Deacons' response to the New Board Concept Paper

1. We should attract a more diverse range of companies, including quality "New Economy" companies and international companies, to list here.

In order to stay competitive as an international financial centre as well as a leading listing venue, Hong Kong definitely should seek to attract a more diverse range of companies to list here. We believe that the target issuers should include quality technology and innovative firms (including those Mainland Chinese technology and innovative companies which have already been listed elsewhere) as well as international firms (which can be "New Economy" or other industries and which may or may not have already been listed elsewhere).

2. Our views on the New Board proposal

We welcome the Exchange's initiative to undertake a review of our current listing regime to identify the barriers to attracting "New Economy" companies to list on the local bourse and to explore ways to introduce changes to our current listing regime to accommodate those companies' needs.

One of the key features of the New Board proposal is to open up the market to companies with non-standard governance structures, which are prohibited under our current listing regime. Noting that non-standard governance structures are prevalent in "New Economy" companies, we believe that our market should keep an open mind towards non-standard governance structures while bearing in mind the need to maintain robust regulatory standards to protect investors' interests. Please refer to paragraph 3 below for a further elaboration of our views on non-standard governance structures.

We also agree with the proposal to remove the current "centre of gravity outside China" restriction under the 2013 JPS so as to allow Mainland Chinese technology and innovative companies which have already been listed elsewhere to seek a secondary listing in Hong Kong.

As to the other features of the New Board proposal, we set out below our concerns and suggest the Exchange to give further thoughts to these matters.

(1) A separate New Board for "New Economy" companies

Practical issues in determining whether a company qualifies as a "New Economy" company for admission to the New Board

The current proposal is that an applicant seeking a listing on the New Board is required to demonstrate that it has the characteristics of a "New Economy" company. As it is the key admission criteria for the New Board, it is important to work out a clear definition of "New Economy" companies. Any uncertainty or ambiguity in the definition may make it possible for companies from industries that we are not aiming to attract to list on the New Board. As a market practitioner, we would like to see that:

(a) there are clear rules and guidelines so that we can properly advise our clients on such an admission criteria;

(b) the Exchange's officers handling New Board listing applications are equipped with the requisite expertise in understanding the "New Economy" characteristics and that they will consistently apply the rules and principles in determining whether an applicant has demonstrated that it has the characteristics of a "New Economy" company; and

(c) the Exchange's officers are trained to identify attempts to manoeuvre the definition of "New Economy" in order to obtain a listing on the New Board (say, for example, companies may claim themselves to be technology companies by setting up online platforms despite that they are in essence engaged in traditional industries).

"New Economy" is a concept that evolves over time. New Board companies may cease to qualify as "New Economy" companies after listing.

"New Economy" is a concept that evolves over time. Even if companies do not change their business pursuits, features that meet the "New Economy" at the time of listing may not continue to be so after a period of time.

The Concept Paper does not discuss whether New Board companies have to continue to qualify as "New Economy" companies while they are listed on the New Board, and if so, how the Exchange would monitor this and how it proposes to deal with those New Board companies which no longer qualify as "New Economy" companies. If these companies are allowed to stay on the New Board, the positioning of the New Board as a market for "New Economy" companies would be twisted. On the other hand, if they are required to be delisted from the New Board, it would not be fair to their investors who would be left with interests in an unlisted company. While such companies may choose to migrate to GEM or the Main Board if they can meet the applicable admission requirements, they will have to divest time and resources to the migration process, rather than focussing on their business development.

Main Board and GEM also include "New Economy" companies. The proposed positioning of the New Board as a separate board for "New Economy" companies seems to be convoluted.

We note that the rationale of the Exchange's proposed creation of a separate New Board is to clearly distinguish and segment "New Economy" companies. We have reservations on whether this stated objective can be achieved. Our current markets include "New Economy" companies, albeit they represent a relatively small portion compared to those in the traditional industries. Further, existing Main Board and GEM issuers currently in traditional industries may pursue businesses with "New Economy" characteristics in the future while they will remain listed on the Main Board or GEM. Having "New Economy" companies in the current markets as well as in the New Board may create confusion on the proposed positioning of the New Board as a separate board for "New Economy" companies.

(2) New Board PRO

Start-up firms are of high risk nature. Admission of such companies may impact on the quality of our capital markets.

It is proposed that New Board PRO will not require an issuer to have a track record or to meet any minimum financial hurdles, except for an expected minimum market capitalisation of at least HK$200 million at the time of listing. That means start-up firms with no proven track record may seek to list on New Board PRO so long as they can demonstrate that they are "New Economy" companies.

In view of high risk nature and high rate of failure of start-up "New Economy" companies, we are concerned that admission of these companies may impact on the quality of our capital markets. In this regard, we note that the Exchange proposes to adopt an "easy in, easy out" approach such that the New Board PRO companies would be subject to a suspension and delisting mechanism that would more effectively remove poorly performing companies. However, the proposal did not address the need to look after interests of investors of the New Board PRO companies in the event of suspension of trading or delisting.

We believe that there should be other initiatives to allow these companies easier access to alternative fund-raising platforms and channels such as angel investors to develop their businesses. Once they have proven track record and become able to meet certain financial eligibility requirements, they can then tap into our capital markets.

Limiting to "professional investors" only may not be effective in managing risks of start-up firms, and may give rise to other risks.

The Exchange proposes that the New Board PRO would be open to "professional investors" only so as to mitigate the impact of the high risks associated with start-up firms. However, the current definition of "professional investors" still qualifies a large group of people because of the low threshold of portfolio requirement of just HK$8 million, whether or not they actually have sufficient investment experience or are able to understand the high risks involved. As such, limiting to "professional investors" only may not be effective in managing the impact of the high risks associated with start-up firms.

Further, a market comprised of professional investors only tends to lack liquidity and may thus pose greater risks of volatility. It may also make the market less attractive to potential issuers.

3. Our views on non-standard governance structures

As mentioned in paragraph 2 above, we believe that our market should keep an open mind towards non-standard governance structures while bearing in mind the need to maintain robust regulatory standards to protect investors' interests.

Our focus should therefore be on developing a set of rules that are clear and manageable in practice detailing the circumstances under which non-standard governance structures would be permitted, disclosure requirements and other requirements and/or restrictions that would need to be imposed in appropriate cases with a view to safeguarding investors' interests against risk of abuse by those companies' management/controllers through the non-standard governance structures.

We believe that the same principles should apply whether or not the company concerned has already been listed on NYSE, NASDAQ or other stock exchange in considering whether a disclosure-based approach is sufficient or whether additional requirements and/or restrictions should be imposed. A poor compliance record while listed elsewhere would definitely warrant a stricter approach to be adopted. A good compliance record however may well be just a neutral factor. It is more important to focus on the exact features of the non-standard governance structures and other circumstances of the listing applicants concerned in order to determine whether those features should be permitted and if so, whether it is necessary to impose additional requirements and/or restrictions to safeguard investors' interests.

There should also be an education process for the Hong Kong investing public to understand the possible implications of investments in these companies.

There should also be some measures in place to enable the investing public to quickly and easily identify companies with non-standard governance structures. Such measures can include, for example, having a particular prefix in their stock codes and/or stock short names and requiring prominent warning statements in the listing documents and all post-listing corporate communications.

With appropriate measures in place to safeguard investors' interests, we believe all types of investors should have equal opportunity to invest in these companies.

We should however stress that non-standard governance structures should be permissible for new issuers only (rather than existing listed companies) as there are not yet public shareholders at stake before listing and the investing public may have an informed assessment on whether or not to invest in these companies. If existing listed companies are allowed to adopt non-standard governance structures, the minority shareholders will be left with no choice but to either accept that their existing voting rights would be diminished or restricted, or sell their shares.

Deacons
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