

Latest Proposals regarding HKEX Board Reforms

Jeffrey Mak Law Firm

2017.6.30 Corporate Finance

Revision of the HKEx's Listing Rules

On June 16 2017, the Hong Kong Stock Exchange (HKEX) issued two papers: a Consultation Paper on the “Review of the Growth Enterprise Market (GEM) and Changes to the GEM and Main Board Listing Rules” and a Concept Paper for a “New Board”. The HKEX not only fundamentally modifies the Listing Rules of the Main Board and the GEM, but also proposes the creation of New Boards independent of the Main Board and the GEM to attract a wider variety of companies. Through the revision and enactment of several new rules, the HKEX aims to clarify the Listing Rules regarding the Main Board, the responsibility and position of the GEM Board, the abolition of the original GEM Board’s role as a “stepping stone” to the Main Board, and to make it easier for companies temporarily unable to meet the financial and performance requirements of the Main Board and the GEM to apply for listing, thus diversifying the HKEX’s listing platform. The reform will make the distinction between Hong Kong listed companies clearer, and will contribute to improving their quality.

The Main Amendments to the Listing Rules

1. Main Board Listing Rules

The HKEx has made the following amendments to the Listing Rules of the Main Board, which include:

	Current System	Proposal
Minimum expected market capitalisation	HK\$200 million	HK\$500 million

Minimum public float value	HK\$50 million	HK\$125 million
Lock-up period	1 year; cannot be sold within the first six months	2 years, cannot be sold within the first year

The HKEx hopes to develop the Main Board into a more suitable prospect for larger companies, hence the minimum expected market capitalization requirement being raised to HK\$500 million. Furthermore, the minimum public float value has been increased from HK\$50 million to HK\$125 million.

The HKEx has recognized that many controlling shareholders sell their rights and interests in the immediate period after listing, resulting in the manipulation of share values and abnormal fluctuations in stock prices. To ensure that the controlling shareholder has a commitment to the long-term development of the listed company, the HKEx proposes to extend the one year lock-up period to two years. Therefore, the controlling shareholder of a listed company may not sell their rights and interests within two years after the listing of the company.

The above changes to the Listing Rules of the HKEx will reinforce the position of the Main Board as a listing platform for larger companies.

2. Major changes to the GEM Listing Rules

	Current System	Proposal
Cash Flow requirement	HK\$20 million	HK\$30 million

Minimum expected market capitalization	HK\$100 million	HK\$150 million
Minimum public float value	HK\$30 million	HK\$45 million
Lock-up period	1 year; cannot be sold in the first six months	2 years, cannot be sold in the first year
Mandatory public offering mechanism	No mandatory public offering mechanism	10% of the total offer size
Transfer mechanism	<ol style="list-style-type: none"> 1. Do not need to appoint a sponsor. 2. Need to issue a transfer notice. 3. Do not need to carry out sponsor due diligence. 	<ol style="list-style-type: none"> 1. Must appoint a sponsor. 2. Need to prepare a prospectus standard listing document. 3. Need for sponsor due diligence.
Qualification for Transfer	Issued at least one full financial year's financial statements after its listing on the GEM and must not have been subject to any disciplinary investigation for a serious breach or potentially serious breach of Listing Rules for 12 months before being considered for a transfer.	Issued at least two full financial years' financial statements after its listing on the GEM and must not have been subject to any disciplinary investigation for a serious breach or potentially serious breach of Listing Rules for 24 months before being considered for a transfer.

Compared to the position of the GEM as a “stepping stone” to the Main Board, the HKEx has redefined the GEM as a board for small and medium-sized enterprises operating for a certain period, rather than

for “emerging” companies set out in Article 2.12 and 2.2 of the current GEM Listing Rules. As a result, the HKEx has substantially modified the transfer mechanism, which will now require the board to appoint a sponsor, compile a “prospectus-standard” listing document and conduct sponsor due diligence. These enactments will ensure that the GEM and the Main Board will continue to target different types of companies. At the same time, in order to further enhance the quality of GEM applicants, the HKEx has proposed to raise the threshold for applications to the GEM by raising the cash flow requirement from HK\$20 million to HK\$30 million and raising the minimum expected market capitalization from HK\$100 million to HK\$150 million.

In respect of other rules, the HKEx has raised the standard of the GEM Listing Rules akin to that of the Main Board Listing Rules, with the introduction of a mandatory public offering mechanism in which GEM applicants must make a public offer of at least 10% of its total offer size. This will result in a broader shareholder base and contribute to the reduction of post-listing price volatility of GEM issuers.

New Board

The Hong Kong's stock exchange's insistence on its long-held stock structure requirement has led to Alibaba, and other companies utilizing a different equity structure, opting to list in the United States as opposed to Hong Kong. However, there are currently hundreds of Mainland enterprises which meet the requirements to list in Hong Kong, including science and technology enterprises such as Tencent (700) which have been very attractive to investors. Therefore, in addition to revising the existing Listing Rules and the GEM Listing Rules, the HKEx proposes to set up new boards independent of the Main Board and the GEM to broaden the Hong Kong market and attract a greater variety of enterprises in Hong Kong, such as those enterprises listed in the US (e.g. Alibaba, Baidu, Jingdong). Compared to the capital markets in Europe and the US, the culture, language and geographical proximity of Hong Kong are relatively closer, which will provide a greater competitive advantage. The new board will target three types of companies:

- (a) Companies that are not yet profitable;

- (b) Companies that do not have traditional governance structures;
- (c) Companies that want to develop a second listed company in Hong Kong.

To this end, the HKEx has designed a framework which sets out two New Boards:

(1) New Board PRO

The main targets of the New Board PRO are start-up companies that fail to meet the requirements of the Main Board or the GEM's financial or operating conditions, as well as companies that are unable to meet the same level of shareholder protection (such as Alibaba). It is only open to professional investors, therefore the relevant listing rules will be more relaxed. However, listings on the New Board PRO are relatively high-risk with the potential of high-growth, so investors should seek to fully understand the quality of the listings when choosing their investments.

HKEx recommends that the issuer be subject to a minimum market capitalization at the time of listing of HK\$200 million, and that the issuer does not need to have a track record or meet minimum financial criteria. The listing application must have a minimum of 100 investors at the time of listing and a minimum public float at listing of 25%. However, the HKEx retains its right to reject an applicant to the New Board PRO if it considers that the application meets the requirements of the Main Board or the GEM. These measures will ensure that the New Board PRO is only an option for companies with high growth potential but are not yet profitable.

An applicant listing on New Board PRO will only be required to appoint a Financial Adviser. Listing applications will be vetted and approved by the Listing Department under authority from the Listing Committee. An applicant will not need to adhere to the usual prospectus requirements; instead, it must produce a Listing Document that provides accurate information sufficient to enable professional investors to make an informed investment decision.

(2) New Board PREMIUM

New Board PREMIUM provides a path for listing for new economy companies that meet the Main Board's financial and track record requirements but have unconventional governance structures. The Board will be open to both retail and professional investors, and therefore will adopt a stricter regulatory approach. While its regulations, thresholds and procedures are in line with the current Main Board, the difference is that companies with a dual-share structure and companies that are seeking a secondary listing will be allowed to list on New Board PREMIUM.

HKEx recommends that applicants must appoint a sponsor and prepare a prospectus. The listing application will be presented to the Listing Committee for approval after it has been vetted by the Listing Department.

There will be no fast-track migration mechanism between the New Boards and the Main Board or GEM, or from New Board PRO to New Board PREMIUM. A New Board PRO listed company who wants to attract retail investors will have to meet all the admission criteria and other listing requirements of the relevant board. It is worth noting that both the New Boards will feature an accelerated delisting mechanism whereby a listing of a company will be canceled if it has been suspended for a continuous period of 90 days. The purpose of the mechanism is not only to lower the threshold and the cost of listing, but to also remove suspended companies in a quicker manner to prevent the existence of "shell" companies. The consultation paper also states that if a company fails to meet certain quantitative conditions for continuous listing, such as having a share price above a threshold, it will be placed in a watchlist. If the company is not able to meet the required conditions after a period on the watchlist, the company will be delisted.

Conclusion

The HKEx's amendments to the Listing Rules and the establishment of the new Boards demonstrate the HKMA's determination to substantially revise Hong Kong's listing framework. Although Hong Kong's capital market is still the first place for PRC enterprises

to seek an IPO, the HKEx must continually review and revise its existing listing structure in order to meet the changing needs of investors and issuers in order to maintain Hong Kong capital market's role as a global

leader moving forward. The relevant amendments to the Hong Kong Stock Exchange will increase the strength of the capital market in Hong Kong and lead it to greater heights.

Jeffrey Mak Law Firm | J M L is a corporate finance law firm focusing on deal structuring, corporate compliance and financial inclusion

**Jeffrey Mak Law Firm | J M L
13th Floor, Prince's Building
10 Chater Road, Central, Hong Kong
www.jmaklegal.com**

Information in this article is for reference only and should not be relied on as legal advice.

All rights reserved