

The Hong Kong Chartered Governance Institute

Online Submission

The Stock Exchange of Hong Kong Limited (Exchange)

Consultation Paper on GEM Listing Reforms

The Hong Kong Chartered Governance Institute 香港公司治理公會

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[Unless the context requires otherwise, the terms and expressions used in this submission shall have the meanings set out under the Consultation Paper.]

About HKCGI

The Hong Kong Chartered Governance Institute (HKCGI), formerly known as The Hong Kong Institute of Chartered Secretaries, is the only qualifying institution in Hong Kong and the Mainland of China for the internationally recognised Chartered Secretary and Chartered Governance Professional qualifications.

With over 70 years of history and as the Hong Kong/China Division of The Chartered Governance Institute (CGI), the Institute's reach and professional recognition extend to all of CGI's nine divisions, with about 40,000 members and students worldwide. The Institute is one of the fastest growing divisions of CGI, with a current membership of over 7,000, 300 graduates and 2,600 students with significant representations within listed companies and other cross industry governance functions.

Believing that better governance leads to a better future, HKCGI's mission is to promote good governance in an increasingly complex world and to advance leadership in the effective governance and efficient administration of commerce, industry and public affairs. As recognised thought leaders in our field, the Institute educates and advocates for the highest standards in governance and promotes an expansive approach which takes account of the interests of all stakeholders.

Overall Support

From the applied governance perspective, we support the proposals under the Consultation Paper to offer a favourable setting for listing SMEs on the GEM Board while upholding strict requirements for investor protection. Specifically, we support a streamlined process for qualifying GEM businesses to move to the Main Board without needing a sponsor or prospectus-standard listing paperwork. This is subject to the criteria for eligibility, including financial performance, daily turnover, market capitalisation, and compliance records consistent with an applied governance approach. Also, the new alternative eligibility test is targeted at high-growth businesses that invest heavily in R&D, and to pass this test, we agree that a minimum amount must be spent on R&D, and a percentage of all operating expenditures must be consistent with the desired results of applied governance. Further, eliminating mandatory quarterly reporting and matching other ongoing obligations to level the playing field for governance requirements with the Main Board is appropriate for consistency in governance standards across the Main and GEM Boards.

'Question 1: Do you agree that an alternative eligibility test should be introduced to enable the listing of high growth enterprises substantially engaged in R&D activities on GEM? Please give reasons for your views.'

Yes. We agree that high-growth businesses engaged in GEM R&D should have access to a different eligibility test. These businesses frequently lack positive cash flow due to their R&D expenditures. The alternative test is necessary to give them a customised listing pathway. It acknowledges the distinctiveness of these businesses and promotes economic development, innovation, and job creation.

'Question 2: If your answer to Question 1 is "Yes," do you have any comments on the proposed thresholds for the alternative eligibility test set out in paragraphs 63 to 75 of the Consultation Paper? Please give reasons for your views.'

Yes. The suggested thresholds for the alternative eligibility test appear well-balanced. They consist of a sufficient track record of trading, a larger market capitalisation, substantial revenue, and significant R&D spending. These requirements ensure that businesses seeking to list via this alternate route have a strong foundation for expansion and sufficient investor support. Additionally, they make Hong Kong more alluring for high-growth tech firms. The recommended thresholds are reasonable and well-considered.

'Question 3: Do you agree with the proposal to reduce the post-IPO 24-month lock-up period imposed on controlling shareholders of GEM issuers to 12 months as set out in paragraph 76 of the Consultation Paper? Please give reasons for your views.'

Yes. We support the suggestion to shorten the post-IPO lock-up period for controlling shareholders from 24 to 12 months. The increase to 24 months was made to combat shell activity, which has mostly stopped due to the Exchange and the SFC's efforts. By lowering the lock-up period to 12 months, Hong Kong's regulations will align with those of international junior markets, and they will encourage liquidity and quicker access to capital for newly listed GEM issuers.

'Question 4: Should any other existing eligibility requirement for a listing on GEM be amended? If so, please state the requirement(s) that should be amended and give reasons for your views.'

Based on the information provided in the Consultation Paper, the proposed changes, including the alternative eligibility test and the reduction of the post-IPO lock-up period, address the specific needs and challenges faced by high-growth enterprises engaged in R&D and appear comprehensive and well-considered. If there are further regulatory reforms, we will provide input.

'Question 5 Do you agree with the proposed consequential and housekeeping amendments to the reverse takeover and extreme transaction Rules as set out in paragraphs 81 and 82 of the Consultation Paper? Please give reasons for your views.'

Yes. The proposed consequential and housekeeping clerical changes to the reverse takeover and extreme transaction Rules are acceptable. These adjustments maintain consistency in the rules and are logical extensions of the proposed reduction in the lock-up time. These changes will simplify the listing procedure and enable a more effective and useful framework.

'Question 6: Do you agree with the Exchange's proposal to remove GEM's compliance officer requirement as set out in paragraph 85(a) of the Consultation Paper? Please give reasons for your views.'

Yes. We agree with the Exchange's proposal to do away with the GEM compliance officer requirement, as directors should be expected to have experience as Main Board directors. This modification is justified from the applied governance perspective because it lowers compliance costs, and with the maturity of GEM-listed firms, aligning the governance regime with the Main Board makes sense.

Further, the removal of the compliance officer requirement is consistent with GEM LR 17.03 and Main Board LR 3.08 on collective responsibilities of directors in contrast with requiring one of the EDs to assume responsibility for acting as the issuer's compliance officer in the current GEM LR 5.19.

Given the proposed removal of the compliance officer requirement and alignment of expectations with directors of Main Board listed issuers our Institute stresses the importance of directors' training. Our Institute would be delighted to support the delivery of cost-effective thought leadership training and research in line with regulatory and market expectations and look forward to collaboration with HKEX to the extent appropriate.

'Question 7: Do you agree with the Exchange's proposal to shorten the period of engagement of GEM issuers' compliance advisers and to remove the additional obligations currently imposed on a GEM issuer's compliance adviser as set out in paragraphs 85(b) and 86 of the Consultation Paper? Please give reasons for your views.'

Yes. We concur with the Exchange's proposal to reduce the duration of the compliance consultants' advisers with GEM issuers and to eliminate further obligations. These adjustments simplify compliance processes, lower issuer costs, and more closely match GEM's position as a market for established SMEs as set out under paragraph 89 of the Consultation Paper.

'Question 8: Should any other continuing obligation currently applicable to a GEM listed issuer also be removed? If so, please state the requirement(s) and give reasons for your views.'

While there is currently no particular continuing obligation we identify, we recommend a careful examination to find any potential obligations that might no longer be required given the maturity of GEM-listed firms, depending on the success of the reform and market feedback. The aim should be to ensure that GEM's rules support market expansion and balance investor protections.

'Question 9: Do you agree with the Exchange's proposal to remove quarterly financial reporting as a mandatory requirement for GEM issuers and instead introduce it as a recommended best practice in GEM's Corporate Governance Code? Please give reasons for your views.'

Yes. We support the Exchange's proposal to stop requiring GEM issuers to submit financial reports quarterly as GEM is no longer a 'buyer beware' market. This modification reflects the maturity of GEM-listed firms and harmonises the reporting requirements for GEM with those for Main Board issuers, lowering compliance expenses. It allows issuers the flexibility they need to cater to investor needs while maintaining the amount and timeliness of disclosure.

'Question 10: Do you agree with the Exchange's proposal to align the timeframes for GEM issuers to publish their annual reports, interim reports, and preliminary announcements of results with those for the Main Board? Please give reasons for your views.'

Yes. We agree with the Exchange's proposal to match the reporting deadlines for the Main Board and GEM issuers. This alignment streamlines regulatory procedures, lessens the reporting burden, and improves market effectiveness. It is justified by the development of companies with GEM listings, the increasing convergence of standards for GEM and Main Board issuers, and the applied governance perspective.

'Question 11: Do you agree that a streamlined mechanism should be introduced to enable qualified GEM issuers to transfer their listing to the Main Board? Please give reasons for your views.'

Yes. The proposed streamlined transfer mechanism for qualified GEM issuers to the Main Board improves market efficiency and lower costs while providing several advantages. First, offering a clear transfer path to the Main Board increases the appeal of companies listing on GEM, perhaps leading to more listings. Second, it lowers compliance costs by doing away with the requirement for a sponsor and a "prospectus-standard" listing paperwork. Thirdly, requiring companies to adhere to standards and keep a clean compliance record promotes market integrity and quality.

Finally, making it easier for qualifying companies to transfer can increase market liquidity and trading volumes.

'Question 12: If your answer to Question 11 is "Yes," do you agree with the removal of the requirement for the appointment of a sponsor for the purpose of a streamlined transfer as set out in paragraph 108 of the Consultation Paper? Please give reasons for your views.'

Yes. The context is an existing GEM Board company that complies with Main Board requirements. Removing the sponsor requirement for streamlined transfers offers cost-reduction benefits by making a listing on GEM and transitioning to the Main Board more financially feasible. Simultaneously, it simplifies and expedites the process, which is particularly beneficial for established GEM issuers. This change strengthens market efficiency, aligning with Hong Kong's market competitiveness and attractiveness goals, ultimately promoting efficiency, reducing compliance costs, and increasing accessibility for eligible issuers.

'Question 13: If your answer to Question 11 is "Yes," do you agree with, for the purpose of a streamlined transfer, the removal of the requirements for a "prospectus-standard" listing document and other requirements as set out in paragraphs 111 to 114 of the Consultation Paper? Please give reasons for your views.'

Yes. We support removing the "prospectus-standard" listing document requirement for streamlined transfers. This change offers cost reduction and efficiency, simplifying the process for eligible GEM issuers while focusing on essential information and maintaining transparency. Importantly, integrity and compliance with Listing Rules remain intact, making this shift beneficial.

'Question 14: If your answer to Question 11 is "Yes," do you agree with the track record requirements for a streamlined transfer applicant as set out in paragraphs 117 to 118 of the Consultation Paper? Please give reasons for your views.'

Yes. The proposed track record criteria permit only proven GEM issuers with a minimum three-year financial track record to transfer and uphold the Main Board's calibre and market integrity and guard against major changes in the run-up to transfer, preserving ownership continuity and business stability. Investor trust is increased due to being able to rely on stable enterprises, which reduces regulatory arbitrage. In conclusion, these requirements help the plan maintain Main Board quality while providing a workable transfer route for established GEM issuers.

'Question 15: If your answer to Question 11 is "Yes," do you agree with the daily turnover and volume weighted average market capitalisation requirements for a streamlined transfer applicant as set out in paragraphs 120 to 133 of the Consultation Paper? Please give reasons for your views.'

Yes. The volume weighted average market capitalisation and daily turnover requirements for streamlined transfer applicants are appropriate and have several significant benefits. First, they provide the bare minimum of share liquidity, which is essential for the stability of the Main Board. Second, they avoid listings with insufficient market capitalisation and preserve conformance with Main Board rules. Thirdly, these requirements preserve Main Board quality by fostering investor confidence by ensuring that transferred businesses meet liquidity and market capitalisation rules. Additionally, they are consistent with similar practices in other markets, strengthening Hong Kong's international alignment and credibility while strengthening market quality and investor trust.

'Question 16: If your answer to Question 15 is "Yes," should the Minimum Daily Turnover Threshold for the Daily Turnover Test be set at: (a) HK\$100,000; (b) HK\$50,000; or (c) another figure (please specify)? Please give reasons for your views.'

We defer to market consensus, but from the applied governance point of view, option (a) at HK\$100,000 ensures robust daily turnover, aligning with Main Board standards, but it must avoid becoming a barrier for smaller, promising companies. Option (b) at HK\$50,000, while not as stringent as Main Board standards, makes the streamlined transfer accessible to a wider range of GEM issuers, potentially increasing Main Board listings and market activity. If considering another figure, it should be carefully analysed to balance market integrity and inclusivity for smaller companies. The chosen threshold should reflect market conditions, issuer characteristics, and broader market goals. Monitoring its impact post-implementation and remaining open to adjustments is advisable.

'Question 17: If your answer to Question 11 is "Yes," do you agree with the proposed compliance record requirement for a streamlined transfer applicant as set out in paragraph 134 of the Consultation Paper? Please give reasons for your views.'

Yes. Our support is because the compliance record requirement for streamlined transfer applicants is reasonable for several reasons. Firstly, it upholds the integrity of the Main Board by ensuring that transfer applicants have not committed serious breaches of Listing Rules in the 12 months preceding their application and throughout the transfer process. Secondly, it safeguards investor protection and maintains high regulatory standards for companies transferred to the Main Board. Thirdly, it preserves the Main Board's reputation and reinforces its image as a market with stringent regulatory controls.

'Question 18: Do you agree with the proposed modification to the existing compliance record requirement for a transfer from GEM to the Main Board as set out in paragraph 136 of the Consultation Paper? Please give reasons for your views.'

Yes. There are justifications for the proposed change to the paragraph 136 compliance record requirement for transfers from GEM to the Main Board. Ensuring that all transfers, even those made using the streamlined procedure, comply with the same compliance standard improves regulatory uniformity and clarity while streamlining the regulatory system. It avoids inconsistencies by applying uniform criteria to all transfers, maintaining high regulatory standards regardless of the transfer mechanism. The update also strengthens regulatory monitoring by prohibiting businesses with recent major violations from avoiding examination by selecting a different transfer mechanism, protecting the Main Board's integrity and calibre.

'Question 19 Do you agree that the Exchange should exempt GEM transferees to the Main Board from the Main Board initial listing fee? Please give reasons for your views.'

Yes. We support the Exchange's exemption of GEM transferees to the Main Board from the initial listing fee for several reasons. It aligns to reduce overall transfer costs, potentially encouraging more GEM issuers to consider Main Board transfers. Also, it directly addresses stakeholder concerns about the financial burden of listing transfers. Moreover, it enhances the Main Board's appeal by making it more attractive to GEM issuers, which could lead to increased transfers and Main Board activity.

If there are any questions, please feel free to reach out to Ellie Pang FCG HKFCG(PE), Chief Executive, HKCGI or Mohan Datwani FCG HKFCG(PE), Deputy Chief Executive, HKCGI at 2881 6177 or research@hkcgi.org.hk.

Yours sincerely,

For and on behalf of
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