

# Concept Paper on the New Board and Consultation Paper on Review of the GEM and Changes to the GEM and Main Board Listing Rules

## Response from Linklaters

We set out below some comments and observations in relation to the issues raised in Hong Kong Exchanges and Clearing Limited (“**Exchange**”)’s Concept Paper on the New Board. We also set out below our general comments on the Consultation Paper on Review of the GEM and Changes to the GEM and Main Board Listing Rules.

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### **A Concept Paper on the New Board**

#### **1 Summary**

- 1.1** We support Exchange’s efforts to open up the Hong Kong listing platform to a more diverse range of issuers. In particular, we support Exchange’s effort to attract “new economy” companies, including pre-profit technology companies and companies with unconventional governance structures.
- 1.2** Certain commentators have expressed a lack of confidence in the proposals in the New Board Concept Paper, noting that the success of other markets in specialist sectors is based on sector-focussed analyst and investor communities and liquidity rather than listing regulation. We agree that a full ecosystem, including analyst and investor communities, which incubates and supports innovative industries in Hong Kong is of critical importance and that rule changes alone are not going to bring about substantive changes. However, we recognise that it will be difficult to bring about change of this nature in the short term and therefore welcome the proposals to consider changing the relevant regulations.
- 1.3** On the specific proposals set out in the New Board Concept Paper, we make the following two observations and suggestions, which we further elaborate on in this response:
- (a) Unconventional governance structures (“UGS”): We think that the market rather than regulators should judge whether an individual listing applicant is a suitable candidate for UGSs. The regulators should put in place rules which ensure that there is sufficient market scrutiny of companies with UGSs and sufficient investor protection.
  - (b) Segmentation and New Board PRO: We do not support the extensive segmentation of boards proposed in the New Board Concept Paper. Too many separate boards, which are similar in nature, will lead to confusion amongst issuers, investors and regulators alike. If a New Board PRO is nevertheless adopted, we believe the regulators should use it as testing ground for a purely disclosure-based regime, instead of a regime where financial advisers act as gate keepers.

#### **2 Unconventional governance structures**

- 2.1** One of the key reasons put forth by proponents of UGSs is that Hong Kong competes on a global platform against other leading capital markets such as New York and London. To the extent other listing venues permit UGSs, Hong Kong is at a competitive disadvantage as listing applicants will gravitate towards listing venues which give them (and their founders)

maximum flexibility, including by allowing UGSs. A key question which the Concept Paper does not explore is whether this presumption is accurate. We encourage future consultation papers to further investigate this, particularly from two perspectives:

- (a) Is Hong Kong's current system of regulation – which prevents the listing of companies with UGSs – a or the determinative reason why high-profile companies like Alibaba chose not to list in Hong Kong and is it likely that a material number of similar issuers would in the future choose not to list in Hong Kong for this reason. In our experience, an issuer's choice of the listing venue usually takes into account a large number of factors, with no one factor, particularly the rules applying to UGSs, being determinative.
- (b) What do Hong Kong's key competitors allow? Increasingly, Hong Kong's key competitors are the Shanghai and Shenzhen stock exchanges. This is evidenced by the number of take-privates of US-listed Chinese businesses which have been listing on markets which permit UGSs, yet are seeking re-listings on a Mainland China stock exchange. These stock exchanges do not permit UGSs, which suggests the availability of UGSs is not the sole driving factor for companies when selecting listing venues. As far as we are aware, there is no proposal for the UK Listing Authority to permit UGSs. We understand that there has been widespread opposition in the UK to allowing dispensations from the UKLA's normal listing requirements for sovereign controlled companies.

**2.2** Putting aside the significance (or not) of the availability of UGSs in a listing applicant's decision as to listing venue, it is clear that some of the most successful listed companies in the world have UGSs. That alone suggests it is not desirable for regulators to disallow UGSs entirely.

**2.3** Although not expressly spelt out in the Concept Paper, the proposal appears to contemplate permitting UGSs for some but not all companies, with the dispensation being granted to "new economy companies". We find it very difficult to see any principle-based reason for this approach. First, there is the practical difficulty in defining "new economy companies". If the distinction is based on actual or predicted rates of growth, what could be used as a benchmark growth rate and what consequence would arise if the company fails to achieve the expected growth rate? If the distinction is based on industry or sector, which industries and sectors fall within this definition? Can listing applicants be clearly identified as falling within one industry or sector? For example, Alibaba may have started life being identified as an e-commerce company, but is now regarded by many as a data company. Second, and more importantly, we see no basis for concluding that one type of company, whether by reference to growth rates or industries or sectors, is more suitable for UGSs than others. Why should a large, well governed and steadily growing old economy company (e.g. a resources or infrastructure company) not be allowed UGSs, but a nascent, unproven and potentially riskier company be allowed them? On this basis, we think there should not be any regulatory presumption that UGSs may or may not be permissible for a particular category of companies but not others.

**2.4** The next question is who should decide whether a particular listing applicant is suitable for and should be allowed a UGS and how that decision should be made. We are not attracted by an approach that allows the Exchange or other regulators to determine the permissibility of UGSs on a "case-by-case" basis. In addition to placing considerable pressure on the relevant regulator(s) to make difficult judgements, this will inevitably produce anomalous results. It will also leave listing applicants and their advisers in the unattractive position of

not knowing whether they are eligible for UGSs or not. Would-be listing applicants with UGSs may need to incur the cost of engaging advisers to make pre-A1 submissions (or worse still file a listing application) before they can be confident that they are eligible for UGSs.

- 2.5** We believe a regulator-led assessment of a listing applicant's suitability for UGSs is unlikely to be workable. Rather, we think that the question of whether it is desirable for a particular listing applicant to have a UGS is a commercial question and that the market is better placed to make this judgement than the Exchange or any regulator. We therefore think that UGSs should, in principle, be available to any applicant for listing but that safeguards should be put in place to ensure enhanced market scrutiny and greater investor protection. We would welcome a consultation paper which focuses on how to achieve this.
- 2.6** Possible measures to allow the market to effectively scrutinise UGS companies and judge whether UGSs are desirable for a particular listing applicant and offer adequate investor protection include:
- (a) enhanced disclosure in the prospectus of the reasons why a UGS is desirable or needed (with regulatory scrutiny aimed at preventing boilerplate descriptions of the "importance of the owner/management team");
  - (b) an increased "public float" requirement to ensure there is greater investor support at the time of listing placing further pressure on the listing applicant to justify the UGSs or risk inadequate demand preventing the listing;
  - (c) restrictions on the number/percentage of shares that can be allocated to cornerstone investors to avoid any distortion during the price discovery process for a UGS company;
  - (d) "sunset" clauses for UGSs which at least define the circumstances when they will fall away (by reference to the reasons for having them in the first place);
  - (e) an enhanced INED requirement (e.g., where only independent shareholders may vote on their appointment);
  - (f) a requirement for an annual assessment of the effectiveness of the UGS by INEDs and disclosure of their reasons and conclusions in the annual report;
  - (g) an ability for independent shareholders to express their views effectively on the performance of the founder/management team (e.g., through an annual non-binding vote); and
  - (h) adopt a threshold less than 5% at which connected transactions for UGS companies require independent shareholder approval.

- 2.7** In addition, we think that any future consultation paper should clearly spell out which of the existing provisions in the Listing Rules that restrict how controlling shareholders can exercise control (e.g., LR 2.07, Chapter 14A, the requirements in Chapter 3 for independent directors and board committees, the Corporate Governance Code) will apply to UGS companies.

### **3 Segmentation and New Board PRO**

- 3.1** We are not supportive of the proposal to have four separate boards. As a starting point, we do not think there are sufficient differences between the existing boards and some of the proposed boards (e.g., Main Board vs New Board Premium) to warrant having separate boards. For example, the only difference between Main Board and New Board Premium

appears to be that the latter will permit UGSs. If there is a desire to clearly identify those companies with UGSs this can be easily achieved by reflecting the fact that they have UGSs in their stock codes (in the same way that companies with secondary listings must have a “S” in their stock code).

- 3.2** We note some of the reasons set out in the Concept Paper for establishing new, separate boards, such as market quality concerns, regulatory expectations, index inclusion, etc. These concerns will not be overcome by pushing UGS companies to a separate board. Indeed, a separate board for companies with UGSs may exacerbate such concerns, resulting in one board with companies which may have good growth prospects (and are thus able to convince the market of their suitability for UGSs) but weak governance, and another with companies which may have good governance but weaker growth prospects. If listing applicants survive enhanced market scrutiny and can justify their UGSs, they are likely to be “icons of the future” and should be permitted on the premier board in Hong Kong.
- 3.3** We believe that two boards should suffice: a premier board for more mature companies and a junior board (whether as GEM, New Board PRO or other board) to allow early stage companies to access equity capital. Further segmentation beyond these two boards is likely to result in confusion amongst issuers, investors and regulators alike.
- 3.4** If a junior board along the lines of the New Board PRO as described in the Concept Paper is proposed, we have a number of specific observations. First, it is worth further exploring why the New Board PRO should be limited to professional investors only. If it is felt that an investment in the listing applicant carries too much risk and therefore is unsuitable for wider market investment, query whether such companies belong in the private market rather than the public market.
- 3.5** Second, if a professionals-only board is adopted, it should apply a purely disclosure-based regime and not require financial advisers with quasi-sponsor responsibilities to act as gatekeepers. The logic behind a professional investors-only board is that professional investors have the requisite ability to assess listing applicants with heightened risk profiles. If financial advisers are required to act as gatekeepers, they will be put into a difficult position, and will almost inevitably adopt due diligence standards which are equivalent to those which apply to them in a sponsor role, undermining the theoretical benefits of a “lighter touch” regime.
- 3.6** Also, we suggest listed companies on such a professionals-only board should migrate to a board which permits retail participation after certain criteria are satisfied – for example, after a rolling period of three years during which the minimum profits requirement is satisfied, and/or a minimum market capitalisation is achieved and/or after a three-year period of good governance.

## **4 Others**

### **4.1 Reforming the CCASS nominee arrangement**

We would welcome consideration being given to the CCASS nominee arrangement and how this constrains independent shareholders in making their view known. Under the current regime, independent shareholders holding their shares through CCASS rely on HKSCC Nominees to exercise their voting rights in general meetings. Unless proxy or election forms are deposited well in advance of the relevant meeting, independent shareholders are unable to attend or vote at general meetings. If new circumstances arise after the deadline for lodging proxy and election forms, independent shareholders have little ability to change or

submit their votes. A listed company which wishes to seek out its shareholders' views also has great difficulty as it is very difficult to know who its shareholders are. If one of the key concerns over UGSs is the weakening of corporate governance, reforms which ensure the views of the independent shareholders are easily heard should be examined, including reforms of the CCASS nominee arrangements. Whilst reforming the CCASS nominee arrangement alone may not attract a significantly more diverse group of issuers to Hong Kong, it contributes towards an ecosystem which is more open and user-friendly for overseas companies.

#### **4.2 "Centre of Gravity"**

Finally, we note that the Concept Paper asks whether the "Centre of Gravity" restriction on Chinese-based businesses seeking a secondary listing in Hong Kong should be continued. We are supportive of loosening the "Centre of Gravity" restriction, except in a situation where the relevant listed company has adopted UGSs, but UGSs would not be permitted if it sought a primary listing in Hong Kong.

## **B Consultation Paper on Review of the GEM and Changes to the GEM and Main Board Listing Rules**

### **1 GEM to Main Board transfer regime**

We support the proposal that GEM should be re-positioned as a stand-alone board and that the current GEM to Main Board transfer regime should be removed. GEM migrations to the Main Board should be treated as a new listing, with the exception of the requirements relating to a public offering, no trading of shares by connected persons (MB Rule 9.09), post-IPO lock up and no fund-raising for the following 12 months.

### **2 GEM admission requirements**

We agree with the proposals in Chapter 3 of the Consultation Paper to lift the quality of GEM issuers by raising the admission thresholds. We believe the implementation of the proposals should be effective to weed out sub-standard companies seeking a GEM listing.

### **3 Proposals on Main Board rules**

- 3.1** Profit requirements – the current requirements are effective and we do not see a need to change them.
- 3.2** Minimum market capitalisation – to demarcate the Main Board as the premium board for more mature companies, we agree the minimum market capitalisation of a Main Board listing applicant should be increased and the consequential changes outlined in the Consultation Paper should be adopted.
- 3.3** Post-IPO lock up – if the post-IPO lock up requirements proposed in the Consultation Paper are adopted in the GEM rules, the same change should be made to the Main Board rules. We see no reason why the requirements should be different for the two boards.

**Linklaters**

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