

Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please reply to the questions below on the proposed change discussed in the Consultation Paper downloadable from the HKEX website at:

<http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2017062.pdf>

Where there is insufficient space provided for your comments, please attach additional pages.

1. Do you agree with the proposal to re-position GEM as a stand-alone board and hence remove the GEM Streamlined Process for GEM Transfers and re-introduce the requirements to (a) appoint a sponsor to conduct due diligence for GEM Transfers; and (b) publish a "prospectus-standard" listing document such that GEM Transfer applications are treated as a new listing application (without requiring the applicant to conduct an offering)?

Yes

No

Please give reasons for your views.

Please refer to Appendix I.

2. Do you agree with the proposal to require all GEM Transfer applicants to have (a) published and distributed at least two full financial years of financial statements after their GEM listings; and (b) not been subject to any disciplinary investigations by the Exchange in relation to a serious breach or potentially serious breach of any Listing Rules for 24 months before they can be considered for a GEM Transfer?

Yes

No

Please give reasons for your views.

There is no reason that admission requirements for GEM Transfer applicants should be more stringent than those for Main Board listing applicants. (i) The number of financial years for which the GEM issuer is required to publish financial statements and (ii) the period during which the GEM issuer has not been subject to any disciplinary investigations for serious or potentially serious breaches after listing on GEM, together with the track record period requirement for GEM, should be the same length as the track record requirement for the Main Board. As such, we propose that the current requirements to (i) publish at least one full financial year of financial statements after listing on GEM and (ii) not having been subject to any disciplinary investigations for serious or potentially serious breaches 12 months before GEM Transfers are retained, provided that the current track record requirements of three financial years for the Main Board and two financial years for GEM are also retained (as proposed).

Further, as we take the view that the GEM Board should continue to be positioned as a "stepping stone" to the Main Board, we disagree as a matter of principle that GEM issuers able to meet Main Board listing requirements within a financial year of listing on GEM should have to postpone their GEM Transfer.

3. Do you agree with the proposal to retain the current track record requirement under the GEM Listing Rules (i.e. two financial years)?

Yes

No

Please give reasons for your views.

The current track record requirement under the GEM Listing Rules should be viewed in conjunction with the admission requirements for GEM Transfers to the Main Board. Provided that the current requirements to (i) publish at least one full financial year of financial statements after listing on GEM and (ii) not having been subject to any disciplinary investigations for serious or potentially serious breaches 12 months before GEM Transfers are retained, there is no reason to change the current track record requirement. Please also refer to our answer to Q.2.

4. Do you agree with the proposal to retain the current practice of not requiring a GEM applicant that can meet the Main Board admission requirements to list on the Main Board instead of GEM?

Yes

No

Please give reasons for your views.

We consider that retention of the current practice would be contrary to the Exchange's objective of preserving the respective positions of GEM as a market for small to mid-size companies and the Main Board as a market for larger companies. Likewise, GEM issuers that can meet the Main Board admission requirements are not required to transfer to the Main Board. Taken together with the removal of the GEM Streamlined Process, the result would be an ambiguously positioned, stagnating and eventually, unpopular GEM with no exit to the Main Board and GEM issuers of ever increasing size.

5. Do you agree with the proposal to increase the Cashflow Requirement from at least HK\$20 million to at least HK\$30 million?

Yes

No

Please give reasons for your views. We invite suggestions on other potential quantitative tests for admission to GEM.

We accept that it may improve the overall quality of GEM listing applicants. The increase in cashflow requirement should be proportional to any increase in the minimum market capitalisation requirement, and vice versa.

6. Do you agree with the proposal to increase the minimum market capitalisation requirement at listing from HK\$100 million to HK\$150 million?

Yes

No

Please give reasons for your views.

We accept that it may improve the overall quality of GEM listing applicants. The increase in minimal market capitalisation requirement should be proportional to any increase in the cashflow requirement, and vice versa.

7. Do you agree with the proposal to increase the post-IPO lock-up requirement such that controlling shareholders of GEM issuers:

(a) cannot dispose of any of their equity interest in a GEM issuer within the first year of listing; and

(b) cannot dispose of any interest in the subsequent year that would result in them no longer being a controlling shareholder as defined under GEM Listing Rule 1.01?

Yes

No

Please give reasons for your views.

We agree with the proposal to increase the post-IPO lock-up requirement. However, we consider the Exchange's belief that the proposed extension of the post-IPO lock-up period on controlling shareholders will not be unduly disruptive cannot be its basis. That GEM listing applicants' controlling shareholders have voluntarily offered to remain as the applicants' controlling shareholders for a longer period than required may be attributable to the Exchange's possible perception of GEM listing applicants whose controlling shareholder have changed as shell companies. Indeed, as the Exchange notes, 44% of GEM applicants' controlling shareholders made such an offer after the publication of the 2016 Suitability Guidance Letter. We consider that such demonstration should be voluntary and motivated by market perception, and that they already do so begs the need to compel them.

However, we consider that, to the extent that the Exchange's proposal **gives the market a clear indicator of its requirement**, it is beneficial to potential GEM listing applicants. That is, should a GEM listing applicant comply with the minimum post-IPO lock-up period now proposed by the Exchange, the applicant should not be penalised, or perceived to be a shell company or more likely to be a shell company for not offering a longer period, by the Exchange.

8. Do you agree with the proposal to introduce a mandatory public offering mechanism of at least 10% of the total offer size for all GEM IPOs?

Yes

No

Please give reasons for your views.

We agree that the proposal to introduce a mandatory public offering mechanism of at least 10% of the total offer size of all GEM IPOs addresses the problem of high shareholding concentration at listing and its resulting issues. We also agree that the proposed mechanism would provide more certainty on how to comply with the requirement under GEM Listing Rule 11.23 that there must be an open market in the securities for which listing is sought.

9. Do you agree with the proposals to align the GEM Listing Rules on:

(a) placing to core connected persons, connected clients and existing shareholders, and their respective close associates with those under Appendix 6 to the Main Board Listing Rules and Guidance Letter HKEX-GL85-16 "*Placing to connected clients, and existing shareholders or their close associates, under the Rules*"; and

Yes

No

Please give reasons for your views.

We agree that such alignment would safeguard GEM shareholders.

- (b) the allocation of offer shares between the public and placing tranches and the clawback mechanism with those in Practice Note 18 to the Main Board Listing Rules?

Yes

No

Please give reasons for your views.

We agree that such alignment would safeguard GEM shareholders.

10. Do you agree with the proposal to increase the minimum public float value of securities from HK\$30 million to HK\$45 million?

Yes

No

Please give reasons for your views.

Provided that the minimum market capitalisation at the time of listing is increased to HK\$150 million as proposed, we agree. The increase in minimum public float value of securities should be in line with any increase in minimum market capitalisation, such that the minimum public float value of securities remains 30% of the minimum market capitalisation at the time of listing.

11. Do you agree with using the Profit Requirement to determine eligibility to list on the Main Board?

Yes

No

If not, what alternative test should be used? Please give reasons for your views.

The Profit Requirement is a more reliable indicator of the quality of Main Board listing applicants than minimum market capitalisation, as the latter may be affected by market conditions.

12. If you agree to retain the Profit Requirement, do you agree that the current level of profit under the Profit Requirement should remain unchanged?

Yes

No

Please give reasons for your views.

Provided that GEM's admission requirements are increased (as proposed), the Profit Requirement should be increased to preserve the respective positions of GEM and the Main Board.

13. Do you agree with the proposal to increase the minimum market capitalisation requirement at listing for Main Board applicants from at least HK\$200 million to at least HK\$500 million?

Yes

No

Please give reasons for your views.

Please refer to Appendix II.

14. Do you agree with the proposal to proportionately increase the minimum public float value of securities for Main Board applicants from HK\$50 million to HK\$125 million?

Yes

No

Please give reasons for your views.

As stated in Appendix II, we propose that the minimum market capitalisation at listing on the Main Board should be HK\$300 million. The increase to the minimum public float value for Main Board applicants should be in line with any increase to the minimum market capitalisation, such that the minimum public float value remains 25% of the minimum market capitalisation. As such, we propose that the minimum public float value is increased to HK\$75 million.

15. Do you agree with the proposal to increase the post-IPO lock-up requirement such that the controlling shareholders of Main Board issuers:

- (a) cannot dispose of any of their equity interest in a Main Board issuer within the first year of listing; and
- (b) cannot dispose of any interest in the subsequent year that would result in them no longer being a controlling shareholder as defined under Main Board Listing Rule 1.01?

Yes

No

Alternatively, do you believe that it is not appropriate to extend the post-IPO lock-up requirements for Main Board applicants, given that they are less likely to have the characteristics identified in the 2016 Suitability Guidance Letter because of their larger size and our proposal to raise the minimum market capitalisation requirement to HK\$500 million.

Please give reasons for your views.

As for the equivalent proposal for GEM, we consider that the proposal is beneficial to potential listing applicants as long as it gives the market a clear indicator of the Exchange's requirement. Please also refer to our answer to Q.7.

The post-IPO lock-up period on controlling shareholders should be the same as that for GEM issuers.

To address your concern over shell companies transferring to the Main Board, which is legitimate, we propose that as a general rule, an identical lock-up period be imposed on the controlling shareholders of GEM Transfer applicants that have changed their controlling shareholders and/or principal businesses since listing to demonstrate their commitment to the applicant and that the transfer is not due to larger premium attached to the listing status of a Main Board company. Please also refer to our answer to Q.1.

16. Do you agree that the proposals for the Main Board should be considered independently irrespective of the outcome of the proposals for GEM?

Yes

No

Please give reasons for your views.

As stated on p.16 of Consultation Paper, the proposed amendments to the GEM Listing Rules, if adopted, will mean that the GEM listing requirements will be close to, or exceed, the equivalent requirements of the Main Board. The Exchange has **therefore** reviewed and proposed to amend certain Main Board requirements to preserve the Main Board's position as a market for **larger** companies.

As such, the premise for the proposals relating to the Main Board is the outcome of the equivalent proposals relating to GEM. For instance, it would not be reasonable, or indeed desirable, for the post-IPO lock-up period on controlling shareholders for the Main Board to be longer than that for GEM. Further, as the Exchange implied, the respective positions of GEM and Main Board are linked together. As such, the proposals of the Main Board and GEM, and their outcome, should be considered as a whole.

- End -

Appendix I

Question 1

The Main Board is widely recognised as a better fundraising platform than GEM. Naturally, therefore, GEM issuers seek to transfer to the Main Board when they become eligible. To introduce obstacles to GEM Transfers is a backward step in developing our market for businesses seeking a fundraising platform to grow. In any event, such introduction does not address the legitimate concern of regulatory arbitrage.

We disagree with the proposal to re-position GEM as a stand-alone board.

As set out on page 8 of the Consultation Paper, the Exchange considers that GEM's "stepping stone" position has achieved limited success, in view of the following:

- (i) only one H-share company has listed on GEM since the 2008 Rule Changes and up to 31 December 2016;
- (ii) since the 2008 Rule Changes and up to 31 December 2016, the number of GEM Transfers per annum has not exceeded the 14 transfers that were completed in the second half of 2008 immediately after the implementation of the GEM Streamlined Process; and
- (iii) the total number of GEM Transfers compared to the total number of GEM issuers eligible for a GEM Transfer, decreased from 7.2% in second half of 2008 to 2.7% in 2016.

There is nothing fundamentally wrong with the characteristics of GEM as a "stepping stone". To contend that GEM has failed to provide them with a "stepping stone" is to say that:

- (i) access to capital cannot facilitate growth; and/or
- (ii) the GEM Streamlined Process cannot facilitate transfers.

Neither is, of course, true.

Evidently, GEM has achieved more than "limited success" as a "stepping stone" to the Main Board. GEM issuers have made such use of GEM and transferred to the Main Board. The 99 GEM Transfers during 2003 to 2016 represent approximately 45% of the 222 GEM issuers as at 31 December 2015 and approximately 28% of the 349 GEM issuers that listed during 1999 to 2015.

The Consultation Paper states on page 25: “The rate of GEM Transfers has been decreasing from 7.2% in the second half of 2008 to 2.7% in 2016.” However, it is no clear and convincing evidence of a downward trend in GEM Transfers. The rate and number of GEM Transfers fluctuates from year to year. In 2015, the rate was 6.9%, a mere 0.2% short of the 7.2% in the second half of 2008, and the number was 14, the same as that in the second half of 2008. The average number and rate of GEM Transfers per year have increased since the GEM Streamlined Process became effective from approximately 3 to 9 and approximately 1.8% to 5.0%, respectively.

Moreover, the rates of GEM Transfers set out in Table 1 on page 26 of the Consultation Paper are misleading. The denominator is the total number of GEM issuers, including newly listed GEM issuers, as of the preceding year or period end. As noted on page 26 of the Consultation Paper, GEM Transfer applicants are listed on GEM for an average of 5.4 years before transferring to the Main Board, and the denominator should have been adjusted accordingly.

In any event, GEM’s success as a “stepping stone” should not be measured solely by the rate of GEM Transfers. It is commercial reality that the growth, pace of growth and actions of businesses vary, and those issuers depend not on the nature and attributes of the listing platform but principally other commercial and economic factors.

We disagree with the proposal to remove the GEM Streamlined Process for GEM Transfers, except for GEM Transfer applicants that have changed their controlling shareholders and/or principal businesses.

As set out on page 8 of the Consultation Paper, there are concerns that the GEM Streamlined Process may provide an opportunity for regulatory arbitrage due to the following differences between the Main Board and GEM:

- (i) GEM’s optional placing only offering mechanism and lower public shareholder requirement;
- (ii) GEM’s lower admission requirements; and
- (iii) the less comprehensive due diligence process for GEM Transfer applicants.

As set out on page 8 of the Consultation Paper, there are concerns that GEM’s optional placing only mechanism and lower public shareholder requirement may have led to a high concentration of shareholders, illiquid shares and increased price volatility post-listing. In addition to the 2017 Joint Statement, these issues are, and should be, addressed by the proposals relating to the open market requirement: (i) the mandatory public offering mechanism of at least 10% of the

total offer size; and (ii) the alignment of GEM requirements with Practice Note 18 to the Main Board Listing Rules.

As set out on page 8 of the Consultation Paper, there are concerns that GEM's lower admission requirements may have been exploited by certain companies to access the Hong Kong capital markets for the premium attached to a listing status and this may have led to an increase in the number of potential shell companies listed on GEM. However GEM's lower admission requirements are necessary to preserve its position as a market for small to mid-size companies. We note that the Exchange believes that the likelihood of the lower admission requirements having been abused is low.

The Consultation Paper states on page 23 that GEM Transfer applicants are not subject to a due diligence process as comprehensive as that for new applicants directly applying to be listed on the Main Board, leading to potential shell companies being listed on the Main Board. We disagree that the due diligence process for GEM Transfer applicants is less comprehensive, given the due diligence to which they were subject as GEM listing applicants.

We recognise the legitimate concerns over those GEM Transfer applicants that have changed their controlling shareholders and/or principal businesses since listing. To address this, we propose that such GEM Transfer applicants are excluded from the GEM Streamlined Process and subject to the proposed requirements of appointing a sponsor to conduct due diligence for GEM Transfers; and publish a "prospectus-standard" listing document. Further, we propose that a lock-up period of two years be imposed on the controlling shareholders of such GEM Transfer applicants to demonstrate their commitment to the applicant and that the transfer is not due to larger premium attached to the listing status of a Main Board company. We consider that such a targeted approach addresses the concerns without penalising genuine GEM Transfer applicants.

In view of the utility and success of GEM as a "stepping stone" to the Main Board and we disagree that the GEM Streamlined Process for GEM Transfers should be removed. The removal of the GEM Streamlined Process would significantly increase the costs of, and thereby create a strong disincentive for, GEM Transfers. On the contrary, we should encourage GEM issuers to aim for a GEM Transfer, as their growth and development create value for all stakeholders, including but not limited to, their investors and employees. The GEM Streamlined Process clearly facilitates and is conducive to this process. Some GEM issuers could not, or did not, transfer to the Main Board. It does not follow that other GEM issuers' should be hindered from doing so, to the detriment of the economy and stakeholders.

Further, regulatory arbitrage does not arise from the GEM Streamlined Process and cannot be resolved by removal thereof. Responding to concerns of regulatory arbitrage by undermining

GEM's utility as a "stepping stone" to the Main Board and the frustration of GEM issuers with legitimate reasons for listing is ill-conceived.

We disagree with the proposal to re-introduce the requirements to (a) appoint a sponsor to conduct due diligence for GEM Transfers; and (b) publish a "prospectus-standard" listing document such that GEM Transfer applications are treated as a new listing application (without requiring the applicant to conduct an offering), except for GEM Transfer applicants that have changed their controlling shareholders and/or principal businesses.

As stated above, we disagree with the removal of the GEM Streamlined Process. For those GEM Transfer applicants who have not changed their controlling shareholders and/or principal businesses after listing on GEM, we consider that additional due diligence and publication of a "prospectus-standard" listing document would be superfluous, "unduly disruptive" to GEM issuer and significantly increase the costs of a GEM Transfer, creating a strong disincentive for GEM Transfers, which would be harmful to the economy and stakeholders.

We consider the Transitional Arrangements unreasonable.

The Transitional Period should be at least six years from the date of listing. As the Exchange noted, GEM Transfer Applicants are listed on GEM for an average of 5.4 years before transferring to the Main Board. Moreover, general economic conditions have been favourable since the global financial crisis of 2007 to 2008. A Transitional Period of six years would leave no buffer for an economic downturn. Assuming that the Transitional Period will be six years from the date of listing, we agree that eligibility of GEM Transfer Applicants for GEM Transfers should be assessed **in accordance with the existing Main Board Listing Rules as at the date of the Consultation Paper** during the Transitional Period.

As stated above, we agree that applicants that have changed their principal businesses and/or controlling shareholders since listing on GEM should be required to appoint a sponsor to conduct due diligence and publish a "prospectus standard" listing document as if they are new listing applicants to the Main Board during the Transitional Period. However, as we do not consider that the due diligence process for GEM Transfer applicants is less comprehensive than Main Board listing applicants, we disagree that applicants that have not undergone such change(s) should be required to appoint a sponsor in connection with the GEM Transfer announcement.

Appendix II

Question 13

We disagree with the proposal to increase the minimum market capitalisation requirement at listing for Main Board applicants from at least HK\$200 million to at least HK\$500 million.

As set out on page 60 of the Consultation Paper, the Exchange proposes the figure of HK\$500 million for the following reasons:

- (i) it broadly reflects the doubling in the average size of listed companies since the minimum market capitalisation requirement was introduced in 2004;
- (ii) it significantly reduces the percentage of Selected GEM Issuers that could have met the Main Board requirement. Only 9% of Selected GEM Issuers would have been able to meet a HK\$500 million market capitalisation requirement, compared with 71% of Selected GEM Issuers that could meet the current HK\$200 million requirement much further effect, as 7% of the Selected GEM Issuers could meet a requirement that was as high as HK\$900 million;
- (iii) it would have excluded only 13% of direct listing applicants to the Main Board from 2010 to 2016 and 33% of GEM transfers to the Main Board. This means the Main Board would remain available as a listing venue for a majority of larger companies (providing benefits to them such as eligibility for Hang Seng Indexes) and GEM would continue to be available for excluded companies; and
- (iv) it positions our Main Board closer to some of the Selected Overseas Main Markets (i.e. Nasdaq Global Select Market, NYSE and SGX) with regards to their expected market capitalisation requirements.

We consider that the proposed increase to the minimum market capitalisation of the Main Board would be excessive for the Main Board to preserve its position as a market for larger companies. The Exchange proposes to increase it 2.5 times as compared to the proposed 1.5 times for GEM, when a proportional increase to HK\$300 million would suffice.

While the average market capitalisation of a Main Board listed company has increased to HK\$14.7 billion, it does not follow that the admission requirements should also increase. The doubling of the average market capitalisation of Main Board listed companies since 2004 demonstrates the effectiveness of the Main Board as a growth platform for companies of HK\$200 million or greater in market capitalisation over time. Their success does not justify an entry barrier to future Main Board applicants. On the contrary, such success should be facilitated.

The reasoning that the Main Board would remain available as a listing venue for a majority of larger companies and that GEM would continue to be available for small-to-mid size companies would apply whether the minimum market capitalisation were HK\$250 million or HK\$700 million (as illustrated in Table 8 on page 59 of the Consultation Paper).

That 71% of Selected GEM Issuers meet the current minimum market capitalisation and 37% of Selected GEM Issuers met the current minimum market capitalisation of the Main Board at listing are meaningless, when the Exchange does not compel such GEM issuers to transfer or list, as the case may be, on the Main Board.

The Exchange has not clearly articulated where the Main Board would be positioned relative to the Selected Overseas Main Markets, nor has it substantiated the reasons for, and benefits of, such re-positioning.

We consider the comparison of the minimum market capitalisation requirement of Selected Overseas Main Markets and the Main Board set out in Table 9 on page 60 of the Consultation Paper to be limited. The minimum market capitalisation of a stock market should be considered in conjunction with other admission requirements, which were relegated to the footnotes. For instance, the approximately HK\$843 million requirement for SGX applies to applicants that cannot meet the SGX profit requirement, whereas the minimum market capitalisation requirement that the Exchange is proposing to change applies to applicants that meet the Main Board profit test. The market capitalisations required under the market capitalisation/ revenue/ cash flow and market capitalisation/ revenue tests are HK\$4 billion and HK\$2 billion, respectively.