

18th August 2017

Sent by Email and by Post

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

Dear Sirs/Madams,

Re: Market Consultation on GEM Review and New Board Concept Paper

The Hong Kong Society of Financial Analysts Ltd (HK SFA) has the pleasure to submit its response to the captioned.

HK SFA would like to commend the Stock Exchange of Hong Kong Limited (“SEHK”) for putting forth a review of the GEM board and a thoughtful concept paper that aims to balance the need for investor protection and for the Hong Kong stock market to attract listings and stay competitive.

In general, HK SFA agrees that the existence of the GEM board in its present form should be a subject under review and supports the Exchange’s proposed measures in strengthening the quality of the market. Over the past years, it is evident that the GEM board has failed to serve its purpose, given the little amount of funds being raised and the low amount of trading turnover. In short, both investors and genuine issuers do not find the board useful. Worse, the GEM board has degenerated into a platform for “shell manufacturing” activities, hurting the reputation of Hong Kong being an international finance center.

Under the Hong Kong Exchange's proposal to revamp the GEM board and the intention to set up the New Board, one may wonder whether there is a purpose to keep the GEM board, or it may be better off to combine it with the Main Board. In a normal year, the total fund raising amount and the turnover of GEM Board are about 2 to 3% of the Main Board’s. If all of the Exchange’s proposed measures are being adopted, there will be little quality difference for the two boards, saved for the requirements of profit, cash flow, market capitalisation and open market IPO. In addition, the original intention of the GEM board can be served by New Board PRO. In the investment world, investing in new startups should be an area reserved for Venture Capital funds.

For the proposal of creating the New Board, HK SFA believes the concept can be further explored. We recognise there is a need for the New Board, given the big push for the development of the New Economy in China. Hong Kong’s financial market, with the New Board, could benefit from this huge development. However, in whatever form, the foremost priority is investor protection. Hong Kong should not compromise its regulatory standard in return for additional business. For instance, allowing companies that have a US listing to be secondarily listed in the New Board Premium may pass the test of investor protection, but allowing companies to list on New Board PRO with a WVR structure may not. If the latter is allowed, we favor the structure to contain a "sunset clause". In addition, participants in New Board PRO should be limited to Institutional/Corporate Professional Investors, not Professional Investors in the general sense. The Exchange should also further examine if there is great demand for New Board PRO, as China already has the equivalent market with a huge amount of listed companies and trading at a high PE multiple.

For the response to the specific questions posted by the Concept Paper on New Board, please see the appendix of this letter.

Yours sincerely,
For and on behalf of
The Hong Kong Society of Financial Analysts

Frederick Tsang, CFA
Co-chair, Advocacy Committee

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Co-chair, Advocacy Committee

Appendix: HK SFA's Response to Specific Questions

Q.1:

What are your views on the need for Hong Kong to seek to attract a more diverse range of companies and, in particular, those from New Economy industries to list here? Do you agree that the New Board would have a positive impact on Hong Kong's ability to attract additional New Economy issuers to our market? Please give reasons for your views.

Answer to Q.1:

We agree that Hong Kong can benefit from a more diverse range of companies, including listings from New Economy industries. Whether the New Board would have a positive impact on Hong Kong's ability to attract such companies will depend on a number of factors including listing standards, including whether special considerations will be given to certain New Economy industries that SEHK aims to attract.

Q.2:

What are your views on whether the targeted companies should be segregated onto a New Board, rather than being included on the Main Board or GEM? Please give reasons for your views.

Answer to Q.2:

It depends on which issue the New Board is trying to address and whether the New Board is substantially different from the existing Main Board or GEM. If the objective is to attract certain New Economy industries with certain characteristics and providing it with a streamlined listing standards, then a New Board may be better equipped to do so, as it can create new industry segment awareness amongst the investing public. However, generally speaking, SEHK should consider using the existing Main Board and GEM infrastructure because creating a New Board can risk spreading or sending existing liquidity across to a competing New Board.

Q.3:

If a New Board is adopted, what are your views on segmenting the New Board into different segments according to the characteristics described in this paper (e.g. restriction to certain types of investor, financial eligibility etc.)? Should the New Board be specifically restricted to particular industries? Please give reasons for your views.

Answer to Q.3:

We agree with restricting New Board PRO listings to certain types of investors in principle, but recommend that it be limited to the following two types:

- Institutional Professional Investors, which is a subset of Professional Investor defined set out in paragraphs (a) to (i) of the definition in Section 1 of Part 1 of Schedule 1 of the Securities and Futures Ordinance; and
- Certain Corporate Professional Investors, which are trust corporations, corporations or partnerships under sections 3(a), (c) and (d) of the Securities and Futures Commission (SFC)'s Professional Investor Rules; and also meeting the conditions of (i) appropriate corporate structure and investment process and controls, (ii) the person(s) responsible for making investment decisions having sufficient investment background and (iii) awareness of the risks involved, defined under paragraph 15.3A of the SFC's Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

In our view, these New Board PRO listings should not be available to individual Professional Investors, who are any individual with HK \$8 million of portfolio investments, and may not have the sophistication to understand the risks involved in New Board PRO listings. Therefore, these listings should not be available to individual Professional Investors for investor protection given their speculative nature.

Q.4:

What are your views on the proposed roles of GEM and the Main Board in the context of the proposed overall listing framework? Please give reasons for your views.

Answer to Q.4:

We note that the listing standards of the New Board Premium are quite similar as the Main Board. We suggest integrating the New Board Premium into the Main Board offerings in some way if possible.

Q. 5:

What are your views on the proposed criteria for moving from New Board PRO to the other boards? Should a public offer requirement be imposed for companies moving from New Board PRO to one of the other boards? Please give reasons for your views.

Answer to Q.5:

We do not recommend setting out a different set of criteria for moving from New Board PRO to other Boards to reduce the likelihood of abuse to circumvent the listing requirements of the other Board. We believe a Board's listing requirement should be consistently applied to reduce the potential for regulatory arbitrage or listing shortcuts.

Q.6:

What are your views on the proposed financial and track record requirements that would apply to issuers on New Board PRO and New Board PREMIUM? Do you agree that the proposed admission criteria are appropriate in light of the targeted investors for each segment? Please give reasons for your views.

Answer to Q.6:

If the objective is to attract New Economy industries by creating New Board PRO, then the listing criteria should reflect that by incorporating it in the eligibility criteria (e.g. by stating the target industries such as technology, biotech, etc.)

Q.7:

What are your views on whether the Exchange should reserve the right to refuse an application for listing on New Board PRO if it believes the applicant could meet the eligibility requirements of New Board PREMIUM, GEM or the Main Board? Please give reasons for your views.

Answer to Q.7:

We believe the Exchange should reserve the right to refuse an application for listing on New Board PRO if it believes other Boards are more appropriate. This provides the Exchange with the power to perform its gatekeeper function to protect the investing public and to minimize potentials for regulatory arbitrage.

Q.8:

What are your views on the proposed requirements for minimum public float and minimum number of investors at listing? Should additional measures be introduced to ensure sufficient liquidity in the trading of shares listed on New Board PRO? If so, what measures would you suggest? Please give reasons for your views.

Answer to Q.8:

No comment.

Q. 9:

What are your views on whether companies listed on a Recognised US Exchange that apply to list on the New Board should be exempted from the requirement to demonstrate that they are subject to shareholder protection standards equivalent to those of Hong Kong? Should companies be elsewhere be similarly exempted? Please give reasons for your views.

Answer to Q.9:

Given the maturity and enforcement infrastructures of the US market, we agree that companies listed on a Recognised US Exchange (e.g. NYSE and NASDAQ) that apply to list on the New Board should be exempt from the requirement to demonstrate that they are subject to shareholder protection standards equivalent to those in Hong Kong. Considerations for similar exemptions should be made on companies listed elsewhere, but should be based on an analysis of the empirical and comparative data regarding shareholder protection standards in different

jurisdictions.

Q. 10:

What are your views on whether we should apply a “lighter touch” suitability assessment to new applicants to New Board PRO? If you are supportive of a “lighter touch” approach, what relaxations versus the Main Board’s current suitability criteria would you recommend? Please give reasons for your views.

Answer to Q.10:

This question should be viewed in conjunction with the question of investor restrictions regarding the aggregate level of investor protection. If we take the view that the New Board PRO listings are speculative and only subject to “light touch” vetting (i.e. minimal gatekeeping function perform on the outset), then the listings on New Board PRO should only be offered to professional investors with bona fide sophistication, such as Institutional Professional Investor or certain Corporate Professional Investors. For details, see response to Question 3 above.

Q.11:

What are your views on whether the New Board PRO should be restricted to professional investors only? What criteria should we use to define a professional investor for this purpose? Please give reasons for your views.

Answer to Q.11:

Please refer to responses to Question 3 and Question 10 above.

Q.12: Should special measures be imposed on Exchange Participants to ensure that investors in New Board PRO -listed securities meet the eligibility criteria for both the initial placing and secondary trading? Please give reasons for your views.

Answer to Q.12:

No comment.

Q.13:

What are your views on the proposal for a Financial Adviser to be appointed by an applicant to list on New Board PRO, rather than applying the existing sponsor regime? If you would advocate more prescriptive due diligence requirements, what specific requirements would you recommend be imposed? Please give reasons for your views.

Answer to Q.13:

This question should be viewed in conjunction with the question of investor restrictions regarding the aggregate level of investor protection. If the investor is restricted to Institutional Professional Investor and Corporate Professional Investor with bona fide sophistication, then the risk to investors may be reduced. That said, in addition to detailed due diligence requirements, other protections may be introduced, including specific detailed conflict of interest rules proscribing due diligence requirements, conflicts and disclosure. Other investor protection mechanism may include arbitration, enhanced enforcement, and remedies for losses suffered by any investors to be paid by the Financial Advisor whose misrepresentation have been relied upon.

Q.14:

What are your views on the proposed role of the Listing Committee in respect of each segment of the New Board ? Please give reasons for your views.

Answer to Q.14:

No comment.

Q.15:

Do you agree that applicants to listing on New Board PRO should only have to produce a Listing Document that provided accurate information sufficient to enable professional investors to make an informed investment decision, rather than a Prospectus? If you would advocate a more prescriptive approach to disclosure, what specific disclosures would you recommend be required? Please give reasons for your views.

Answer to Q.15:

This question should be viewed in conjunction with the question of investor restrictions regarding the aggregate level of investor protection. If the investor is restricted to Institutional Professional Investor and Corporate Professional Investor with bona fide sophistication, then a disclosure based listing document may be sufficient.

Q. 16:

What are your views on the proposed continuous listing obligations for the New Board? Do you believe that different standards should apply to the different segments? Please give reasons for your views.

Answer to Q.16:

Consistent continuous listing obligation, particularly regarding timely and accurate disclosure, should apply to all segments. This will ensure a healthy capital markets with appropriate investor protection, and reduce the risk of scandals that may harm the reputation of the quality and soundness of the Hong Kong capital markets.

Q.17:

For companies that list on the New Board with a WVR structure, should the Exchange take a disclosure - based approach as described in paragraph 153 of this concept Paper? Should this approach apply to both segments of the New Board? Please give reasons for your views.

Answer to Q.17:

Yes, companies that list on the New Board with a WVR structure should be required to disclose the information as described in paragraph 153 of this concept paper. Furthermore, this approach should apply to both segment of the New Board. This is not a costly or competitively disadvantageous information to disclose, and will enhance investor information for a more efficient capital market.

Q.18:

If, in addition, you believe that the Exchange should impose mandatory safeguards for companies that list on the New Board with a WVR structure, what safeguards should we apply? Should the same safeguards apply to both segments of the New Board? Please give reasons for your views.

Answer to Q.18:

Given the potential for abuse for WVR structure by the controlling shareholder and empirical studies noting WVR under-performance, additional safeguard should be applied. For example, it could be that the WVR is only permitted for the initial listing and that voting rights cannot be further reduced by subsequent share issuance. For New Board PRO, the structure should contain a “sunset clause”.

Q.19:

Do you agree that the SEHK should allow companies with unconventional governance features (including those with a WVR structure) to list on PREMIUM or PRO under the “disclosure only” regime described in paragraph 153 of the Concept Paper, if they have a good compliance record as listed companies on NYSE and NASDAQ? Should companies listed elsewhere be similarly exempted? Please give reasons for your views

Answer to Q.19:

No comment.

Q.20:

What are your views on the suspension and delisting proposals put forward for the New Board? Please give reasons for your views.

Answer to Q.20:

No comment.

Q. 21:

Should New Board-listed companies have to meet quantitative performance criteria to maintain a listing? If so, what criteria should we apply? Do you agree that companies that fail to meet these criteria should be

placed on a “watchlist” and delisted if they fail to meet the criteria within a set period of time? Please give reasons for your views.

Answer to Q.21:

Yes, certain quantitative performance criteria must be maintained. Those criteria can be based on and should be materially similar from the initial listing criteria.

Q.22:

Do you consider that an even “lighter touch” enforcement regime should apply to the New Board (e.g. an exchange-regulated platform)? Please give reasons for your views.

Answer to Q.22:

We do not recommend a “lighter touch” enforcement regime. In fact, we need to look at the elements of the investor protection mechanisms in totality and ensure that the overall protection is reasonable. For example, if a market is only for institutional professional investors, perhaps all other elements (including initial listing vetting, ongoing disclosure, and enforcement regime) may be lightened. However, to the extent that you are allowing wealthy but not necessarily sophisticated individuals to participate, then given the lighter initial vetting, you need stronger enforcement or remedial mechanisms for investor recourse to balance the risk.

End