HKEx Launches New Board Proposals

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Introduction

The much anticipated consultation of a new board (the "**New Board**") has been announced and the Stock Exchange of Hong Kong Limited (the "**HKEx**") is inviting public feedback on these two separate but related consultations:

(1) a proposal to establish the New Board; and

(2) proposed changes to the Growth Enterprise Market ("**GEM**") and Main Board Listing Rules.

The proposals aim to broaden capital markets access in Hong Kong and strengthen our listing regime. Although the proposals are set out in separate consultations, they are interlinked and should be viewed holistically.

Background

The concept of a third board was initially proposed in January 2016 by the HKEx in its 2016/18 Strategic Plan. At that time, it was mentioned that a new board would be aimed at new industries that do not fit the requirements of the Main or GEM Boards, and there were mixed views from the market and industry professionals. The SFC also indicated that a new board would not be suitable until the role of the GEM was made clear.

There is, without any doubt, a need for Hong Kong to capture a greater share of listings by international and Mainland Chinese companies and to fill the gaps identified in the current listing regime, including accommodating:

(a) "pre-profit" companies;

(b) companies with non-standard governance procedures; and

(c) Mainland Chinese companies wishing to secondarily list in Hong Kong.

The key objectives of introducing the New Board are to (i) diversify sector and geographic concentrated listings in Hong Kong, and (ii) increase the territory's exposure to higher growth sectors. To enable Hong Kong to raise its competitiveness for more listings, it will also need to ensure its regulatory framework remains robust and key investor protection measures are maintained.

(i) The need for diversification

For as long as one can remember, Mainland issuers have been the key driver in the local IPO market and efforts to diversify Hong Kong's sources of listings have had limited success. International companies that have listed in the past decade in Hong Kong accounted for only 11% of total market capitalisation, as against 55% for the London Stock Exchange ("**LSE**"), and 30% and 20% for the New York Stock Exchange ("**NYSE**") and NASDAQ, respectively.

Hong Kong also has a particularly high concentration of listings by financial and property sectors, but only 3% of companies in the past 10 years have come from "new economy" companies. The proposals aim to attract companies from a wider range of sectors, including biotechnology, health care technology, internet and direct marketing retail, internet software and services, IT services, software, technology hardware, and storage and peripherals ("**new economy companies**")[1]. In contrast, new economy companies account for 60%, 47% and 14% of listings on the NASDAQ, NYSE and LSE, respectively.

(ii) The need for increased market exposure

Key barriers to entry under the current listing framework include a bar on "pre-profit" companies and companies with non-standard governance structures, such as those with weighted voting rights ("**WVR**") structures[2], and

[1] Due to the evolving nature of technology and the relationships between traditional and new economic sectors, the HKEx does not propose a fixed definition for new economy companies.

[2] In August 2014, the HKEx published its Concept Paper on WVR structures which sought views on whether governance structures that give certain persons voting power or other related rights disproportionate to their shareholding should be permitted for companies listed or seeking to list in Hong Kong. After considering market responses, the HKEx concluded that there was

Mainland Chinese companies wishing to list secondarily on the HKEx.

In the US, it is not unusual for companies in high growth sectors, such as biotechnology, to list without a long track record to raise capital for R&D purposes for products that have not reached commercialisation. Many of these companies are also "pre-revenue". All three tiers of NASDAQ allow "pre-profit" and "pre-revenue" companies to list, whereas Hong Kong has strict financial and trading record requirements for listing. For issuers from overseas markets that do not fall within one of the "Recognised Jurisdictions", there is the added hurdle of demonstrating equivalent shareholder protection standards. By comparison, many other listing venues have regimes to accommodate foreign companies.

Competition from the Mainland exchanges has increased in recent years, coupled with simplification of the onshore listing process in China. Hong Kong has also faced stiff competition from the US market due to our inability to accept WVR structures, which is the structure of choice of some new economy companies such as Facebook and Google. WVR structures are permitted in the US and under consideration in Singapore. New economy companies are playing an increasingly large part in the global financial markets so the New Board consultation is a timely review of Hong Kong's market structure. The paper also flags the issue of large Mainland new economy companies seeking secondary listings away from Hong Kong due to our "centre of gravity" test under the 2013 JPS[3]. For companies already listed elsewhere, the rules and practicalities regarding changing constitutional documents can be arduous and in turn deter companies from listing locally.

support for a second stage consultation on the topic. In contrast, the board of the SFC had unanimously concluded that it did not support the draft proposals and issued a public statement to that effect. As a result, in October 2015, it was announced by the HKEx that after considering the views of the SFC, it will not proceed with its draft proposals on WVR at that time.

3 The Joint Policy Statement Regarding the Listing of Overseas Companies Jointly issued by the SFC and the HKEx in September 2013.

New Board

The New Board will be separate from the Main and GEM Boards. There will be two segments tailored to the New Board to attract different companies for different audiences but the collective aim is to attract more high growth companies from innovative sectors:

(i) ***New Board PRO*** – for early stage companies that do not meet the existing financial and track record eligibility requirements and companies unable or unwilling to meet the existing shareholder protection requirements under the 2013 JPS.

(ii) ***New Board PREMIUM*** – for companies that meet the existing listing requirements but with a non-standard governance structure.

Key characteristics of each board are as follows:

	New Board PRO	New Board PREMIUM
Target	Professional investors only	Retail and professional investors allowed
Entry requirement	None, except for a minimum market capitalisation of at least HK$200 million at the time of listing	Equivalent to the Main Board
Overseas issuers	Regulatory cooperation under the 2013 JPS will apply but without the need to provide equivalent shareholder protection	Regulatory cooperation under the 2013 JPS will apply but companies listed on recognised US Exchanges are exempt from providing equivalent shareholder protection standards
Restrictions on secondary listings by Chinese companies?	No	No
WVR structures	Allowed	Allowed
Listing applications	To be vetted and approved by the Listing Department	Applications presented to the Listing Committee for approval following vetting by the Listing Department
Listing requirements	Lighter approach taken to initial listing requirements	More stringent approach to listing requirements, including existing sponsor regime to apply
Prospectus requirement	Not applicable	Applicable
Public float	25% and at least 100 investors	25% and at least 300 investors

A company would need to meet all admission and listing requirements of the relevant board, and a requirement to raise additional capital via a public offer may also be imposed. The HKEx may refuse a listing application for the New Board Pro if the applicant could meet the eligibility requirements of the New Board Premium, Main or GEM Boards and/or the applicant is unable to demonstrate that it has the characteristics of a new economy company. There will be no fast-track transfer mechanism between the New Board and the Main Board or GEM, or as between the two new boards.

To maintain the quality of listed companies on the New Board, there will also be in place continuous listing and corporate governance obligations, together with an accelerated delisting procedure for companies that fail to meet certain proposed ongoing listing requirements such as, continuous failure to meet prescribed quantitative criteria (for example, share price above a threshold), or the company being suspended from trading for 90 days or six months respectively.

Introduction of ring-fencing and safeguarding requirements for WVR companies have been proposed. One option is to take a disclosure based approach, requiring companies to disclose their WVR structures and associated risks. An alternative approach is to impose mandatory safeguards in addition to disclosure requirements. Safeguard suggestions include restrictions of persons eligible to hold WVRs, minimum equity holdings and restrictions on transfers. Further, the HKEx may allow companies with WVR structures listed on a recognised US Exchange to list on the New Board if they are able to demonstrate a good compliance record.

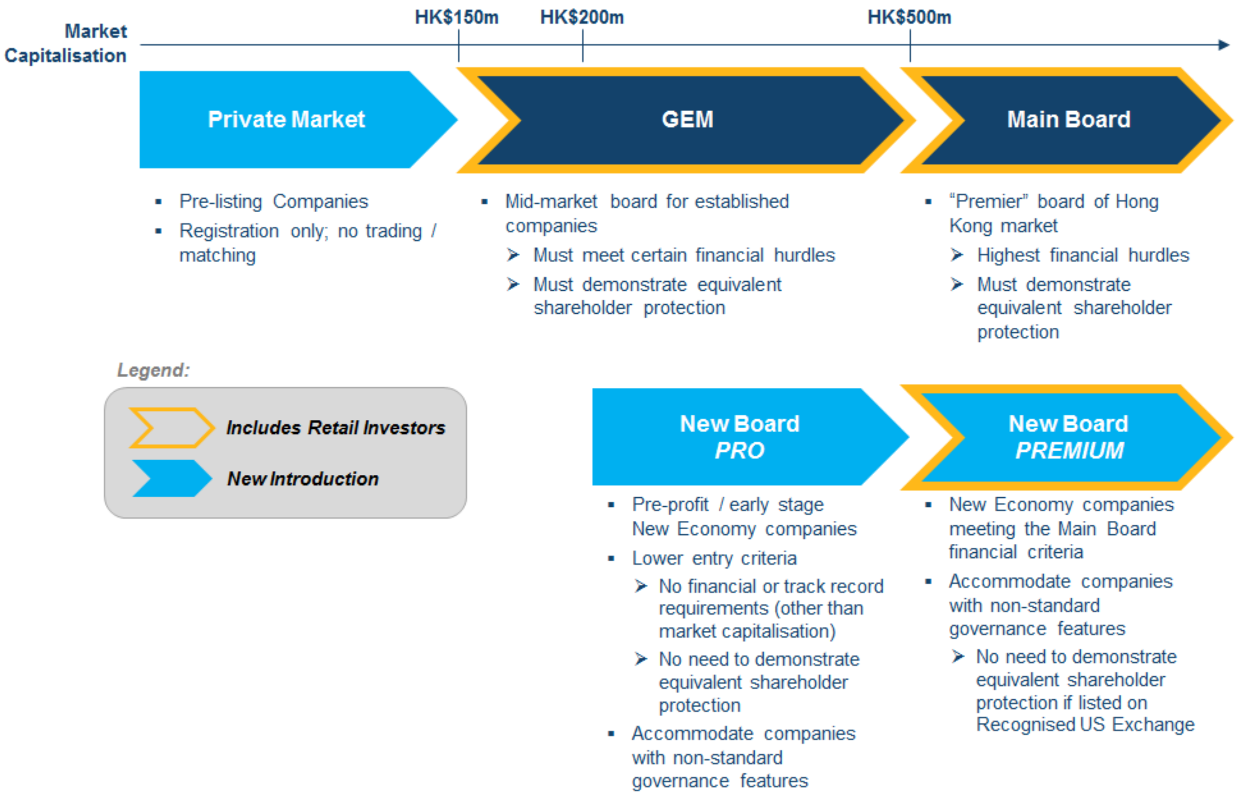
Positioning of the boards

The aim of the New Board is to fill in the gaps in Hong Kong's current framework, particularly in respect of new economy companies and early stage companies but with the appropriate corporate governance and structural framework in place.

The Main Board will be positioned as a premier board. The HKEx plans to raise a listing applicant's capitalisation requirement from HK$200 million to HK$500 million, along with existing financial and track record criteria. By restricting WVR structures to the New Board, the Main Board would also be insulated from any attempt at circumvention.

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

Vision for Hong Kong's Future Listing Framework



<u>Source</u>: Concept Paper – New Board, HKEx, June 2017

GEM Review and Listing Rules Consultation Paper

The HKEx is also proposing reforms to GEM as well as changes to the GEM and Main Board Listing Rules.

The GEM Board was launched in 1999. It was aimed at providing emerging technology firms with a listing platform and alternative to listing on the Main Board due to its less stringent requirements. After the dot-com bubble burst, there was a loss of confidence in the GEM market and a decrease in listings and fund raisings. In 2008, GEM was reposition from an alternative board to a "stepping-stone" to the Main Board but it has achieved limited success over the years.

One of the main consequences of the launch of the New Board (if adopted) is that the admission requirements for the GEM Board will be tougher, and emerging companies will find it more difficult to list on GEM. The consultation aims to address these concerns and to clearly demarcate the Main and GEM Boards.

There are four main areas for review (i) GEM's position as a "stepping stone" to the Main Board, (ii) GEM's admission requirements and delisting requirements, (iii) the open market requirement for GEM companies, and (iv) eligibility requirements for the Main Board.

Key proposals under the consultation are:

(a) to remove the streamlined process for the transfer of a GEM listing to the Main Board (a "**GEM Transfer**") so GEM is then repositioned as a stand-alone board;

(b) to require all GEM Transfer applicants to have (i) published and distributed at least two years of financial statements after listings, and (ii) not been subject to any disciplinary investigations by the HKEx for a serious or potentially serious breach under the Listing Rules for the 24 months prior;

(c) to retain the current track record requirement of two financial years under the GEM Listing Rules;

(d) to retain the current practice of not requiring a GEM applicant that can meet the Main Board admission requirements to list on the Main Board instead of GEM;

(e) to increase in the minimum expected market capitalisation of GEM applicants from HK$100 million to HK$150 million and a corresponding increase in the minimum public float value of a GEM company from HK$30 million to HK$45 million;

(f) to increase in the minimum expected market capitalisation of Main Board applicants from HK$200 million to HK$500 million and a corresponding increase in the minimum public float value of a Main Board company from HK$50 million to HK$125 million;

(g) to increase in the cash flow requirement for GEM applicants from HK$20 million to HK$30 million;

(h) to introduce a mandatory public offering requirement of at least 10% of the total offer size for all GEM IPOs; and

(i) to extend the post-IPO lock-up requirement on controlling shareholders from one year to two years for GEM and, where appropriate, the Main Board.

The consultations are open until 18 August 2017.

Commentary

While Hong Kong has consistently been ranked one of the top international IPO markets, it has in recent years faced increasing competition from international venues. The New Board proposals are an indication that Hong Kong regulators are shifting their focus towards maintaining the city's competitiveness, particularly with the loss of a number of high profile new economy listings with WVR structures that have listed elsewhere in recent years.

The characters and requirements of the New Board also distinguish and segment the targeted new issuers and address the market quality and risk profile concerns. These are very important and target corporate governance of new economy listings or overseas listings in order to improve investor protection. The improved delisting regime could also be a key measure to enhance profitability and corporate governance if listed companies want to maintain their listed status while removing poor performers from the board.

While fewer-than-expected listings by overseas companies in Hong Kong may reflect a lack of investor appetite, this can be improved through more investor education by the regulators or other market participants. Similarly, more marketing and investor education will make investors more savvy with tech or new economy firms, potentially increasing investments and therefore enhancing stock liquidity. This will, in turn, improve confidence in those companies looking to list in Hong Kong. The regulators are also looking at other options to further complement its proposals, for example, the “primary equity connect” concept, an extended model of Shanghai- and Shenzhen-Hong Kong Stock Connect programs as an avenue to help with the liquidity of the current and New Board, which is an important consideration for selecting a listing venue by issuers. One of the primary drivers behind the proposals is to help Hong Kong meet the evolving needs of investors and issuers while retaining its leading position. We believe the markets will be generally receptive to the New Board given it offers fresh listing opportunities, while maintaining a balanced and high regulatory standard. This may be what is required to further bolster HKEx as an internationally renowned stock exchange.

If you have any questions or would like your views to be reflected in our response to proposals, please do not hesitate to contact us.

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