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

August 16, 2017

Dear Madam/ Sir,

The Submission Group (the "Group") [redacted] is pleased to offer our views on the New Board Concept Paper. The Group commends SEHK's efforts in broadening the market. Pathways for WVR/ dual-class share structure and early stage/ pre-revenue[1] companies to list in Hong Kong are much needed. Servicing the capital needs of new economy companies (many are set up with dual-class share structure) at different stages of their development can lead to great business and capital flow for SEHK. Global investor interests in new economy companies are well highlighted in the New Board Concept Paper.

IPO is an important route of capital formation for R&D intensive pre-revenue companies to meet their funding needs. Listing pathway for early stage/ pre-revenue companies will be crucial to success for Hong Kong government's current push to promote investments in R&D and goal to diversify Hong Kong's economy to innovation and tech. Furthermore, under the framework of Greater Bay Area development plan, a world-class capital market with access to global investors is the unique strength Hong Kong has to offer. A Hong Kong-based exchange trading board with the equivalent global reputation and reach of NASDAQ not only is key for Hong Kong to continue its financial leadership but also can serve as an important funding avenue for China's new economy companies. It will further solidify economic cooperation within the Greater Bay Area.

Many Asia governments (e.g. Singapore, Korea, Taiwan, and Thailand) are also promoting development of innovation and tech companies, but yet most lack global-scale private sector/ public market funding mechanism. The impact of a successful New Board can fundamentally change the landscape for all Asia-based tech and healthcare companies; not to mention global new economy companies looking for Asia based capital.

Three main topics were raised in the New Board Concept Paper:

1. WVR/ dual-class share structure
2. Early stage/ pre-revenue company listing
3. Private company market platform

Along with the separate GEM Consultation Paper there are four topics which can potentially be addressed separately independent from each other or together in an holistic manner.

If the three topics raised in the New Board Concept Paper need to be addressed concurrently and taking into account historical debates of the topics, then a New Board maybe the "simplest" (though not easiest) solution. However, the proposed New Board framework under the current New Board Concept Paper poses a few challenges for early stage/ pre-revenue companies to effectively use the new pathway.

WVR/ dual-class share structure company listing

The priority of SEHK (and SFC) should be the **integrity** of the market — listing standards **need not** and **should not** be lowered to accommodate dual-class share structure and early stage/ pre-revenue companies.

Arguably dual-class share structure is a philosophical debate on corporate governance as dual-class share **physically** poses no

[1] It is assumed that the term "pre-profit company" used throughout the New Board Concept Paper is meant to be interchangeable with the term "pre-revenue company" – a company can be "pre-profit" and still meet the existing Main Board listing criteria using Market Cap rules; as such will not need to consider the New Board. A "pre-revenue" company is by definition "pre-profit"; hence a broader definition. There is no existing pathway for "pre-revenue" company to list on SEHK, which is the genesis of the need for the New Board discussion

specific problem in the context of trading platform. Global markets have shown that a company with dual-class share structure **physically trades** the same as those without (e.g. Facebook vs. General Electric, both followed all SEC and exchange rules and are extremely liquid.)

In the purest sense, SEHK's function is to provide a platform for trading and to maintain the integrity of such market. It is investors who should decide if they want to invest in a dual-class structure company based on their own philosophical view on corporate governance. If investors do not believe in the corporate governance structure of a company then they will not invest, as such there will be no demand for the company's shares and the company's IPO will not be successful.

- Wuxi Biologics recently listed on SEHK with an imbedded dual-class share structure was one of the most successful IPOs in 2017 with over 35x retail subscription.

It is arguable whether **Hong Kong** as a listing location (with SFC and SEHK as proxies) needs to take a stand for this specific philosophical debate of one-share-one-vote and not the other perceived "investor protection" debates such as mandatory minimum 30% female Board of Directors ratio or a stricter Environmental, Social and Governance rules and compliance. Thus far no major global investors nor issuers have proclaimed that they will move more funds to Hong Kong or list in Hong Kong because Hong Kong stands for one-share-one-vote? Similarly, NYSE, NASDAQ and SEC are not taking a stand on the issue.

Whether any company's share will be eligible for index inclusion is the decision of the index providers, which are all commercial organizations; index criteria also changes based on the time and investor demand. SEHK's decision for dual-class listing should be independent from the action of the index providers that have no formal relationship with SEHK or SFC.

- S&P and FTSE Russell both recently announced decisions to partially or fully exclude companies with dual-class share structures from their indices ─ S&P will apply the criteria to new companies only. While market constituents of all FTSE Russell indices must have greater than 5% of the company's voting rights held by unrestricted shareholders. Existing constituents will need to comply by September 2022. These changes highlight the growing roles of investors and index providers in shaping governance standards ─ but the changes were at the behest of INVESTORS not action from regulators nor exchange operators.

Not permitting dual-class share structure is inconsistent with other major global exchanges and unnecessarily hindered SEHK's ability to attract good global issuers. Most importantly, inclusion of dual-class shares should not impact the overall functioning of the Hong Kong market. Investors should indeed have their own rights to decide whether to invest in a dual-class share.

Early stage/ pre-revenue company listing

Listing standards, however, will directly impact the overall functioning of the market. If standards are not upheld then the market and Hong Kong's strength as a well-functioned capital market will be negatively affected; e.g. GEM board as it is right now.

The New Board PRO's proposed ""lighter touch" approach to initial listing requirements" and low minimum listing market cap lowered the listing standards and positioned the New Board PRO to below GEM ─ given the broad market view that GEM listed companies are second tier, and even those companies will require a full listing process.

- The implied assumption is that early stage/ pre-revenue companies are subpar and unable to meet the rigor of an IPO process.

There are many "unicorn" – private companies with valuation above US$1 billion, especially in new economy sectors of technology and healthcare. The unicorn companies will be able to meet all the **regulatory** aspect of the Main Board listing requirements most often than not, the only listing rule they are unable to meet is the profit and financial standards requirement of rule 8.05.

There are in essence **two** groups of early stage/ pre-revenue companies that the proposed New Board is trying to address. It is imperative to separate the two groups given their distinct capital needs and **market readiness.**

Group I	**Group II**
• The more established R&D based companies, e.g. companies that are developing new fuel cells for power generators or drug for cancer treatment • Generally have been around longer – as it often takes over ten years to develop a drug and in-depth subject knowledge to invent new technologies • Usually led by industry veterans and experienced institutional VC/ PE investors • The "early stage/ pre-revenue nature" to this group means the **PRODUCT** development is still in process and the main associated risks are R&D risks. They are pre-revenue as R&D intensive companies are cash-burn companies • Higher capital needs for product research and development efforts • Previous institutional VC/ PE rounds set valuation benchmark • Can be companies located anywhere – e.g. a large number based in China or led by Chinese executives and investors	• The younger start-up companies • Generally have been around for only a few years • Usually led by less experienced team with no institutional VC/ PE support • The "early stage/ pre-revenue nature" to this group means the **COMPANY AND PRODUCT** development are still in early stage and the associated risks are more than R&D risks • Given young nature of the company, generally lower capital needs • Usually raised small amount from friends and families • Many local Hong Kong-based start-ups – under the Hong Kong government's active encouragement for Hong Kong population to venture into (new economy) business. However, start-up culture is still relatively new in Hong Kong

Group I companies are market ready and often unicorn companies. If the New Board is meant to be a marquee listing venue for global new economy companies, then Group I should be the targeted issuers of the New Board. The companies will be able to meet all the **regulatory** aspect of the Main Board listing requirements most often than not, the only listing rule they are unable to meet is the profit and financial standards requirement of rule 8.05.

- Many R&D based companies have extensive regulatory filing experience working with IP offices, CFDA, U.S. FDA, and EMA etc.

Founders and owners of Group I companies will want to have a proper IPO process to raise global institutional capital and attract good investors. Preparing a proper prospectus is a given as that is a mean to explain their technologies. The companies will want to have retail tranche for increased liquidity. No reputable global institutional fund managers will invest in a stock without prospectus and proper exchange vetting.

Group II companies are smaller in scale and will benefit from the lowered listing standards. They will appreciate the lowered listing expenses by not requiring a prospectus, sponsor, and public tranche. However, if a company finds the IPO process and the preparation of a prospectus onerous, then it is unlikely it will be able to handle the scrutiny of public institutional and professional investors. The company is simply **not** ready to go public in the proper sense.

By trying to accommodate the needs of both groups, the New Board has inadvertently lowered the listing standards to the lowest denominator, which in the long run may affect the overall integrity of the Hong Kong market.

Most of the Group I companies qualify to list on NYSE and NASDAQ. They will unlikely choose to list on the New Board if it is perceived as having a lower standard and for subpar companies. Only a New Board with equivalent reputation as the Main Board will attract **the best** global new economy issuers and investors.

- The lowered listing standards then lead to need to limit the investments to professional investors only which further reduces attractiveness of the New Board to proper potential issuers.

The New Board as it is proposed now may run the risks in long run to only attract the smaller companies that are not qualified for listing anywhere else ─ akin to Taiwan's now defunct early stage company board, TSX Venture Exchange and Singapore Catalist Board where there are in fact no institutional investors.

- Worst case scenario is that given a pathway, inexperienced management maybe persuaded by dishonest market participants that the company can go public when it is in fact not ready. Going public when not ready can also destroy a company, just as lack of capital.

Proposed New Board set up

The New Board (without tier) should be positioned as the same level as the Main Board and have the same listing requirements and governance rules as the Main Board, including the newly proposed increased market cap and float but with the addition of:

1. Allowance for WVR/ dual-class share structure
2. Additional qualification method for listing (e.g. a new Listing Rule 8.05(4)) that allows new economy company to list if it can achieve listing market cap of **HK$585 million/ US$75 million** ─ same as NYSE Business Development Companies rule and Nasdaq Global Market

    - Along with that there will need to be an expanded 8.05B to apply to new economy companies qualified under new 8.05(4) – The Exchange may accept a shorter trading record period and/or may vary or waive the profit or other financial standards requirement in rule 8.05 (add new 8.05B(4)).

Given the same Main Board rigor for IPO and governance are applied to the New Board, it should then be open to retail investors and have no separate PREMIUM and PRO tiers; i.e. just one New Board that is parallel in positioning as with the Main Board.

- View it from another angle, the proposed New Board can be a "new tier"/ extension of the Main Board; or expanding the proposed New Board PREMIUM to include new economy early stage/ pre-revenue companies.

A New Board with equivalent listing rigor and reputation as the Main Board will attract the best issuers globally and increase the overall visibility and capital flow of SEHK.

To safeguard the application of this "new economy company listing rule", the Listing Committee can work with an independent industry advisory board to determine if the applicant falls under the scope of "new economy." The industry advisory board can also provide views on whether the applicant's business pass the "smell test" ─ especially for companies that are R&D and technology intensive.

To note is verifying the validity of the applicant (i.e. the company's business falls in the defined scope of "new economy") should not be interpreted as guaranteed success of the company's technology or drug. Not all technologies and drug development will come to fruition and the success can be influenced by multitude of factors in addition to availability of capital. A mature company operating a theme park can face competition from nearby new theme park and experience business loss; while the new theme park operator can grossly misjudge consumer's taste and failed to attract tourists to its park. Business success or failure is not unique to new economy companies.

- There should be different independent advisory board for technology and healthcare given specific knowledge of the sectors.

It is not SEHK's responsibility to guarantee success of the New Board companies, neither does it guarantee success of the Main Board companies. However, applying Main Board level rigor of IPO review and governance on the New Board are precisely the value-added services that SEHK can provide to investors (and issuers) given the higher risks of early stage/ pre-revenue investing.

The proposed set up above will also have the benefit of simpler execution from SEHK perspective ─ a new board based on the existing Main Board rules but allowing VWR and adding a fourth qualification rule for new economy companies will be a much simpler task than designing a brand-new board from scratch for the case of New Board PRO.

Requiring sponsors and a proper IPO process will also ensure participation from established global investment banks, law firms and auditors. They can serve as additional check points and safeguard for quality listings. Most importantly, they are the key to bringing in reputable global investors to invest in the New Board companies.

In the U.S. market, which has the longest history for early stage/ pre-revenue company listings, good research analysts and portfolio managers in healthcare and tech sectors serve as thought leaders for investors in a more meaningful way than in less technical sectors such as consumer due to the high knowledge intensity of the sectors. They are often relied upon for their views on seemingly negative or positive news; providing thought leadership on the company and its technology's viability ─ hence indirectly **share price stability**.

To ensure the long-term success of the New Board and ultimately the integrity of the market, SEHK should set up the New Board in a way that allows the creation of a proper ecosystem of marquee issuers, investors, banks, law firms and auditors. GEM board companies highlight the peril of not having top tier professional involved ─ extreme volatility, mostly retail investors, to the extent there are "institutional" investors, they are not the marquee global names.

Thoughts on addressing Group II companies funding needs

A vibrant private capital raising ecosystem will better serve the needs of younger Group II companies that are not ready for public market. There can be a more comprehensive approach to the Private Market than currently proposed in the New Board Concept Paper. An effective private capital raising mechanism can alleviate the need to lower the New Board's standard and maintain the integrity of the market while protecting investors from certain risks.

However, since young start-ups are inherently riskier due to less structure and governance of the companies, it is arguable if the Private Market's potential negative headline risks to SEHK is proportional to the potential revenue gain ─ headline risks likely similar whether as registration platform or actual capital raising services are provided.

- Unscrupulous companies can misrepresent the "registration platform" as "listed on SEHK" to less knowing investors. If SEHK provide capital raising facilitation services hence gatekeeping and governance on the platform, that may in fact help prevent such situations.

- Any negative events from company registered on the platform can be misinterpreted as part of the overall quality of the companies listed on SEHK. As such an open-to-all registration platform may impact the perceived integrity of the market.

- Setting up a full fledge Private Market with safeguard and services will certainly take time and require additional management bandwidth that SEHK might not be able to fill immediately.

To address the social aspect of Hong Kong start-up community needs, one potential approach is to work more closely with industry associations such as HKVCA or other Hong Kong government entities such as Hong Kong Science and Technology Parks and Hong Kong Cyberport that are part of the Hong Kong government's effort to promote entrepreneurship.

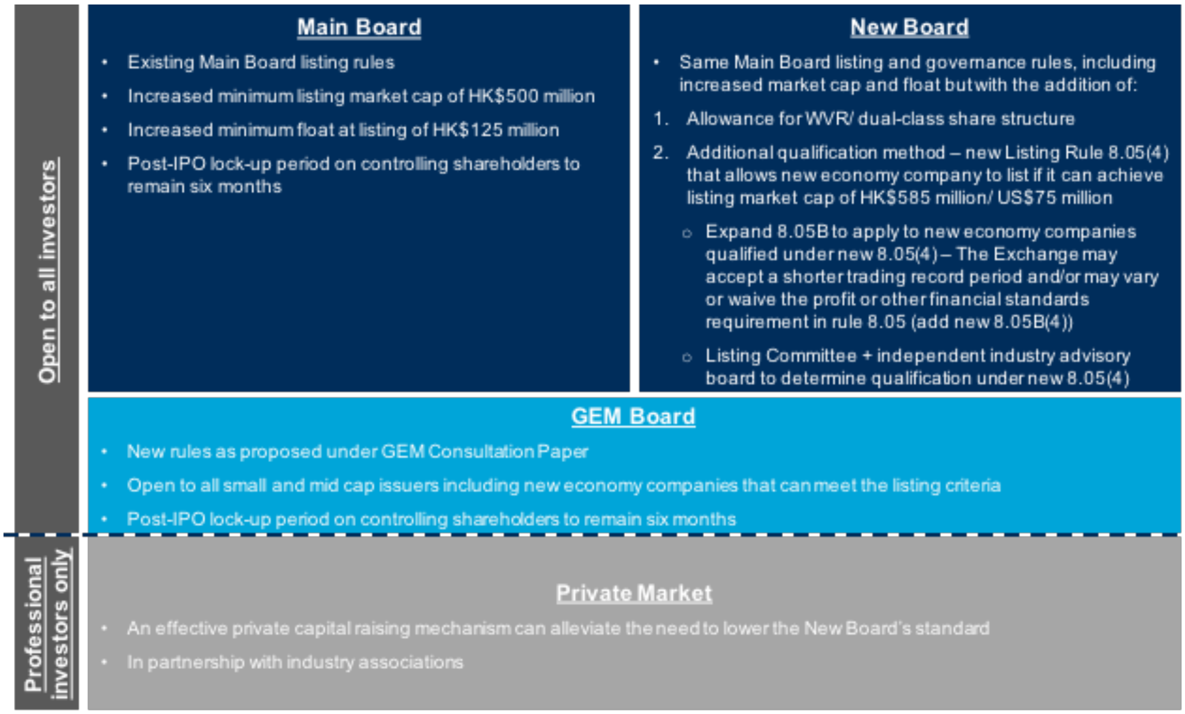
- SEHK to publish a set of best practice guidelines on private capital raising on information requirements (e.g. management info memo format), documentation (e.g. shareholders' agreement key points) and settlement procedures (e.g. timeline) etc. to help facilitate private capital raising process between less experienced management team and investors. SEHK can also provide continuous reporting best practice guidelines such as requirements for semi-annual audited financials or management accounts.

- The set of guidelines and "private capital raising facilitation site" can be hosted by industry association such as HKVCA. HKVCA has a broad private investor network and has the right resources to host a private investment platform. As an investment industry organization independent from SEHK, it is understood that the platform is to facilitate private investments and NOT the implicit endorsement of SEHK. Companies and investors can have the CHOICE to follow SEHK best practice guidelines. The site can also be hosted by other Hong Kong government entities such as HKSTP/ HKC/ ITB.

- SEHK can build on the existing Road-to-IPO program and expand to guideline setting and ultimately capital raising facilitation services.

Proposed New Board and Private Market positioning

The Group strongly believes that the proposed New Board needs to have equivalent listing rigor and reputation as the Main Board in order to attract the best global new economy issuers and investors. Instead of lowering the New Board's listing standard, a vibrant private capital raising ecosystem will better serve the needs of younger companies that are not ready for public market.



Conclusion

Many Asia countries have set up exchange trading board similar in concept to that of the proposed New Board. To-date none have been successful in attracting global investors and issuers, though a few boards were set up specifically with only domestic investors and issuers in mind. If SEHK's aspiration for the New Board is to cater to more than Hong Kong local startups and professional investors, then the experience of other Asia exchanges can serve as precedent case studies. Key to New Board's success will be to avoid the factors that caused global investors (hence potential issuers) to shy away – companies with micro market capitalization and lack of governance structure and listing standard. Without global investors it is hard to have liquidity and price stability.

A successful New Board that attracts global investors and issuers will strengthen Hong Kong's global financial market position, a position Hong Kong cannot afford to lose. A failed New Board will not only limit option for Hong Kong's local startup community, it will also impact the overall reputation of Hong Kong market. Lowering the New Board's standard to cater to the companies that are not public market ready may seem a helpful move but as many countries have already demonstrated, no global investors will/ can invest in such companies which ultimately defeat the purpose of the listing and the board as a whole.

Of all the Asia listing venues, Hong Kong/ SEHK is best equipped to "get this right" given Hong Kong's strong capital market foundation. It is the best venue (some may argue the only venue) capable to create an Asia-based ecosystem for new economy investing similar to that of NASDAQ/ NYSE by global reach. It is important SEHK not lose sight of the big picture while carrying out this very commendable effort of creating the New Board!

Please feel free to contact [redacted] if you have any questions regarding this submission.

Sincerely,
Members of the Submission Group