

Issued on: 6 November 2023

The Exchange's Consultation Paper

GEM Listing Reforms (September 2023)

In relation to the captioned consultation paper, The Hong Kong Institute of Directors has the following views and comments.

General Comments

This is the long-anticipated consultation for GEM reform. We can support the proposals, but we have concerns in some respects.

Initial listing requirements – slanting towards tech companies with R&D

One main feature among the proposals is to introduce an alternative eligibility test that incorporates an R&D expense requirement. There would seem to be a slanting towards tech companies with substantial R&D, and there may be the larger economic policy reason behind it – to support Hong Kong's own innovation & technology development and to attract quality tech start-ups in the GBA to list and raise funds in Hong Kong. See Consultation Paper para 48. However, SMEs with less involvement in R&D and being less tech-oriented could be excluded from participation in the GEM market. It may be possible for the Exchange to yet devise another alternative eligibility test that could be helpful to more SMEs in the general economy.

Board's role in governance should be the same for GEM and Main Board issuers

The proposals will bring GEM issuers' continuing obligations in line with those for Main Board issuers. Consultation Paper para 83-84. In particular, connected transaction requirements will continue to apply. We are FOR this position. The application of the relevant rules would not prohibit those transactions per se, but they require the right governance procedures at the board level. Legitimate connected transactions that could fuel further growth, if properly handled and disclosed, can even add transparency to give further investor confidence.

The proposals will also remove or reduce the role of compliance officers and compliance advisers for GEM applicants/issuers. Consultation Paper para 85-89. A company's board of directors has ultimate responsibility for the company's governance, and each board member should have the awareness and be ready to discharge the collective governing duty. The board can and should engage professional advisers for assistance but should not defer or deflect such responsibility to others.

Sustainability matter and ESG requirements

The Exchange will return to ESG-related requirements at a later stage but hinted at a "measured approach" for GEM issuers when implementing new ESG-related requirements. Until then, GM issuers will be subject to the same ESG reporting requirements as Main Board issuers.

GEM applicants/issuers may have less resources to spend on meeting ESG reporting requirements. How the Exchange will consider scalability and phasing-in measures for the application of IFRS Sustainability Disclosure Standards would be of significant interest to them.

But the potential positive impact of some GEM applicants/issuers on planet sustainability may not be small since they could be the ones undergoing R&D for groundbreaking solutions. The Exchange may want to provide interim guidance to allow GEM applicants/issuers to apply qualitative approaches in their disclosure in a manner that would relieve some of their burden but still yield useful information.

Streamlined transfer mechanism

Another prominent feature among the proposals is to implement a streamlined transfer mechanism with modified eligibility requirements. Under the proposed mechanism, the transfer applicant would not need to appoint a sponsor nor to have a “prospectus-standard” listing document for purpose of the transfer, but would have to be listed on GEM for three full financial years.

A transfer applicant will have previously been subject to a due diligence process conducted by a sponsor, and it will also have been subject to continuing disclosure and audit requirements while on GEM. See Consultation Paper para 109-110. There is also the requirement that the transfer applicant has maintained continuity in ownership and control and has not changed its principal line of business. See Consultation Paper para 117-118. Background information and current conditions of the transfer applicant would have been made available to investors to make informed decisions.

There will also be a minimum Daily Turnover Threshold and a volume weighted market capitalisation requirement over a Reference Period stretching to 250 days prior to the transfer application. Consultation Paper para 120-133. A genuine showing of investor interest is the aim here.

The requirements are on the whole reasonable. The effect of these requirements, whether desired or unintended, could be to keep more GEM issuers on GEM, making it more a meaningful and hopefully vibrant market. To allow streamlined transfer in one year (as would be under existing requirement) could render GEM not much more than a steppingstone.

Compliance costs

The proposals would include an exemption from the Main Board initial fee for GEM transferees. One rationale is to reduce the costs for a transfer. This is all agreeable, though the Exchange can consider schemes to amortise the amounts payable into instalments over subsequent years post-transfer.

The proposals include other measures to keep down compliance costs. For example, to remove the mandatory quarterly reporting requirement while on GEM (Consultation Paper para 92-100) and to remove the requirement for sponsor and for a “prospectus-standard” listing document in a transfer application (Consultation Paper para 111-116). All these would be helpful, but the largest chunk of expense will remain market practitioner fees at least for the initial GEM listing. See Consultation Paper para 56-57.

Aside from money costs, the GEM listing application would also be a lengthy process to reduce the attractiveness and utility for SME applicants.

Helping SMEs, all SMEs?

We considered the Exchange's proposals as slanting towards tech companies with substantial R&D. We can support the proposals on that premise, though, arguably, candidates which can meet the requirements *will have credible alternative listing venues*. The market will inform us whether the proposals are truly competitive.

Another concern we have is whether the Exchange has started out in a direction for reform that favours tech companies but ignores the capital raising needs of other SMEs, SMEs in the more general economy. Our members, many of whom are owners/directors of SMEs in the more traditional economy, have lamented the difficulty in going public to help take their business to the next level. This is consistent with the views and thoughts of many market practitioners, that SMEs have been having a hard time trying to go public to raise capital.

It is our view that the current proposals, while having merits as far as tech companies with substantial R&D are concerned, do not address the capital raising needs of the many more SMEs in the general economy. The reform proposals may have gone off to a wrong start.

Consultation Questions

Subject to the general comments above, we state below our response to specific questions as set out in the Consultation Paper.

Initial Listing Requirements

Question 1 Do you agree that an alternative eligibility test should be introduced to enable the listing of high growth enterprises substantively engaged in R&D activities on GEM?

HKIoD Response:

- AGREE

Question 2 If the answer to Question 1 is “Yes”, do you have any comments on the proposed thresholds for the alternative eligibility test as set out in paragraphs 63 to 75 of the Consultation Paper?

HKIoD Response:

- As to track record requirement:
 - Track record of at least two full financial years, with the existing one-year ownership and two-year management continuity requirements to still apply. This is reasonable. See Consultation Paper para 64.
- As to market capitalisation requirement:
 - The expected market capitalisation of at least HK\$250 million at time of listing is higher than that under the existing eligibility test. The higher requirement is

to mitigate the absence of a track record of cash flow by way of a higher showing of investor support. This is reasonable. See Consultation Paper para 65.

- As to revenue requirement:
 - This is to impose a new requirement of an expected revenue of at least HK\$100 million in aggregate for the two financial years, *with* year-on-year growth over the two financial years. The newly imposed revenue requirement could be more demanding than the Nasdaq Capital Market tier, but less so than the Beijing Stock Exchange. See Consultation Paper footnote 54. On the whole, the new requirement is reasonable.
 - The Exchange had also considered that GEM applicants between 2018 and 2021 that could meet the current \$30 million cash flow test requirement had recorded on average revenue of \$317 million in aggregate over the two most recent years prior to listing. The proposed \$100 million in aggregate over two years threshold is more lenient. See Consultation Paper para 66-67. The revenue requirement is a surrogate measure of cash inflow, though cash inflow does not necessarily result in positive cash flow in the end.
 - Another reason behind the new revenue requirement is to indirectly require the GEM applicant to have (fully) commercialised its products and/or services. The year-on-year growth prong of the new requirement is to further showcase a meaningful revenue growth over the track record period. See Consultation Paper para 68-69.
- As to R&D requirement:
 - To require R&D expenditure of at least HK\$30 million in aggregate for the two financial years prior to listing, with a minimum R&D expenditure ratio of 15% over total operating expenditure *for each of the two financial years* over the track record period, is on the whole reasonable.
 - To require the same ratio as applied to Commercial Companies under the listing regime for Specialist Technology Companies is an appropriate indicator of resource allocated to R&D to support growth. See Consultation Paper para 70-72.
 - Engaging in promising R&D can be an indication of growth potential (and future prospect). To pair the minimum R&D expenditure threshold with R&D expenditure ratio (over total operating expenditure) does in surrogate require the GEM applicant to have been engaging in substantial R&D activities. See Consultation Paper para 74.
 - There is also the larger economic policy reason, to attract quality tech start-ups in the GBA to list and raise funds in Hong Kong. See Consultation Paper para 48.

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?

HKIoD Response:

- AGREE
 - A 12-month lock-up would seem reasonable. Can be shorter still; 6 months for example. We take note that the Exchange now considers long lock-up no longer necessary due to regulatory efforts that lead to a cessation in shell activities. See Consultation Paper para 77.

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.

HKIoD Response:

- No comments at this time.

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?

HKIoD Response:

- AGREE
 - The proposal is to extend the waiver practices in relation to ownership and management continuity in reverse takeover and extreme transaction situations and apply such to the new market capitalisation / revenue / R&D test and also to already existing alternative eligibility tests under the Listing Rules. The application of the waiver practices should be made consistent.

Continuing obligations

The proposals will bring GEM issuers' continuing obligations in line with those for Main Board issuers. Consultation Paper para 83-84. In particular, connected transaction requirements will continue to apply. We are FOR this position. The application of the relevant rules would not prohibit those transactions per se, but they require the right governance procedures at the board level. Legitimate connected transactions that could fuel further growth, if properly handled and disclosed, can even add transparency as to give further investor confidence.

Compliance Officer and Compliance Adviser

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?

HKIoD Response:

- AGREE
 - The board of directors has ultimate responsibility for the company's governance, and each board member should have the awareness and be ready to discharge the collective governing duty, with compliance matters being one aspect. We do not favour the retention of a "compliance officer" requirement, which could result in a misconception that compliance matters are the responsibility of a select member of the board (or some other officers of the company).

Question 7 Do you agree with the Exchange's proposal to shorten the period of engagement of GEM issuer's 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?

HKIoD Response:

- As to para 85(b):

- The proposal is to shorten the period of engagement of the compliance adviser to end on the date on which the issuer publishes financial results for the first full financial year (instead of second) from date of listing. AGREE.
- As to para 86:
 - The proposal is to align the compliance adviser's responsibilities for a GEM issuer with those for Main Board issuer. AGREE.
- Reasons:
 - The board of directors has ultimate responsibility for the company's governance and each board member should have the awareness and be ready to discharge the collective governing duty. The board can and should engage professional advisers for assistance but should not defer or deflect such responsibility to others. See also our response to Question 6.

Question 8 Should any other continuing obligation currently applicable to a GEM listed issuer also be removed?

HKIoD Response:

- No comments at this time.

Periodic Reporting Requirements

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?

HKIoD Response:

- AGREE
 - The proposals are generally to align periodic reporting requirements with those for Main Board issuers. GEM issuers will still have obligations to promptly disclose price sensitive information. Consultation Paper para 98. The Exchange may also impose additional ongoing disclosure requirements as circumstances require. Consultation Paper para 99. We think investors will still have timely information at the level needed for investment decisions.
 - Mandatory quarterly reporting requirement will become only a recommended best practice, but the Exchange anticipates some GEM issuers to continue to report quarterly on a voluntary basis to meet investor needs. Consultation Paper para 98. Let market forces play their part.

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 for the first half of each financial year with those for the Main Board, as set out in paragraphs 94 and 95 of the Consultation Paper?

HKIoD Response:

- AGREE
 - The proposals are generally to align periodic reporting requirements with those for Main Board issuers. We think investors will still have timely information at the level needed for investment decisions. See also our response to Question 9.



ESG-Related Requirements

(Consultation Paper para 101-104)

(See also the Exchange's recent Regulatory Update

on Consultation on Enhancement of Climate Disclosures

Under ESG Framework, issued 3 November 2023 and available online)

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GEM applicants/issuers may have less resources to spend on meeting ESG reporting requirements. How the Exchange will consider scalability and phasing-in measures for the application of IFRS Sustainability Disclosure Standards would be of significant interest to them.

But the potential positive impact of some GEM applicants/issuers on planet sustainability may not be small since they could be the ones undergoing R&D for groundbreaking solutions. The Exchange may want to provide interim guidance to allow GEM applicants/issuers to apply qualitative approaches in their disclosure in a manner that would relieve some of their burden but still yield useful information.

Transfers to the Main Board

New Streamlined Transfer Mechanism

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?

HKIoD Response:

➤ **AGREE**

- A clear pathway to the Main Board can potentially attract more companies to consider GEM for initial listing.
- GEM issuers that do not meet the proposed streamlined transfer requirements can still apply for a transfer under existing requirements. Consultation Paper para 138.

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?

HKIoD Response:

➤ **AGREE**

- A transfer applicant will have previously been subject to a due diligence process conducted by a sponsor, and it will also have been subject to continuing disclosure and audit requirements over the required GEM listing period of three-full financial years. See Consultation Paper para 109-110. There is also the requirement that the transfer applicant has maintained continuity in ownership and control and has not changed its principal line of business. See Consultation Paper para 117-118. Background information and current conditions of the transfer applicant would have been made available to investors to make informed decisions.

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?

HKIoD Response:

- AGREE
 - Background information and current conditions of the transfer applicant would have been made available to investors to make informed decisions. See also our response to Question 12.

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?

HKIoD Response:

- AGREE
 - To have been listed on GEM for three financial years should be a long enough track record period to lend the basis for removing the requirement to have sponsor and a “prospectus-standard” listing document for purpose of a transfer application.

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?

HKIoD Response:

- AGREE
 - The Daily Turnover Test is to help ensure that the market capitalisation of a transferee, at the time of its listing on the Main Board, is supported by a minimum level of daily turnover over the Reference Period. In combination with the volume weighted market cap test, the two tests work to counteract attempts to inflate or distort valuation, to test and reveal genuine investor demand. Consultation Paper para 129.
 - For the volume weighted market cap test, intraday volume weighted average price will be used rather than the daily closing price, so to counteract attempts to manipulate with large orders near closing of a trading day.

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)?

HKIoD Response:

- We opt for (b) HK\$50,000, or another amount on the low side.

- The Exchange notes that some transfer applicants may have lower liquidity in their shares but still be suitable for transfer to the Main Board. Consultation Paper para 124.

Compliance record

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?

HKIoD Response:

➤ AGREE

- The interest is to ensure the streamlined transfer applicant has a clean compliance record. The requirements under para 134 are reasonable generally, but some clarification of what may constitute “serious breach” of rules could be helpful.

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?

HKIoD Response:

➤ AGREE

- This should make the rule practice consistent.

Costs for transfers of listing

Question 19 Do you agree that the Exchange should exempt GEM transferees to the Main Board from the Main Board initial listing fee?

HKIoD Response:

➤ AGREE

- Alternatively, the Exchange can consider a scheme to amortise the amount payable into installments over subsequent years post-transfer.

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