

Hong Kong Capital Markets Update

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HKEX's consultation on the establishment of a New Board and review of the Growth Enterprise Market (GEM)

On 16 June 2017, the Hong Kong Stock Exchange (the Exchange) launched a two-month consultation to seek public feedback on a series of proposals to broaden the accessibility of Hong Kong's capital markets and strengthen its listing regime. The proposals are divided within two separate papers:

- [the New Board Concept Paper](#); and
- [the Consultation Paper on the Review of the GEM and Changes to the GEM and Main Board Listing Rules](#).

The consultation is scheduled to end on 18 August 2017.

The New Board Proposal

The proposals contained in the New Board Concept Paper are designed to enhance Hong Kong's ability to attract companies from the 'new economy'¹ sectors with one or more of the following characteristics that prohibit them from a listing under the current regime:

- Pre-profit companies;
- Companies with non-standard governance structures; and
- Mainland Chinese companies that wish to have a secondary listing in Hong Kong.

The New Board will not accept any established or old economy firms, but only those classified as new economy firms to list.

In this Concept Paper, the Exchange sets out the proposal for a New Board with two distinct segments, **New Board PRO** and **New Board PREMIUM**, to cater the needs of different types of issuers and investors.

New Board PRO – characteristics, admission criteria and listing process

New Board PRO is designed for early stage, pre-profit technology or new economy companies that do not meet the financial or track record criteria for GEM or the Main Board although applicants are subject to a minimum market capitalisation of HK\$200 million at the time of listing. No specific financial or track record requirements would be imposed by the Exchange.

New Board PRO applicants are required to have a minimum of 100 investors at the time of listing and a minimum public float of 25 percent, consistent with the GEM requirements.

New Board PRO would only be open to professional investors. Given the early stage development and the investor eligibility requirement, New Board PRO would allow a 'light-touch' approach to the vetting process. It is proposed that a New Board PRO applicant should appoint a financial adviser (instead of a sponsor) and carry out the necessary investigations to ensure the accuracy and sufficiency of information in the listing document to enable professional investors to make an informed investment decision.

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

New Board PREMIUM – characteristics, admission criteria and listing process

New Board PREMIUM, on the other hand, will target technology or 'new economy' companies that meet the existing financial and track record requirements of the Main Board, with the exception of having 'standard' governance structures. For example, structures other than 'one-share, one-vote'.

¹ The Exchange aims to develop a set of guidelines on what constitutes New Economy for purposes of listing on the New Board. No fixed definition is proposed and the Listing Committee of the Exchange will retain the ultimate discretion to determine the listing eligibility on a principle-based approach.

New Board PREMIUM would be open to both retail and professional investors similar to the Main Board. Consequently, it would also adopt a similar regulatory approach as the Main Board. These include, but not limited to, the sponsor regime, the prospectus requirements, the approval mechanism where each application is presented to the Listing Committee for approval, a minimum public float of 25 percent to be held by at least 300 shareholders.

Both segments would allow non-standard governance structures (e.g. dual class shareholding) and impose no restrictions for secondary listings by Mainland Chinese companies. This would allow Mainland Chinese companies already listed on other stock exchanges to pursue a secondary listing in Hong Kong.

Continuous listing and corporate governance obligations

Companies listed on the New Board would be expected to comply with the standards applicable to Main Board listed companies in respect of:

- a) Timely disclosure of material information;
- b) Publication of financial statements under prescribed accounting standards;
- c) Notifiable and connected party transaction rules;
- d) Director suitability and independent non-executive director representation;
- e) Requirement to appoint a company secretary;
- f) General meetings;
- g) Super-majority voting on certain fundamental matters; and
- h) Pre-emption rights for existing shareholders.

Suspension and delisting

The Exchange would suspend trading of securities of the New Board issuer for material breach of the New Board listing rules.

The New Board would have an accelerated delisting mechanism for companies that failed to meet its ongoing listing requirements. It is proposed that the Exchange would cancel the listing status of the New Board PRO issuer or the New Board PREMIUM issuer if it had been suspended for a continuous period of 90 calendar days and 6 months, respectively.

Additional requirements for weighted voting rights (WVR) companies

The Exchange proposes two possible approaches - a disclosure-based approach or a specific safeguards approach, to regulate companies with, or seeking, a listing on the New Board with a WVR structure.

Under the disclosure-based approach, companies are required to prominently disclose their adoptions of the WVR structures and the risks associated therewith.

Alternatively, the Exchange would impose mandatory safeguards (e.g. 'sunset clause') for companies with WVR structures in addition to the disclosure requirements.

According to the Concept Paper, concessions are also allowed for companies with WVR structures currently listed on a recognised stock exchange in the US and have demonstrated a good compliance record. Under the proposals, these companies may follow a 'disclosure based' approach if they seek a primary or secondary listing on the New Board.

The next step

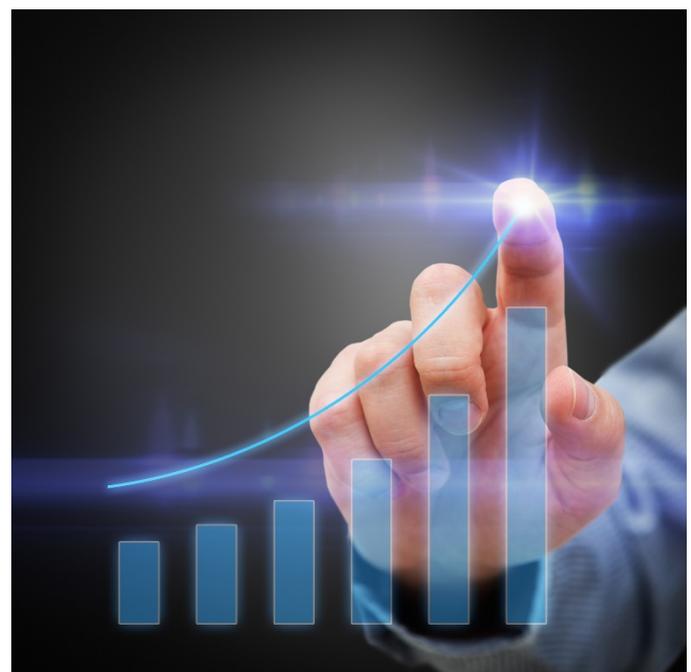
If there is market support for the New Board, the Exchange aims to finalise detailed New Board listing rules in early 2018.



Transfers between segments / boards

The Exchange indicated in the FAQ that 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.

A company listed on New Board PRO wishing to list on other boards to attract retail investors would have to meet all the admission criteria and other listing requirements of the relevant board.



Proposed GEM reforms

Three areas are identified for review by the securities regulator: (i) GEM's position as a stepping stone to the Main Board; (ii) admission requirements and delisting mechanism; and (iii) the open market requirement.

GEM's position as a stepping stone to the Main Board

GEM was positioned in 2008 as a 'stepping stone' to the Main Board and a streamlined process for transfer to Main Board was introduced. Under the streamlined process, GEM issuers can apply for a transfer to the Main Board if they meet the Main Board admission requirements, without the need to appoint a sponsor and issue a listing document.

In recent years, the streamlined transfer process has been criticised for the possibility of regulatory arbitrage between the Main Board and GEM, which could harm the quality of the market.

To address the potential issues, the regulators re-examined the current profile of GEM and propose to (i) re-position GEM as a stand-alone board that caters for smaller or mid-sized companies; and (ii) remove the 'stepping stone' mechanism and, therefore, the existing streamlined transfer process.

Proposal: Appointment of sponsor and issue of prospectus-standard listing document for GEM transfers

The removal of the streamlined transfer process would mean an applicant would need to appoint a sponsor to perform the appropriate due diligence and issue a 'prospectus-standard' listing document with full disclosures. It is also proposed that a GEM transfer would only be considered if the applicant:

- a) published and distributed at least two annual financial statements after a GEM listing (current: one annual financial statement); and
- b) has not been subject to any regulatory disciplinary actions in relation to a serious breach or potential serious breach of any listing rules for 24 months (current: 12 months).

Admission requirements and delisting mechanism

Issues such as high shareholding concentration, illiquidity and high volatility of the share prices of certain GEM listed companies raised concerns as to whether the existing admission requirements are too lax. To improve the quality of GEM issuers, the Exchange proposes to (i) increase the minimum cashflow requirement, (ii) increase the minimum market capitalisation requirement, and (iii) extend the post-IPO lock-up requirement.

Proposal: Increase cashflow requirement from a minimum of HK\$20 million to HK\$30 million.

The Exchange proposes to increase the minimum amount of aggregate operating cashflow (before changes in working capital) a GEM applicant is required to demonstrate over the two financial years immediately before the issue of its listing document (the 'Cashflow Requirement') from HK\$20 million to HK\$30 million.

Proposal: Increase minimum market capitalisation at listing from HK\$100 million to HK\$150 million

Proposal: Extend post-IPO lock-up requirement

The Exchange proposes to extend the post-IPO lock-up requirement such that the controlling shareholder cannot dispose any shares within the first year (current: 6 months) of listing; and the controlling shareholder cannot dispose shares to the extent of losing the controlling status in the subsequent year (current: 6 months after).

Under the existing regime, GEM listing applications are delegated to the Exchange's Listing Department for approval. As part of the GEM reform, the delegated authority will be unwinded and the power to approve or reject GEM listing applications will return to the Listing Committee.

Open market requirement

Under the existing regime, a GEM applicant may list by way of placing only. In a recent review of GEM IPO placings, the regulators have identified a number of instances in which shares were placed in the hands of a small number of shareholders. Such high shareholding concentration has led to extreme volatility among some GEM stocks.

To address the problems associated with highly concentrated shareholdings at listing and other related issues, the Exchange proposes to (i) introduce mandatory public offering mechanism, (ii) align GEM placing requirements with those of Main Board, and (iii) increase the minimum public float value of securities.

Proposal: Mandatory public offer of at least 10 percent of the total offer size.

Proposal: Align GEM placing requirements with those of Main Board

The Exchange proposes to align the GEM requirements in regards to placements with core connected persons, connected clients, existing shareholders or their close associates with those of the Main Board².

With the introduction of mandatory public offering, it also proposes to extend the rules on allocation of offer shares between public and placing tranches and the clawback mechanism on Main Board offerings to GEM.

² [Appendix 6](#) to the Main Board Listing Rules and Guidance Letter [HKEX-GL-85-16](#).

Proposal: Increase minimum public float of securities

In addition, the Exchange proposes to increase the minimum public float value of securities from HK\$30 million to HK\$45 million.

Implications of the GEM proposals on Main Board requirements

The GEM proposals, if adopted, will result in an uplift of the GEM requirements to the extent that some are close to or even exceed the equivalent requirements of the Main Board. In order to preserve the Main Board's position as a market for larger companies and to make a clear distinction between the different markets, the Exchange proposes several changes to the Main Board admission requirements.

Proposals:

(i) increase the minimum market capitalisation at listing from HK\$200 million to HK\$500 million;

(ii) increase the minimum market public float value from HK\$50 million to HK\$125 million; and

(iii) extend the post-IPO lock-up requirement for Main Board issuers to 2 years, consistent with GEM issuers.

Transitional arrangements of Main Board and GEM listing applications and GEM transfers

To minimise the impact on stakeholders, a set of transitional arrangements will be in place to allow sufficient time for an applicant and issuer to comply with the more stringent rules if the proposals are adopted.

Main Board and GEM listing applications

All Main Board and GEM listing applications will continue to be processed in accordance with the rules and requirements currently in force until the amendment effective date³.

GEM transfers

For issuers who have submitted transfer applications on or before the amendment effective date

All transfer applications submitted on or before the amendment effective date will be processed under the current regime, including assessment on eligibility.

For GEM issuers listed on or before the date of the consultation paper and GEM applicants who have submitted a valid listing application on or before the date of the consultation paper

A transitional period of three years will be given for these eligible issuers to submit their transfer applications. During this period, the applicant's eligibility to transfer will be assessed in accordance with the transitional arrangements as follows:

- for applicant whose principal business or controlling shareholder(s) have *changed* since listing:

The applicant is required to appoint a sponsor and prepare and publish a 'prospectus standard' listing document as if it is a new listing applicant to the Main Board.

- for applicant whose principal business or controlling shareholder(s) have *not changed* since listing:

The applicant is required to prepare a GEM transfer announcement and to appoint a sponsor to conduct due diligence in respect of the applicant's activities during the most recent full financial year and up to date of the announcement.



Reminders

The proposals, if adopted, will likely result in increased listing costs and an extended timetable for GEM listings and transfers.

Applicants are encouraged to consult their professional advisers the extent in which the proposals, if adopted, may impact their listing or transfer plans.

If you have any questions about the matters discussed in this publication, please feel free to contact the following partners in our Capital Markets Advisory Group.

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³ The amendment effective date is expected to be approximately six months after the date of the GEM consultation paper

Appendix 1 – Key features of the New Board

	New Board <i>PRO</i>	New Board <i>PREMIUM</i>
Target issuers	Early-stage or pre-profit new economy companies	New economy companies that meet Main Board financial and other key requirements, but are unable to meet certain criteria such as: <ul style="list-style-type: none"> • Non-standard equity governance structures • US-listed companies with standards differing from HK
Investor eligibility	Professional investors ⁽¹⁾	Same as Main Board – retail and professional investors

Admission criteria		
Financial requirements	No financial requirements	Same as Main Board
Minimum market capitalisation at listing	HK\$200 million	Same as Main Board
Overseas issuers	Must have IOSCO MMOU ⁽²⁾ / SFC bilateral agreement No requirement for HK equivalent shareholder protection as required by the 2013 JPS ⁽³⁾ Permits secondary listing of Mainland companies	Must have IOSCO MMOU / SFC bilateral agreement Waivers for issuers already listed on a recognised US Exchange with HK 'equivalent' shareholder protection standards Permits secondary listing of Mainland companies

Open market requirements		
Minimum public float and investors	25 percent, at least 100 investors	25 percent, at least 300 investors
Offering Mechanism	Placement	Public Offer

Listing process		
Supervision	Listing Committee and SFC	
Vetting process	Light touch	Same as Main Board
Listing approval	Listing Department (Under delegation from Listing Committee)	Listing Committee
Listing advisor	Financial Advisers (Type 6 Licence Holders ⁽⁴⁾)	Sponsor
Listing document	Listing Document ⁽⁵⁾	Prospectus ⁽⁶⁾

Appendix 1 – Key features of the New Board (Continued)

	New Board <i>PRO</i>	New Board <i>PREMIUM</i>
Continuing listing obligations and delisting		
Continuing listing obligations	<p>Companies listed on the New Board would be expected to comply with standards similar to the Main Board:</p> <ul style="list-style-type: none"> • Timely disclosure of material information • Publication of financial statements for the half-year and full-year under prescribed accounting standards • Notifiable and connected party transaction rules • Directors' suitability and minimum INED representation • Company secretary must be appointed • General meetings will be required • Super-majority voting is required on certain fundamental matters • Pre-emption rights for existing shareholders to protect them from dilution 	
Delisting	Automatic delisting if continuously suspended for 90 days	Automatic delisting if continuously suspended for 6 months

Note:

- (1) As defined in the SFO or by the SFC (e.g. the \$8 million minimum portfolio threshold for individuals).
- (2) IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information
- (3) The Joint Policy Statement Regarding the Listing of Overseas Companies jointly issued by the SFC and SEHK in September 2013
- (4) Subject to market feedback and further consideration by the SFC.
- (5) Contains all material information that would be required by a professional investor in order to make an investment decision.
- (6) A prospectus refers to a listing document that is required to be registered under Companies Ordinance because it involves an offer to the public.

Appendix 2 – Summary of the proposals of GEM reform and consequential change to Main Board listing requirements

	Current Regime	Proposed Changes
Requirements for GEM transfers:		
Appointment of sponsor and preparation of prospectus-standard listing document	Not required	Required
Admission requirements	Published <u>one</u> full year's financial statements since listing + no investigations for serious breaches <u>12 months</u> before transfer	Published <u>two</u> full years' financial statements since listing + no investigations for serious breaches <u>24 months</u> before transfer

GEM listings:		
Admission requirements:		
Minimum cashflow requirement	HK\$20 million	HK\$30 million
Minimum market capitalisation at listing	HK\$100 million	HK\$150 million
Post-IPO lock-up period on controlling shareholder:		
- the first lock-up period ⁽¹⁾	6 months	12 months
- the second lock-up period ⁽²⁾	6 months	12 months

Open market requirements:		
Minimum public float	HK\$30 million	HK\$45 million
Offering Mechanism	100% placing allowed	Mandatory public offering of at least 10% of total offer size ⁽³⁾
Placing to connected persons / connected clients	No restriction provided full disclosure is made in the listing document	Align with Main Board where waiver / consent of the Exchange is required

Main Board listings:		
Minimum market capitalisation at listing	HK\$200 million	HK\$500 million
Minimum public float	HK\$50 million	HK\$125 million
Post-IPO lock up period on controlling shareholder:		
- the first lock-up period ⁽¹⁾	6 months	12 months
- the second lock-up period ⁽²⁾	6 months	12 months

Note:

- (1) The period starting from the date of listing, where controlling shareholder(s) cannot dispose any of their equity interests.
- (2) The period subsequent to the first lock-up period, where controlling shareholder(s) cannot dispose their equity interests to the extent of losing the control status.
- (3) Main Board requirements on the allocation of offer shares between the public and placing tranches and claw mechanism would apply.

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