香港董事學會
The Hong Kong Institute of Directors
FOUNDED 1997

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The Exchange's Consultation Paper

The Main Board Profit Requirement (November 2020)

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

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General comments

The present consultation paper is on proposals to raise the profit requirement under Listing Rule 8.05(1). HKIoD does not support the proposals.

We are concerned that the proposals if implemented will deprive small and medium sized companies especially those operating the more traditional businesses the fair opportunity for a Main Board listing. The Hong Kong capital market should be one that can serve companies big and small, from industries old and new. We should provide more opportunities for different types of companies to have meaningful access to the Hong Kong stock market.

To long for better market quality is good, but the Hong Kong capital market should aspire to be one wherein capital can flow from investors to listed companies when investors have knowledge of what they are buying into, and when issuers have market incentives to compete for investors' capital through the signalling effect of responsible corporate governance. We should pay attention to how we achieve and sustain that market quality.

Is the increase necessary for market quality?

The effect of the proposals would make the Main Board listing requirements the most stringent among the select overseas markets that the Consultation Paper picks as comparison. An increase in a mechanical criterion being the profit requirement does not by itself guarantee market quality, however.

To up the profit requirement could have a well-meaning effect that the Main Board is the premier board (and safe). The effect, however, would also be to leave the impression that because a company is on a premier board, bad things will not happen. But we know there is no guarantee. And it is not the case that Main Board issuers had never been found to have irregularities.

Even if a heightened profit requirement can be an underpin for a better quality Main Board, the Exchange could just create another market quality problem for itself. If applicants that will not be able to meet the heightened profit requirement are made to go to GEM, does it not say that those prospective GEM issuers would be of lesser quality and GEM would therefore be an inferior market?

Given the limitations and problems that commentators and market participants have been pointing out, we do not believe GEM is a viable alternative for those applicants who may henceforth be barred entry to the Main Board.

If those applicants seek listing elsewhere and are successful, that should count as them having met some measures of quality but would at the same time spell a lower quality for us in terms of diversity and choice. Our members may have a shot at being named directors still, but harder probably. The local corporate finance industry and the related ecosystem of practitioners and professionals could see fewer deal opportunities, and rather quickly. This does not seem ideal when Hong Kong should be vying to keep and maintain its international financial centre pedigree.

Ample means already exist to address regulatory concerns
The Exchange appears to make the case for an increase on some "regulatory concerns" which are set out in Consultation Paper para 3-6; para 18-23. Those paragraphs leave some aftertaste of smaller cap issuers being chastised as the greatest risk factor in market quality.

We are not convinced of a systemic occurrence of irregularities among smaller cap issuers, though we are open to consider more information or data that may go to support that postulation. We do know there are small cap issuers with credible board governance and fit-for-purpose corporate governance in place.

When there are regulatory concerns to address, the Exchange and the SFC would already have ample means available, either at the pre-listing application vetting phase or post-listing enforcement.

Can we not help investors fend for themselves?
Although some profit requirement or track record would be a criterion to seek (Main Board) listing status, we should remember that an investment decision should rest more on the future prospect of the issuer. And we know there are those warning labels: "past performance information is not indicative of future performance".

Market quality and investor protection is not always guaranteed by hard rules or mechanical criteria. Rather than to fiddle with a mechanical criterion like the profit requirement on listing, the Exchange could well consider other approaches towards improving market quality. The ultimate investor protection tool is for investors to be able to fend for themselves. Investors fending for themselves will need good information to rest investment decisions on.

For instance, some applicants at the margin may be listing at a "high historical P/E ratio" (25 under current profit requirement). The Consultation Paper would suggest that a "high historical P/E" is a serious risk to the issuer specifically or to the market overall. We do not think that would necessarily be true, at least not *a priori*.

Context matters. Does the current form, content and mode of disclosure give investors the necessary information in a timely manner to understand and consider that context – the future prospect of the issuer. It may be worthwhile to consider what changes or improvements to disclosure could still be possible to help investors (particularly retail investors).

Better boards for better quality market: role of directors
Market quality would also be a reflection on the collective quality of board and corporate governance of issuers tapping the market. Better quality directors should translate into better market quality.

We believe with proper training and continuing development, directors serving issuers – all issuers big and small, from industries old and new – will come to a proper understanding of their responsibilities and the fuller appreciation of their role in governance. Better board composition that gives a more diverse range of views for deliberation should enhance the quality of decisions made.

The perceived and actual independence of directors is also an important factor. There is certainly room to consider whether we should move towards a requirement to have a majority of INEDs among issuer's board. There is well-founded postulation that requiring a majority could make INEDs collectively better able to play their director roles.

Alongside disclosure that boards will have to make, a better shareholder engagement strategy and engagement operations should help shareholders and stakeholders better understand the prospect of the issuer.

HKIoD would be happy to work with the Exchange to keep raising the board governance and corporate governance game, for issuers big and small, from industries old and new.

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<u>Consultation questions</u>

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

Question 1
Do you agree that the Profit Requirement should be increased by either Option 1 (150%) or Option 2 (200%)?

HKIoD Response:

- DISAGREE as to either Option 1 (150%) or Option 2 (200%).

Question 2
Besides the proposed increase in the Profit Requirement, is there any other alternative requirement that should be considered?

HKIoD Response:

- Rather than to fiddle with a mechanical criterion like the profit requirement on listing, the Exchange could well consider other approaches towards improving market quality. See our general comments.

Question 3
Do you agree that the Exchange should consider granting temporary relief from the increased Profit Requirement due to the challenging economic environment?

HKIoD Response:

- DISAGREE, given that we do not favour a change to the profit requirement.

Question 4
If your answer to Question 3 is yes, do you agree with the conditions to the temporary relief as set out in paragraph 55?

HKIoD Response:

- No comment, as we DISAGREE with Question 3.

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