

18 August 2017

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

**BY EMAIL
AND BY MAIL**

Dear Sirs,

Re: New Board Concept Paper

We refer to the Concept Paper on New Board issued by the Exchange in June 2017 (the “Concept Paper”).

We, China Tian Yuan Finance Group, being one of the Exchange Participants (types 1 and 2 regulated activities under the SFO), support regulatory policy change where it increases transparency, protects investors, and/or promotes responsible growth of the capital market. We believe that regulators must keep abreast of the times, make appropriate policy changes where necessary, in order to provide a level-playing field with Hong Kong’s competitors.

Our response to the Concept Paper

We believe this “straw man” proposal is a correct and significant progress in the further development of the leading status of the Hong Kong stock market. We appreciate the efforts of the Exchange in preparing this proposal and would like to share our views on this matter.

Response to Question 1

The New Economy industries are booming. There is no doubt that companies engaged in these industries will become the main drive in future IPO listings worldwide. Yet, Hong Kong’s inability to attract the New Economy industries has been abundantly clear and alarming. We believe that an absolute ban on WVR has placed Hong Kong at a significant disadvantage to its competitors, having missed out some of the high profile tech companies to the United States along the way.

In Hong Kong, accepting WVRs may seem unconventional and controversial. Nonetheless, WVRs have been around in other exchanges for some time. The very existence of the WVR structure in the modern economy indicates the importance of human capital contributed by the founders (i.e. leadership, entrepreneurship and vision) and how this is acknowledged and valued by investors. We are minded that whether to acquire an interest in a WVR company is entirely up to the investor’s decision, which is based on the balance of risk and returns. We do not see any significant issues if an investor is able to make an informed assessment based on full and fair disclosures of the issuers.

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Some has argued that a WVR structure would enable the founders to engage in activities that would benefit themselves at the expense of the shareholders. We disagree. The existing Listing Rules (e.g. the connected transaction Rules) provide strong protection for minority shareholders which would be equally applicable and effective to issuers with WVR structures.

Overall, we consider that Hong Kong has an appropriate, sufficient and effective regulatory framework to protect shareholders of an issuer with WVR structures. We believe that Hong Kong investors in general are well educated, experienced, and risk adverse. Thus, investors should not be deprived of the opportunity to participate in some of the renowned, fast growing and dynamic companies that uses WVR structures.

Having said that, we recognize the market's concern on risk of abuse and the need for minority shareholders protection. We therefore recommend:-

- (i) listing of an applicant with WVR structure should only be allowed in exceptional cases;
- (ii) full and fair disclosures of the WVR structure with an appropriate risk assessment must be included in the prospectus;
- (iii) mandatory safeguard provisions are put in place (see our response to question 18 for details);
- (iv) requiring sunset clauses with a life span of no more than 10 years;
- (v) WVR shares should be restricted to the founders only, i.e. the special rights associated with the WVR shares could not be transferred or inherited; and
- (vi) automatic conversion clauses - WVR shares would be automatically converted into ordinary shares in certain events, including (a) when the founders no longer holds a management position at the company; and (b) when the company changes its principal business activities and a WVR structure is uncommon in that particular industry.

Response to Question 2

We agree that segregation provides a clearer picture to investors about the characteristics and associated risks regarding listed issuers with unconventional governance features. While we do not oppose the establishment of the New Board, we would point out that the New Board may cause some confusion to the general public as New Economy issuers co-exist on both the Main Board and the New Board.

Response to Question 3

We have no particular views on whether the New Board should be segregated by characteristics (e.g. eligibility, risks etc.) or by industry (i.e. the New Economy). However, we would raise our concerns on industry segregation:-

- (i) It is difficult to define New Economy. Any definition would be subjective and arbitrary at times. The boundaries between New Economy and traditional economy have been very blurred already and applicants might not fall neatly within a particular industry. The obscurity of the definition provides unnecessary risks to potential applicants and professional parties in their IPO preparation; and
- (ii) An applicant that engages in a New Economy industry might be considered as "new" at the time of its initial listing, but may no longer be perceived the same years or decades later. If the definition of New Economy would be updated from time to time, how would that affect the New Board issuers which no longer engages in "new" economy industries and have become "obsolete". Will they be transferred to another board or be delisted?

Our preliminary view is that the New Board should only admit applicants with unconventional governance features, such as WVR, and such features are commonly found in its respective industry. We ordinarily would expect these industries to be the so-called New Economy, where human capital are highly valued.

Response to Question 4

Generally, we are in support of the proposed overall listing framework. However, we believe that smooth transfers between different boards would be beneficial. We advocate the following transfer mechanisms:

Fast-track promotion mechanism

The Exchange should retain the current transfer mechanism between GEM and the Main Board (i.e. no need to appoint sponsor). The Exchange should also allow a similar transfer mechanism between the New Board PRO and GEM but with additional requirements due to Listing Rule differences between the two boards. We believe these mechanisms would provide additional incentive for potential applicants to list on the New Board PRO. We consider that the additional costs for engaging a sponsor to be unnecessary and avoidable, given the eligible issuers would have complied with the continuous listing obligations prior to the transfer.

Relegation mechanism

Main Board issuers that have performed poorly (either financially or has numerous Listing Rules non-compliances) over a consecutive period should be relegated to GEM. This would reduce the number of shell companies and ensure the quality of the listed issuers is consistent with the positioning of their respective boards.

Response to Question 5

As mentioned in our response to question 4, we believe that a fast-track migration mechanism between the boards is beneficial.

Public offer

Public offer should only be imposed if the two boards have different public float requirements. We do not see any justification otherwise. A listed issuer should not be forced into making a public offer if it has no specific use for those proceeds. A mandatory public issue may adversely impact existing shareholders' interests.

Response to Question 6

New Board PRO

We agree that there should not be any bright line financial and track record requirements. Nonetheless, applicants should (i) not have a long history of operating loss; and (ii) be able to demonstrate or explain its plan and ability (for instance, management experience) to turn profitable after listing.

Separately, we consider that the market capitalization requirement of HK\$200 million might be excessive. We note that in most cases a company with a pre-IPO valuation of HK\$200 million has already met or will soon be able to meet the admission requirements of GEM. As such, we suggest to lower the threshold to HK\$150 million instead.

New Board PREMIUM

We are concerned that the same eligibility requirements for both the New Board PREMIUM and the Main Board may incentivize potential applicants of the Main Board in adopting a WVR structure and opt for the New Board. We believe this would be in contrast with the policy intent.

WVR Structure

Here, we also put forth some admission criteria for a WVR applicant which we consider relevant:-

- (i) the applicant must demonstrate that the WVR structure is a common feature in its respective industry;
- (ii) the applicant must demonstrate that the WVR structure is a critical success factor to the company, i.e. this structure is a must and it relies heavily to be successful;
- (iii) the facts and circumstances that lead to the WVR structure (i.e. how did the applicant's founders lose their controlling stakes, did they realized their interests for their own economic benefit or whether their interest was diluted by new capital); and
- (iv) the applicant does not have a controlling shareholder.

Response to Question 7

We agree. However, it may be difficult for the Exchange to make this determination given the limited information contained in New Board PRO application as compared to GEM or Main Board listing applications.

Response to Question 8

Given the nature of New Board PRO and the limited number of professional investors in Hong Kong (according to Credit Suisse, only 115,000 individuals in Hong Kong would meet profession investor's eligibility criteria), it is probable that many IPO cases would be under-subscribed (in terms of number of subscribers). We therefore suggest to relax the minimum number of investors at listing.

To ensure liquidity, we suggest the Exchange to allow an option for issuers to lower the subscribers to 20 profession investors when the issuer has appointed a market maker for a certain period. The market maker may be the IPO underwriter or the controlling shareholder (to the extent that the controlling shareholder will not lose its controlling stake).

Response to Question 9

We agree that exemption may be granted. However, such exemption should only be considered on a case by case basis. Applicants incorporated in a jurisdiction that is uncommon or not well-recognized should be questioned. The Exchange should not simply apply a general exemption Rule and shift its vetting responsibility to other exchanges.

Response to Question 10

We support a "lighter touch" approach on suitability assessment for applicants of the New Board PRO, particularly on:-

- (i) WVR structures - for the reasons mentioned in the concept paper;
- (ii) shell company characteristics under GL68-13A - applicants typically are asset-light and have small market capitalization;
- (iii) reliance on customer/supplier - applicants may have concentrated customers and/or suppliers due to their small business scale; and
- (iv) sustainability of business - it is difficult to assess the sustainability of an applicant's business when it has no proven track record. Instead, the Exchange should assess whether an applicant has sufficient working capital to maintain as a going concern.

Response to Question 11

While we see the merits (namely, risks and in alignment with the existence SFO regulation framework) for allowing only profession investors to participate the New Board PRO, this may however result in an inactive trading board. The Exchange may also consider the following:-

- (i) introducing the New Board PRO in two phases, i.e. opening to the professional investors initially, then allowing retail investors to participate at the next stage;
- (ii) lowering the eligibility criteria of profession investors;
- (iii) allowing certain retail investors that have the intellect and industry-specific knowledge to participate; or
- (iv) adopting a similar disclosure approach applied by listed GEM securities and listed warrants. For instance, including a warning statement about the risk associated with the listed securities of the New Board PRO in all public documents.

Response to Question 12

The procedures of the Exchange Participants (such as Know-Your-Client) should be strengthened and optimized to cater the additional eligibility criteria of professional investors, if any, for the New Board PRO.

Response to Question 13

We support this proposal. New Board PRO applicants should be allowed to minimize their IPO costs.

Response to Question 14

We agree that the listing approval should be made by the Listing Committee. However, we are concerned whether the current mix of the Listing Committee has sufficient and relevant experience and expertise in deciding listing approvals for the New Economy applicants. In order to fulfill the Exchange's objective to attract issuers of a wider range of industries, the Listing Committee should comprise a healthy mix of market representatives that reflects the same. We advocate the Listing Committee to invite a number of new members that are engaged in the New Economy industries.

Response to Question 15

New Board PRO applicants should be allowed to minimize their IPO costs. As such, a Listing Document rather than a prospectus is preferred as we believe the benefits (less IPO costs) outweigh the costs (risks to professional investors).

Response to Question 16

Other than the mandatory safeguard provisions regarding WVRs, the standard of the continuous listing obligations for the New Board PREMIUM should be comparable with the Main Board.

For the New Board PRO, we leaned towards a lower standard of continuous listing obligations due to (i) its size and impact on the market; and (ii) lower maintenance costs is preferred.

Response to Question 17

As mentioned in our response to question 1, we believe that the Exchange should impose mandatory safeguards provisions to reduce risk of abuse and to ensure sufficient shareholder protection. This is also consistent with the Exchange's regulatory approach on other novel issues, such as variable interest entity structures. We do not consider it appropriate for the Exchange to simply follow the disclosure-based approach adopted by the United States.

Response to Question 18

Mandatory safeguards provision should be put in place to ensure the principle of sufficient investor protection is not compromised. Here, we give out some of our suggestions:-

- (i) the issuer's corporate governance must be held to the highest standards and in compliance with the latest applicable international standards;
- (ii) a board of directors that consists of a simple majority of INEDs;
- (iii) corporate governance related committees that consists of INEDs only;
- (iv) publication of quarterly financial results;
- (v) shareholders may have veto rights on certain affairs, e.g. connected transactions, very substantial acquisitions and disposals, reverse takeovers, large scale equity issues, takeovers that met certain criteria (for instance, the offer price is at 100% premium to the then market price), etc; and
- (vi) some amendments to the existing connected transaction Rules may be required (such as deeming all WVR shareholders as a group of connected persons, regardless of their relationship and position with the company).

We would also suggest the Exchange to allow issuers to adopt an online voting system in order to improve the voting participation rate by public shareholders.

Response to Question 19

While a good compliance record would certainly help its case, we consider that any applicant seeking a primary listing in Hong Kong (no matter if it is listed on another exchange or not) should follow the same set of continuous listing obligations as with its peers on the same board, i.e. no exemption should be granted.

In the case of a secondary listing, however, we are inclined to agree with such exemption as this is consistent with the existing practice.

Response to Question 20

We agree. Mandatory delisting provisions help improve the overall quality of the New Board.

Response to Question 21

We agree with the current proposal. We believe an established delisting mechanism would: (i) improve overall quality of the New Board; (ii) reduce the number of shell companies on the market; and (iii) encourage New Board PRO issuers to improve its financial performance.

Response to Question 22

We do not see any justification for the New Board PREMIUM to apply a lighter touch enforcement regime comparing to the Main Board. Regulators should apply the same standards for the primary issuers of both boards.

As for the New Board PRO, we incline towards lowering the enforcement regime as professional investors may require less regulatory protection.

Conclusion

We appreciate the opportunity to address and comment on the Concept Paper. We would welcome any further discussion on this matter.

Yours sincerely,

For and on behalf of China Tian Yuan Finance Group

Jason Young

Director

Asset Management Department

China Tian Yuan Finance Group