf of
Central China International Capital Limited


Billy C.W. Cheung
General Manager