HKEX
香港交易所

16 June 2017

# Q&A on Proposed New Board and GEM Review

## PROPOSALS

**1. What is the Exchange proposing?**

The Exchange is seeking market feedback on proposals in two separate but related papers.

In the New Board Concept Paper, the Exchange proposes establishment of a New Board, separate from the Main Board and the Growth Enterprise Market (GEM), to broaden capital markets access in Hong Kong by opening up to a more diverse range of issuers.

In the Review of GEM and Changes to the GEM and Main Board Listing Rules Consultation Paper, the Exchange proposes changes to the two Boards to ensure they reflect currently acceptable standards in the market and address the recent regulatory and market concerns on GEM applicants and listed issuers. The proposed changes to the Main Board eligibility requirements are to preserve the Main Board's position as a market for larger companies.

The papers stem from a holistic review of Hong Kong's listing framework that considered how best to improve access to listings and further enhance overall market quality. Although responses to each paper should be submitted separately, the Exchange recognises that there are interdependencies in certain aspects and will therefore consider responses to both papers holistically when deciding the way forward.

**2. How will the Exchange's boards be positioned if the proposals are adopted?**

The Main Board would be positioned as a "premier board" with an increased minimum market capitalisation requirement of $500 million (raised from $200 million), along with existing financial and track record criteria.

GEM would serve the needs of small and mid-sized issuers that meet its financial and track record criteria and desire to attract retail as well as professional investors.

The New Board would fill the gaps in Hong Kong's current listing framework, so that the needs of New Economy and early-stage companies could be accommodated while maintaining appropriate regulatory and shareholder protection standards.

**3. What are the key proposals in the New Board paper?**

The Exchange proposes a New Board with two distinct segments: (1) New Board PRO for earlier stage companies that do not meet the financial or track record criteria for GEM or the Main Board, and/or have non-standard governance structures; and (2) New Board PREMIUM for companies that meet the existing financial and track record requirements of the Main Board, but are currently ineligible to list in Hong Kong because they have non-standard governance structures. Neither segment would have any restrictions on secondary listings by Mainland enterprises.

New Board PRO would be open to professional investors only. Given the early stage development and the investor eligibility requirement, New Board PRO would provide a "lighter touch" approach to initial listing requirements. New Board PREMIUM would be open to retail as well as professional investors similar to the Main Board, and consequently regulatory approach similar to the Main Board would apply.

To help ensure the quality of the market, the New Board would have an accelerated delisting mechanism for companies that failed to meet its ongoing listing requirements.

**4. What are the key proposals in the GEM paper?**

The Exchange proposes removing the "stepping stone" concept (GEM as a stepping stone to the Main Board) and the streamlined process for transfers from GEM to the Main Board. This means that GEM Transfer applicants will be required to appoint a sponsor and issue a "prospectus-standard" listing document. Further, the Exchange proposes all GEM Transfer applicants to have published and distributed at least two full financial years of financial statements after their GEM listings before they can be considered for a GEM Transfer.

Also, the initial listing requirements will be raised, including:

i. Increasing minimum market capitalisation requirement from $100 million to $150 million and a corresponding increase in the minimum public float value from $30 million to $45 million;
ii. Increasing minimum cash flow requirement from $20 million to $30 million in the two financial years prior to listing; and
iii. Introducing a mandatory public offering mechanism of at least 10 per cent of the total offer size; and
iv. Aligning the GEM Listing Rules on (1) placing to core connected persons, connected clients and existing shareholders, and their respective close associates; and (2) the allocation of offer shares between the public and placing tranches and the clawback mechanism, with the relevant requirements under the Main Board Listing Rules.

The Exchange also propose to increase the Main Board's minimum market capitalisation at listing (from $200 million to $500 million), and increase the minimum public float value (from $50 million to $125 million).

The lock-up on controlling shareholders upon listing will also be extended from one year to two years for GEM, and where appropriate, the Main Board.

To minimise impact on stakeholders, transitional arrangements would be put in place for existing GEM companies and applicants should the GEM review proposals be implemented.

**5. What are the transitional arrangements if the GEM review proposals are adopted?**

A summary of the transitional arrangements are set out below.

<table>
<tr><th></th><th>Prior to the Amendment Effective Date</th><th>Transitional Period (Three years from the Amendment Effective Date)</th><th>After the end of the Transitional Period</th></tr>
<tr><td>GEM listing applicants</td><td>Applications will be processed and eligibility assessed under GEM Listing Rules in force as at the date of the GEM consultation paper</td><td colspan="2">Applications will be processed and eligibility assessed under <u>revised</u> GEM Listing Rules</td></tr>
<tr><td>GEM Transfer applicants</td><td>GEM Transfer applications will be:<br><br>- processed under the current GEM Streamlined Process; and<br><br>- eligibility assessed under the Main Board Listing Rules in force as at the date of the GEM consultation paper</td><td>GEM Transfer applications by Eligible Issuers who have not changed controlling shareholder/principal business:<br><br>- required to publish a GEM transfer announcement with key disclosures;<br><br>- required to appoint sponsor to conduct due diligence for the last financial year and up to announcement date; and<br><br>- eligibility assessed under the Main Board Listing Rules in force as at the date of the GEM consultation paper</td><td>All GEM Transfer applications will be processed and eligibility assessed under the Main Board <u>revised</u> Listing Rules</td></tr>
</table>

<table>
<tr><th></th><th>Prior to the Amendment Effective Date</th><th>Transitional Period (Three years from the Amendment Effective Date)</th><th>After the end of the Transitional Period</th></tr>
<tr><td rowspan="2"></td><td rowspan="2"></td><td>GEM Transfer applications by Eligible Issuers who changed controlling shareholder/principal business:<br><br>- required to publish a “prospectus standard” listing document; appoint a sponsor to conduct due diligence as if the application is a new listing; and<br><br>- eligibility assessed under the Main Board Listing Rules in force as at the date of the GEM consultation paper</td><td rowspan="2"></td></tr>
<tr><td>GEM Transfer applications from non-Eligible Issuers will be processed and eligibility assessed under the revised Main Board Listing Rules</td></tr>
<tr><td>Main Board listing applicants</td><td>Applications will be processed and eligibility assessed under the Main Board Listing Rules in force as at the date of the GEM consultation paper</td><td colspan="2">Applications will be processed and eligibility assessed under revised Main Board Listing Rules</td></tr>
</table>

Eligible Issuers are:

- issuers listed on GEM; and
- GEM applicants who have submitted a valid listing application and successfully listed (with only one refreshment of application allowed) as at the date of the GEM consultation paper.

HKEX
香港交易所

## RATIONALE

**6. Why is the Exchange proposing a New Board and GEM review?**

To meet the evolving needs of investors and issuers and help Hong Kong retain its leading position, the Exchange has to review its market structure periodically and revise it when necessary. Hong Kong has been highly successful in developing its securities market and establishing itself as a leading IPO centre. However, in its most recent review, the Exchange identified areas where the current regime could be strengthened and expanded to address concerns in the market and provide access to a more diverse range of companies, so as to better serve investors as well as potential issuers, and to enhance Hong Kong as a global financial centre.

The proposals under the GEM review are intended to ensure that the rules reflect currently acceptable standards in the market and address recent regulatory and market concerns on GEM listing applicants and listed issuers.

**7. What is the thinking behind the proposed New Board?**

There is a high concentration of listings in the financial and property sectors, which together account for 44 per cent of the total market capitalisation in Hong Kong today. In contrast, listings from New Economy industries in the past 10 years account for only 3 per cent of total market capitalisation, compared with 59 per cent and 44 per cent for NASDAQ and the New York Stock Exchange, respectively. In addition, some of the fastest growing industries are notably underrepresented in Hong Kong's securities market (pharmaceuticals, biotech and life sciences; healthcare equipment and services; and software and services, excluding the largest company in the sector each account for just 1 per cent of the total market capitalisation).

There is a significant risk that the Hong Kong market's low exposure to higher growth sectors will lead to stagnation and a lack of investor interest, depressing valuations and in turn dampening Hong Kong's appeal to prospective new issuers.

One of the major barriers for New Economy companies is that the current listing framework bars pre-profit companies and companies with non-standard governance features from listing in Hong Kong. To illustrate this point, last year 68 per cent of companies that listed in the US were pre-profit. Moreover, Weighted Voting Rights (WVR) structures are currently permitted in the US and under consideration in Singapore. Secondary listings from overseas-listed Mainland enterprises are also prohibited in Hong Kong.

There is significant opportunity for Hong Kong to capture a greater share of international and Mainland companies seeking to raise capital, giving investors a more diverse range of exposures. In aggregate, the IPO funds raised by companies in categories targeted by the New Board for which Hong Kong was unable to compete for the listings totalled US$49 billion in the past ten years, or 17 per cent of the IPO funds raised in Hong Kong over the same period.

In 2014, the Financial Services Development Council recommended that the Exchange should consider appropriate segmentation to better accommodate investors with different risk appetites and issuers with different profiles. The Exchange notes other international markets have adopted segmentation while maintaining high standards and appropriate investor protection measures, and believes a segmented market with calibrated shareholder protection standards based on the level of perceived risk in each segment, would be the best way to attract a greater diversity of listings in Hong Kong.

In addition, segmentation addresses concerns about forced participation through inclusion in key benchmark indices and other issues that arose in response to a paper the Exchange issued on possible changes to the Main Board to open it to a more diverse range of issuers.

**8. What is the thinking behind the proposed GEM review and changes to the listing rules?**

GEM was launched in November 1999 to provide emerging companies with a capital formation platform and as an alternative market to the Main Board. It was designed to have less stringent admission requirements than the Main Board and an "enhanced disclosure-based" regime with prominent "buyer beware" risk warnings in listing documents. GEM's launch coincided with the "dot-com" boom of 1999/2000, a time of great enthusiasm for companies seen to have good growth potential. After the "dot-com" bubble burst, GEM suffered a general loss of confidence; there were fewer new listings and post-listing fundraising declined.

GEM was repositioned in July 2008 as a "stepping stone" to the Main Board after a market consultation. Despite the new role, success has remained limited. A recent Exchange study found transfers from GEM to the Main Board over a full year have never exceeded the 14 that were completed in the second half of 2008 immediately after the GEM Streamlined Process was implemented.

There has also been a decrease in transfers among issuers that have been listed on GEM for more than one financial year (which is a condition for transfer in addition to satisfying the Main Board eligibility requirements). Between the second half of 2008 and 2016, the rate of GEM transfers decreased fell from 7.2 per cent to 2.7 per cent; and during this period, only one-H-share company has listed on GEM, which fell short of the initial expectation that GEM might attract H-share companies.

Moreover, there have been market concerns, in recent years, on the quality and performance of GEM issuers. These concerns include high concentration of shareholders, illiquid shares, post-IPO volatility, the creation of "shell" companies and possible exploitation of GEM as a means of achieving a Main Board listing.

The Exchange believes that GEM continues to play a role in our market as a capital raising platform for small to mid-sized enterprises. However in view of the limited success of the "stepping stone" positioning and given the recent concerns on the quality and performance of GEM issuers, it is appropriate to remove the streamlined transfer process to the Main Board and raise admission requirements in order to improve the overall quality of GEM listings.

The Exchange also proposes to amend the Main Board Listing Rules to preserve the Main Board's position as a market for larger companies.

## REGULATORY CONSIDERATIONS

**9. Did The Exchange have any guiding principles when it considered the regulatory issues related to its proposals?**

The Exchange believes Hong Kong has to adapt to the evolving capital market needs of issuers while maintaining appropriate and robust regulatory standards to ensure investors' interests are protected and it continues have a quality market. It is the Exchange's duty as a central market operator and frontline market regulator to continue looking at ways to both enhance market quality and facilitate economic development amidst the fast-changing world economy and market.

**10. Why does the proposed New Board comprise two parts?**

The two parts reflect the need to balance the interests of a wide range of investors and issuers against the interests of those who may be vulnerable and therefore need protection. In general, the more sophisticated the investor, the less regulatory protection is required.

The Exchange proposes that New Board PRO be open to professional investors only, given the additional risks posed by issuers in that segment, as it is expected to include New Economy and early-stage companies, and the proposed "lighter touch" approach to initial listing requirements that would apply.

The proposed New Board PREMIUM would be open to retail as well as professional investors and would therefore be subject to a more stringent regulatory approach. The proposed structure is also consistent with the recommendations of the Financial Services Development Council for a segmented approach to accommodate investors with different risk appetites.

**11. How will the New Board PRO's "professional investors only" eligibility requirements be enforced if the New Board proposal is adopted?**

Exchange Participants would be expected to ensure that their investor clients (including clients trading through an affiliate or intermediary) investing in New Board PRO-listed securities meet the standard of professional investor under the Securities and Futures Ordinance.

**12. How is the Exchange proposing to regulate New Board listings and applicants with a Weighted Voting Rights (WVR) structure?**

The Exchange proposes two possible approaches: One requires such companies to prominently disclose that they have a WVR structure and the risks associated with the structure. In addition, they could potentially be required to disclose other matters, such as the identities of WVR holders. The other approach is to impose mandatory safeguards for companies with WVR structures in addition to disclosure requirements. The safeguards could vary depending on whether the company was listed on PREMIUM or PRO. For example, WVRs could be subject to a sunset clause and expire after a certain period of time.

In addition, the Exchange proposes companies with unconventional governance features, including companies with WVR structures, could list on the New Board if they are also listed on a Recognised US Exchange and demonstrate, to the Exchange's satisfaction, a strong compliance record during that time. This proposal is based on the US's robust regulatory environment and strict private enforcement mechanisms. Companies seeking a primary or secondary listing in this way would be allowed to maintain their WVR structures and would be exempt from any safeguards imposed on companies with WVR structures generally. The Exchange would reserve the right not to approve the listing of a company, on suitability grounds, if its departure from Hong Kong governance norms was extreme.

The Exchange welcomes feedback on the proposed approaches.

HKEX
香港交易所

**13. How will you define New Economy companies?**

The intention of the New Board proposal is to attract more high growth companies from innovative sectors, or New Economy companies. Such companies may encompass a range of different sectors including biotech, health care technology, internet and direct marketing retail, internet software and services, IT services, software, technology hardware and storage and peripherals.

The Exchange aims to develop a set of guidelines for the definition of what constitutes New Economy for the purposes of listing on the New Board. In light of the evolving nature of technology and the interactive relationship between the traditional and new economic sectors, no fixed definition is proposed and the Listing Committee will retain the ultimate discretion to determine the listing eligibility for the New Board on a principle-based approach. The key principle is to identify companies whose businesses are in sectors where innovation, technology, intellectual property, and new ways of commerce in totality are the primary drivers for its growth and business successes.

The New Board paper also includes a question on whether the New Board should be specifically restricted to particular industries. The Exchange will consider the term New Economy companies further after it analyses the comments it receives from respondents to the New Board Concept Paper.

**14. How will IPO applications be handled if the Exchange adopts the proposals of the New Board and GEM review?**

Listing applications for New Board PRO, the professionals only board, would be vetted and approved by the Listing Department under delegated authority from the Listing Committee (similar to the current GEM applications approval arrangement).

Listing applications for New Board PREMIUM would be presented to the Listing Committee for approval following vetting by the Listing Department. The proposed arrangement for New Board PREMIUM is in line with the current Main Board practice. The Listing Committee would make decisions on the cancellation of listings, disciplinary matters and be responsible for hearing appeals for both New Board segments.

Authority to approve GEM listing applications, which has been delegated to the Listing Department since the Rule changes, would return to the Listing Committee and the GEM listing applications would be approved by the Listing Committee thereafter.

**15. Do you expect there to be an influx of applications to list on GEM or the Main Board, or to transfer from GEM to the Main Board, before the proposals are implemented?**

The Exchange acknowledges that, since the proposals in the GEM consultation paper, if adopted, will raise the GEM and Main Board admission requirements, there may be a temporary increase of applications for listing on GEM or the Main Board (including transfer applications) while the consultation is ongoing.

HKEX 香港交易所

16. **Will it be possible for companies to transfer between segments on the New Board and between the New Board, the Main Board and GEM?**

    There would be no fast-track migration mechanism between the New Board and the Main Board or GEM, or from New Board PRO to New Board PREMIUM. For a company listed on New Board PRO wishing to list on these platforms to attract retail investors, it would have to meet all the admission criteria and other listing requirements of the relevant board (e.g. issuing a "prospectus standard" listing document). A requirement to raise additional capital through a public offer may also be imposed.

17. **What role has the Securities and Futures Commission (SFC) had in the New Board and GEM review proposals, and what role will it have if the proposals are adopted?**

    The Exchange has discussed the New Board proposals with the SFC. The SFC would continue to play a leading role in market regulation for the New Board, in the same way as it currently does for the Main Board and GEM and have statutory powers of investigation and have enforcement in cases involving corporate or market misconduct.

    The Listing Department and the SFC Corporate Finance Division have been working together on the review of GEM and established a joint working group in October 2015. The SFC supports the consultation on the review of GEM.

## PROCESS / NEXT STEPS

18. **What are the next steps?**

    The Exchange encourages its stakeholders to submit their views and suggestions during the comment period which will end on 18 August 2017. All responses will be analysed and considered, and the way forward will be determined in light of the feedback the Exchange receives.

    If there is market support for the New Board proposal, the Exchange aims to finalise detailed New Board listing rules in early 2018. The Exchange also aims to publish its conclusions on the GEM review proposals in late 2017.