

16 AUGUST 2017

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

BY POST AND EMAIL

Dear Sirs

New Board Concept Paper and the Consultation Paper on Review of the Growth Enterprise Market ("GEM") and Changes to the GEM and Main Board Listing Rules (the "Papers") issued by The Stock Exchange of Hong Kong Limited ("HKSE")

The HeungKong Financial Group welcomes the opportunity to respond to the HKSE's request for comments on the Papers issued in June 2017.

As a comprehensive financial services platform, the HeungKong Financial Group appreciates the importance of the questions raised in the Papers to the Hong Kong financial market and fully supports HKSE in its initiatives to promote Hong Kong's competitiveness as an international financial centre and the attractiveness of HKSE as a listing venue.

As market practitioners, we welcome the introduction of new boards to address some of the shortcomings of the current market regime and are in general agreement with the proposals raised in the New Board Concept Paper. Set out below is our detailed response to some of the specific issues raised in the Papers. We express no particular views on matters which are not addressed below.

1. Definition of "New Economies"

- 1.1 The requirement for companies to fit into a few specific industries deemed "New Economies" raises several issues. In an era of fast paced global development, new ideas, industries and business models are constantly emerging, and it would be difficult to predict the "new economies" of the future. Requiring listing applicants to fit into pre-defined categories would, firstly, alienate quality companies from other industries; secondly, prompt applicants which do not ostensibly qualify as being from "New Economy" industries to create gratuitous business lines to bring themselves within the definition; and, thirdly, render new rule changes necessary if new economies and business models not currently anticipated emerge in the future.
- 1.2 We therefore believe that the new boards should be open to application by companies from all industries (subject only to requirements of legality and considerations of public policy).



2. New Board PRO

- 2.1 We welcome the positioning of New Board PRO as a funding platform for pre-growth stage companies seeking what is traditionally known as the pre-IPO rounds of investments. There are many innovative companies in the market which are led by entrepreneurs with creative ideas and are only in need of funding to see their ideas come to fruition. We believe that a light touch regime for fundraising by these companies would not only provide a platform for matching investors with quality investment opportunities but also help standardise the disclosures and processes for pre-IPO private equity investments.

Financial eligibility criteria

- 2.2 Given its positioning as a funding platform for pre-profit companies, we would recommend that the proposed market capitalisation requirement of HK\$200 million be either removed or lowered for applicants to New Board PRO as it would be difficult for pre-profit companies without a financial track record to justify a minimum market capitalisation.
- 2.3 While we see great value in New Board PRO being an avenue for pre-profit companies to raise funding, the pre-profit nature of the issuers means that the shares will, at least in the initial stages, be illiquid as investors will unlikely sell their shares before the issuer enters a profit generating phase. In that respect, we would suggest that the minimum investor requirement be set at a maximum figure of 50 to minimise barriers to entry and to enable New Board PRO to better serve as an efficient and cost-effective funding channel to pre-profit companies. At the pre-growth stage, the priority should be to enable applicants to overcome development barriers brought about by a lack of funding and the need to satisfy numerical thresholds and requirements may detract from that objective.

Application of sponsor regime

- 2.4 Regardless of its issuer or investor base, listings on New Board PRO nonetheless constitute regulated offers for which the input of sponsors, being experienced advisers on securities offerings, would not only improve investor confidence but also help enhance the integrity of the market. Management of the listing process requires a specific skills set (e.g. the conduct of a thorough due diligence exercise and the ability to advise on procedures, systems and controls and regulatory requirements, draft listing documents to requisite disclosure standards and communicate effectively with regulators) which licensed persons in Type 6 regulated activity with no track record in public offerings may not possess. We are therefore of the view that the existing sponsor regime should apply to listings on New Board PRO in order to enhance and maintain its credibility and attractiveness.

HKSE's right to refuse applicants meeting requirements for other boards to list on New Board PRO

- 2.5 It is our view that each board should be successful in its own right in attracting a diverse issuer base and providing investors access to quality companies. As such, each applicant should be free to choose the board which is most appropriate for it having regard to its own needs and profile.



3. Investor eligibility

WVR Structures

- 3.1 As market practitioners, we are acutely aware of the difficulties in balancing the need for adequate investor protection and the attractiveness of HKSE as a listing venue. While we consider the need to uphold the principle of equality between shareholders to be of paramount importance in maintaining the integrity of our markets, we believe the fairest way of achieving both objectives is to limit the eligibility to invest in companies with WVR structures or non-equivalent shareholder protection standards to professional investors only.

Pre-profit companies

- 3.2 As investment in pre-profit companies poses significantly higher risk to investors, we agree with the proposal that only professional investors may invest in New Board PRO.

4. WVR structures – investor protection

- 4.1 We agree that there should be flexibility in allowing companies with WVR structures to list on the new boards. If these companies are available for investment by professional investors only, we believe that adequate disclosure of the applicable WVR structure and corporate governance provisions would suffice. However, if companies with WVR structures are available for investment by retail investors, then at least the following investor protections should be in place:

- (a) only individuals who satisfy strict criteria (e.g. founders) may hold shares carrying more than one vote per share (“Class B Shares”);
- (b) Class B Shares shall not be transferrable; and
- (c) Class B Shares shall automatically convert to shares carrying one vote per share upon the expiration of a time limit (with a maximum time limit provided for by the Listing Rules).

5. Definition of “professional investors” and verification of professional status

- 5.1 We believe the criteria for defining “professional investor” should be the same as that used in other regulatory contexts (i.e. as defined under Schedule 1 of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)), as the principles and reasons behind the use of the term “professional investors” in considering investor eligibility with respect to the new boards are the same as those which apply in other contexts.
- 5.2 We note the practical difficulty of ensuring that only professional investors take part in the secondary trading of shares listed on the new boards and do not agree that Exchange Participants should bear the full weight of the compliance burden for ensuring that only professional investors trade on the new boards. We would recommend that Exchange Participants be required to verify investors’ professional status at account opening and at no more than annual intervals for the investor to be able to trade throughout the year.



6. Continuing obligations – minimum quantitative criteria

- 6.1 In the Concept Paper, HKSE also sought views on whether to require companies listed on the new boards to meet quantitative criteria on a continuous basis (e.g. share price above a threshold) to help to improve market quality by facilitating the removal of poorly performing companies and to reduce the possibility of such companies becoming “shells”.
- 6.2 Whilst we agree that there should be mechanisms to discourage the maintenance of and trading in “shell” companies, we are of the view that minimum quantitative requirements are not effective ways of achieving that aim. The requirement for issuers to meet quantitative criteria would divert the issuer’s efforts and resources to satisfying the criteria rather than to the benefit of its long term goals, thereby rendering the targets meaningless.¹ Moreover, quantitative measures such as a minimum share price can be easily circumvented by methods such as the consolidation of shares.
- 6.3 We therefore suggest that the appraisal of the quality of listed companies be left to market forces, and that rules for enhanced disclosure requirements (e.g. taking a stricter approach to issuers who fail to disclose material information) be enforced to promote market integrity and transparency.

7. Companies with secondary listings

- 7.1 We welcome HKSE’s initiatives to attract companies with a primary listing elsewhere to list in Hong Kong and, subject to the observations made in paragraph 3 (Investor eligibility), agree that certain requirements should be relaxed for issuers from Recognised US Exchanges seeking secondary listings in Hong Kong.

8. Expedited delisting process

- 8.1 In recent years there has been a prevalence of companies maintaining its listed “shell” in anticipation of buyers who wish to acquire listing status. This phenomenon has given rise to issues which are beyond the scope of the present discussion, but our view is that the implementation of an expedited delisting process would have the benefit of disincentivising the creation and maintenance of listed shells. On the other hand, an expedited delisting process would also greatly increase investors’ risk exposure, as a delisting would deprive investors of the protections afforded to shareholders of a listed company. We would therefore suggest, consistently with our earlier recommendation, that the new boards be restricted to investment by professional investors only.

9. Proposals relating to GEM and the Main Board

Raising minimum market capitalisation

- 9.1 We agree with the proposals to increase the minimum market capitalisation requirement for both GEM and the Main Board, as the listing exercise should enable applicants to raise funds which, net of the expenses associated with the listing, make the listing exercise commercially justifiable.

¹ As per Goodhart’s law: “when a measure becomes a target, it ceases to be a good measure”.



Public float requirement

9.2 We believe the public float requirement for GEM should be expressed as a percentage rather than as a figure (which is currently HK\$30 million and is proposed to be increased to HK\$45 million). This would ensure that a large market capitalisation company maintains sufficient public float.


10. Inter-dependency of the proposals

10.1 We are in general agreement with the proposed changes to be made to the financial eligibility criteria for listing on GEM and the Main Board, and agree that these should be considered independently of each other and of the proposals regarding the new boards. Having said that, changes to the positioning of GEM and the Main Board, and the role of the new boards, in the broader framework of the Hong Kong market should, as already noted by HKSE in the Papers, be considered holistically.

As mentioned earlier, we welcome the HKSE's initiatives to explore innovative ways to improve Hong Kong's standing as a leading international financial centre. HeungKong Financial Group firmly believes that a regime which protects shareholders while promoting Hong Kong's global competitiveness will support the healthy development of the market which will, in turn, benefit both investors and market practitioners.

Yours faithfully

For and on behalf of the HeungKong Financial Group



Tong Yau
Chief Executive Officer