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Our Ref [redacted]

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Dear Sirs

Re: New Board Concept Paper and Consultation Paper on Review of the Growth Enterprise Market (GEM) and Changes to the GEM and Main Board Listing Rules

KPMG welcomes the opportunity to respond to the New Board Concept Paper and the Consultation Paper on Review of the GEM and Changes to the GEM and Main Board Listing Rules. Unless otherwise noted, terms used in our responses herein shall have the same meanings as those defined in the Concept Paper and the Consultation Paper.

We have considered the proposals in totality and we are in strong support of the need to attract more listings of New Economy companies in Hong Kong and the general direction the HKEX is heading with its proposals to achieve this objective.

The market has changed from the beginning of the decade where the largest listed companies, based on market capitalisation, globally were those from traditional industries such as oil and gas. Instead, the market is now led by technology companies Apple and Alphabet. In addition, technology-based companies such as Amazon, Facebook, Microsoft and Tencent are consistently ranked in the global top 10 listed companies by market capitalisation. In Hong Kong, excluding Tencent, listed companies from the three largest traditional sectors (finance, real estates and consumer goods) represented around 60 percent of both market capitalisation and stock turnover of the HKEX in 2016, while I.T. companies (as defined under Hang Seng Industry Classification System) were less than 5%. In our view, the relative scarcity of New Economy listing in Hong Kong poses a clear threat on the attractiveness of our capital markets, given that a substantial portion of the IPO pipeline and other capital market related activities are expected to come from New Economy enterprises.

For Hong Kong to maintain and preserve its status as a global leading financial hub and a gateway between China and the rest of the world, we need to adapt to the ever-changing business environment and seek to attract listings from a more diverse range of companies, especially New Economy companies. On the other hand, it is of upmost importance that we preserve the high level of quality of our capital markets.

Under this premise, we have set out the following comments and suggestions to facilitate further development or consideration of the proposals.

New Board PREMIUM – Capturing the iconic New Economy companies

On the whole, we are supportive of the key concepts behind New Board PREMIUM. We are also of the view that the objectives of New Board PREMIUM could be achieved without establishing a separate board. We trust that the HKEX will carefully consider the pros and cons of a separate board, as opposed to accommodating the listing of New Economy companies with non-standard governance structures on the Main Board.

We consider the listing requirements for New Board PREMIUM (regardless of the establishment of a separate board) should be similar to those of the Main Board. This is because Main Board listing rules have proven over the year to be of a high-standard, although modifications to facilitate the listing of New Economy companies with non-standard governance structures will be required as elaborated further below.

Non-standard governance features

The founders of a New Economy company play a unique role in the way businesses operate and are shaped, which cannot be found in other sectors. Investors recognise the importance of the founders and are often willing to let them retain control of their companies through preferential arrangements, e.g. adopting non-standard governance structures. These non-standard governance structures (i.e. weighted voting rights or WVR) are common in many U.S. New Economy giants such as Alphabet and Facebook, as well as the recent listing of Snapchat in March 2017.

In principle, we are supportive of the proposal to allow New Economy companies with non-standard governance structures to list in Hong Kong. We believe this is essential in attracting high quality New Economy companies to seek a primary listing in Hong Kong as well as the secondary listings of iconic New Economy companies that are already listed elsewhere.

We are, however, mindful of the need for high regulatory standards and the possibility of abuse of power by shareholders with superior voting rights. The permission of the WVR structures should not come at the expense of diminished shareholder protection. Therefore, we propose that the use of non-standard governance structures should be accompanied by proper mandatory investor protection safeguards. Restrictions that are commonly seen in the U.S. market that the HKEX may consider adopting include "restriction on transfers", "minimum equity threshold held by founders", and "sunset clause" (i.e. require the non-standard governance structures to fall away after a pre-determined period of time).

We agree that companies listed on a Recognised US Exchange with a good compliance record and are seeking a secondary listing in Hong Kong should be exempted from adopting the mandatory safeguards based on the general premise that secondary listed companies should be principally regulated by the rules and authorities of the jurisdiction where they are primary listed.

Removal of the "centre of gravity" requirement

We understand that the intention of prohibiting companies with a "centre of gravity" in Greater China to pursue a secondary listing in Hong Kong is to discourage such companies from seeking "regulatory arbitrage". However we have noted that most Chinese companies' listings on overseas stock exchanges (mostly in the U.S.) were driven by factors such as valuations and the ability to adopt WVR structures – rather than regulatory arbitrage.

In addition, the combination of globalisation and the expanding business footprints of many New Economy businesses (e.g. internet and direct marketing retail) meant the concept of "centre of gravity" has become less relevant. As a result, we strongly support the proposed elimination of the "centre of gravity" requirement.

Delisting

The current intention is that New Board PREMIUM companies should meet quantitative entry requirements equivalent to those of the Main Board. Companies following a listing would be expected to comply with the standards applicable to Main Board listed companies. Following that, it appears to us New Board PREMIUM, if such a board is to be established, should also follow the delisting process of the Main Board. This is in spite of the recognition that the existing Main Board delisting process is slow and inefficient. Nevertheless, it is important for any revised delisting process or policy to be subject to the same holistic, robust review that we understand the HKEX will undertake for the Main Board and GEM.

Therefore, we are not sure there is a strong rationale to introduce an accelerated delisting process as stipulated in the proposals, which would require the listing status of New Board PREMIUM issuers be cancelled if they have been suspended for a continuous period of 6 months.

To further elaborate, we are in strong support of an accelerated delisting framework as prolonged suspensions of problematic companies undermines the reputation of the Hong Kong financial markets. However, we believe this should be achieved through a holistic review of the existing process and a broad market consultation.

New Board PRO – Striking a balance between ease of fundraising and market quality

While we support the objective to facilitate easier fundraising by pre-profit New Economy companies, we stress that this should not come at the expense of diminished market quality.

Under the proposals, pre-profit companies (or companies that do not meet the track record requirements of the Main Board or GEM) with a minimum market capitalisation of HK$ 200 million at the time of listing may be qualified for a listing on New Board PRO. We note that some sections of the market are concerned about the quality of these companies which may not have passed the developmental stage and are therefore yet to be able to demonstrate a sustainable business model.

Even though New Board PRO companies would only be opened to professional investors, allowing companies with no track record to list in Hong Kong under a "lighter touch" vetting approach may be detrimental to the general health of the Hong Kong capital markets.

Under the existing capital market ecosystem, start-up or pre-profit companies with growth potentials often obtain financial support from private equity, venture capital and/or other institutional investors through several rounds of fund raising activities (i.e. seed/angel-, A-, B- and C-round financing) before they eventually go for a listing. These pre-IPO investors can offer start-ups not only the funds they need for expansion, but also the business expertise and connections that the start-ups are looking for.

If a new board catered for "quality" small to mid-sized New Economy issuers is to be established, we suggest the HKEX to carefully assess the eligibility requirements including the possibility of raising the bar for entry (e.g. the minimum market capitalisation at the time of listing). It would also be helpful if the HKEX could provide insights, in their next round of markets consultations, as to how New Board PRO could fit into the existing entrepreneurship ecosystem, in particular to how it is expected to correspond with the different development (and funding) stages of New Economy companies that are raising capital and how New Board PRO can complement the existing capital markets infrastructure.

On the other hand, market concerns over the possibility of low trading turnover or illiquidity of New Board PRO should be considered as part of the listing eligibility assessment. Under the proposals, New Board PRO is restricted to professional investors only, which resembles the positioning of the Mainland's National Equities Exchange and Quotations (NEEQ). Recent market statistics have shown that the total number of newly listed NEEQ companies, as well as applicants, has declined year on year. This is in conjunction with a large increase in the number of NEEQ companies seeking a delisting. Amongst all the issues the NEEQ faces, a shortage of liquidity is perhaps the most important as more than half the stocks listed on the bourse do not trade actively. The relatively low admission requirements of the NEEQ is believed to be one of the causes of the illiquidity as investors are not interested in investing in many of these companies, as they are deemed to be of a low-quality.

Liquidity is an important factor for sound market development. For New Board PRO to succeed, we are of the view that a market open to all investors, coupled with due diligence investigations by sponsors as would be taken for other HKEX listed issuers should be followed in order to preserve the level of quality Hong Kong has already established.

We believe a proper cost-benefit analysis is required to maintain the right balance between the ease of fundraising by pre-profit companies and the quality of the market. To avoid delaying the implementation of other proposals, HKEX may consider pushing forward the other proposals first and deferring the implementation of New Board PRO to the next phase of the reform.

Repositioning of GEM and tightening up GEM listing requirements – Importance for upholding a high quality capital market

In light of the issues associated with "shell creation", highly concentrated shareholdings and unusual high price volatility of GEM stocks, we support the HKEX's proposal to uplift the admission and public float requirements. We also support the proposal to re-position GEM as a stand-alone board for small and medium-sized enterprises and remove the streamlined transfer process as a way to tackle some of these issues.

A high quality capital market is essential to attract investors from around the world. Even a small failure in part of the listing framework may significantly damage investor confidence in Hong Kong's capital markets. Therefore, the regulatory issues associated with GEM demand immediate attention and any effective measures that can address the problems should be implemented.

Conclusion

To maintain Hong Kong's position as one of the world's leading equity fundraising destinations, the HKEX should continue to evaluate the overall listing framework and propose possible reforms to strengthen Hong Kong's role as an international financial centre. However, this does not necessarily mean that the changes should come at the cost of giving up its high regulatory standards. A balanced approach - recognising the importance of a fair and efficient market in Hong Kong that remains relevant in an ever-changing economy, while preserving high regulatory standards that protect investors from abuse - should be adopted.

We look forward to seeing the conclusions in relation to the New Board Concept Paper and Consultation Paper on Review of the GEM and Changes to the GEM and Main Board Listing Rules and further consultations on the New Board.

Yours faithfully

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