



**By email (response@hkex.com.hk)**

28 January 2021

Our Ref.: C/CFAP, M128862

Hong Kong Exchanges and Clearing Limited  
8<sup>th</sup> Floor, Two Exchange Square  
8 Connaught Place  
Central  
Hong Kong

Dear Sirs,

**Re: Consultation Paper on The Main Board Profit Requirement**

The Hong Kong Institute of CPAs (“the Institute”) has reviewed the Consultation Paper on the Main Board Profit Requirement and its comments on the proposals are as outlined below and in the attached documents.

In principle, the Institute is supportive of measures to protect the interests of investors and maintain the quality of Main Board listings in Hong Kong. However, we do not believe that the current proposal to increase the minimum Main Board Profit Requirement, for companies that apply to list based on that criterion, is an appropriate approach to dealing with the concerns raised by the Stock Exchange of Hong Kong (“the Exchange”) in the consultation paper.

The proposal could result in over 40% of companies currently eligible to submit applications for listing via the Profit Requirement route being ineligible to do so in the future. This could be expected to have a significant impact on the ability of high-quality small- and medium-sized enterprises (“SMEs”) looking to expand their investor base to raise capital in Hong Kong, as well as on the prospects of many professional practitioners engaged in work on initial public offerings.

The Exchange suggests that companies at an early stage of development and SMEs could continue to access the capital market by listing on the Growth Enterprise Market (“GEM”), which is intended to be a capital-raising platform for companies that are not able to meet the Main Board eligibility requirements. However, many applicants do not view the GEM market as a viable alternative. In practice, the GEM has become a relatively inactive board, with only eight initial public offerings in 2020, and low trading volumes. The removal of the streamlined transfer process from the GEM to the Main Board, in 2018, appears to have discouraged SMEs with ambition and potential to grow from listing on the GEM. The Institute cautioned that this would be the likely outcome, in its response to the Exchange’s 2017 consultation on the review of the GEM<sup>1</sup>.

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<sup>1</sup> Consultation Paper - Review Of The Growth Enterprise Market (GEM) and Changes to the GEM and Main Board Listing Rules (June 2017)



As regards concerns expressed by the Exchange about SMEs listing with a view to creating shell companies for sale after listing, we believe that other, more targeted, measures should be, and have already been, taken to discourage the manufacture of shell companies. For example, Guidance Letter HKEX-GL68-13A, issued in April 2018, lays down seven criteria for suitability for listing. The Exchange has also introduced a number of rule changes to restrict the use of “reverse takeovers” and the restructuring of companies with long-suspended shares.

Furthermore, it would be unfair to assume that the bulk of SMEs seek to list simply to realise the perceived value of the listing status, rather than with the objective of seeking long-term growth and investment. As an international financial and trade centre, Hong Kong should provide reasonable opportunities for a diverse range of companies, in terms of size, background and industry, etc., to raise funds through the capital market, and new listings on the Main Board should not become the preserve mainly of mega corporations, unicorns and “new economy” companies. We agree that quality control is necessary, but it should be exercised through more focused means, such as rigorous gatekeeping and post-listing enforcement measures, rather than by excluding a whole body of potentially successful and valuable businesses from the market.

In addition, given the severe impact of the Covid-19 pandemic on the economy, employment, and the community generally, this is not an opportune time to introduce measures that could well exacerbate the current situation.

More fundamentally, rather than looking at issues such as the Main Board Profit Requirement in isolation, we would suggest that there is a need to formulate a clear strategy and blueprint for the future direction and long-term development of Hong Kong’s capital market as a whole, and to conduct more consultation on this.

— The Institute’s detailed comments on the proposals in the consultation paper are set out in the completed questionnaire and Appendix attached to this letter.

Should you have any questions on the Institute’s submission, please feel free to contact me at the Institute.

Yours faithfully,

Peter Tisman  
Director, Advocacy and Practice Development

PMT/NCL/pk

*Encl.*

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# QUESTIONNAIRE ON THE MAIN BOARD PROFIT REQUIREMENT

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We invite interested parties to respond to the Consultation Paper on The Main Board Profit Requirement (**Consultation Paper**), which can be downloaded from the HKEX website at: <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/November-2020-MB-Profit-Requirement/Consultation-Paper/cp202011.pdf>

This Questionnaire contains the Privacy Policy Statement; Part A: General Information of Respondents; and Part B: Consultation Questions.

All responses should be made in writing by completing and returning to HKEX both Part A and Part B of this Questionnaire no later than **Monday, 1 February 2021** by one of the following methods:

By mail or  
hand delivery to: Hong Kong Exchanges and Clearing Limited  
8<sup>th</sup> Floor, Two Exchange Square  
8 Connaught Place  
Central  
Hong Kong

**Re: Profit Requirement CP**

By fax to: (852) 2524 0149

By e-mail to: [response@hkex.com.hk](mailto:response@hkex.com.hk)

Please mark in the subject line:

**Re: Profit Requirement CP**

Our submission enquiry number is (852) 2840 3844.

The names of persons who submit comments together with the whole or part of their submissions may be disclosed to members of the public. If you do not wish your name to be published please indicate so in Part A.

# Privacy Policy Statement

Hong Kong Exchanges and Clearing Limited, and from time to time, its subsidiaries (together the "**Group**") (and each being "**HKEX**", "**we**", "**us**" or "**member of the Group**" for the purposes of this Privacy Policy Statement as appropriate) recognise their responsibilities in relation to the collection, holding, processing, use and/or transfer of personal data under the Personal Data (Privacy) Ordinance (Cap. 486) ("**PDPO**"). Personal data will be collected only for lawful and relevant purposes and all practicable steps will be taken to ensure that personal data held by us is accurate. We will use your personal data which we may from time to time collect in accordance with this Privacy Policy Statement.

We regularly review this Privacy Policy Statement and may from time to time revise it or add specific instructions, policies and terms. Where any changes to this Privacy Policy Statement are material, we will notify you using the contact details you have provided us with and, where required by the PDPO, give you the opportunity to opt out of these changes by means notified to you at that time. Otherwise, in relation to personal data supplied to us through the HKEX website or otherwise, continued use by you of the HKEX website or your continued relationship with us shall be deemed to be your acceptance of and consent to this Privacy Policy Statement, as amended from time to time.

If you have any questions about this Privacy Policy Statement or how we use your personal data, please contact us through one of the communication channels set out in the "Contact Us" section below.

We will take all practicable steps to ensure the security of the personal data and to avoid unauthorised or accidental access, erasure or other use. This includes physical, technical and procedural security methods, where appropriate, to ensure that the personal data may only be accessed by authorised personnel.

Please note that if you do not provide us with your personal data (or relevant personal data relating to persons appointed by you to act on your behalf) we may not be able to provide the information, products or services you have asked for or process your requests, applications, subscriptions or registrations, and may not be able to perform or discharge the Regulatory Functions (defined below).

## **Purpose**

From time to time we may collect your personal data including but not limited to your name, mailing address, telephone number, email address, date of birth and login name for the following purposes:

1. to process your applications, subscriptions and registration for our products and services;
2. to perform or discharge the functions of HKEX and any company of which HKEX is the recognised exchange controller (as defined in the Securities and Futures Ordinance (Cap. 571)) ("**Regulatory Functions**");
3. to provide you with our products and services and administer your account in relation to such products and services;
4. to conduct research and statistical analysis;
5. to process your application for employment or engagement within HKEX to assess your

- suitability as a candidate for such position and to conduct reference checks with your previous employers; and
6. other purposes directly relating to any of the above.

### **Direct marketing**

Where you have given your consent and have not subsequently opted out, we may also use your name, mailing address, telephone number and email address to send promotional materials to you and conduct direct marketing activities in relation to HKEX financial services and information services, and financial services and information services offered by other members of the Group.

If you do not wish to receive any promotional and direct marketing materials from us or do not wish to receive particular types of promotional and direct marketing materials or do not wish to receive such materials through any particular means of communication, please contact us through one of the communication channels set out in the "Contact Us" section below. To ensure that your request can be processed quickly please provide your full name, email address, log in name and details of the product and/or service you have subscribed.

### **Identity Card Number**

We may also collect your identity card number and process this as required under applicable law or regulation, as required by any regulator having authority over us and, subject to the PDPO, for the purpose of identifying you where it is reasonable for your identity card number to be used for this purpose.

### **Transfers of personal data for direct marketing purposes**

Except to the extent you have already opted out we may transfer your name, mailing address, telephone number and email address to other members of the Group for the purpose of enabling those members of the Group to send promotional materials to you and conduct direct marketing activities in relation to their financial services and information services.

### **Other transfers of personal data**

For one or more of the purposes specified above, the personal data may be:

1. transferred to other members of the Group and made available to appropriate persons in the Group, in Hong Kong or elsewhere and in this regard you consent to the transfer of your data outside of Hong Kong;
2. supplied to any agent, contractor or third party who provides administrative, telecommunications, computer, payment, debt collection, data processing or other services to HKEX and/or any of other member of the Group in Hong Kong or elsewhere; and
3. other parties as notified to you at the time of collection.

### **How we use cookies**

If you access our information or services through the HKEX website, you should be aware that cookies are used. Cookies are data files stored on your browser. The HKEX website

automatically installs and uses cookies on your browser when you access it. Two kinds of cookies are used on the HKEX website:

**Session Cookies:** temporary cookies that only remain in your browser until the time you leave the HKEX website, which are used to obtain and store configuration information and administer the HKEX website, including carrying information from one page to another as you browse the site so as to, for example, avoid you having to re-enter information on each page that you visit. Session cookies are also used to compile anonymous statistics about the use of the HKEX website.

**Persistent Cookies:** cookies that remain in your browser for a longer period of time for the purpose of compiling anonymous statistics about the use of the HKEX website or to track and record user preferences.

The cookies used in connection with the HKEX website do not contain personal data. You may refuse to accept cookies on your browser by modifying the settings in your browser or internet security software. However, if you do so you may not be able to utilise or activate certain functions available on the HKEX website.

## **Compliance with laws and regulations**

HKEX and other members of the Group may be required to retain, process and/or disclose your personal data in order to comply with applicable laws and regulations or in order to comply with a court order, subpoena or other legal process (whether in Hong Kong or elsewhere), or to comply with a request by a government authority, law enforcement agency or similar body (whether situated in Hong Kong or elsewhere) or to perform or discharge the Regulatory Functions. HKEX and other members of the Group may need to disclose your personal data in order to enforce any agreement with you, protect our rights, property or safety, or the rights, property or safety of our employees, or to perform or discharge the Regulatory Functions.

## **Corporate reorganisation**

As we continue to develop our business, we may reorganise our group structure, undergo a change of control or business combination. In these circumstances it may be the case that your personal data is transferred to a third party who will continue to operate our business or a similar service under either this Privacy Policy Statement or a different privacy policy statement which will be notified to you. Such a third party may be located, and use of your personal data may be made, outside of Hong Kong in connection with such acquisition or reorganisation.

## **Access and correction of personal data**

Under the PDPO, you have the right to ascertain whether we hold your personal data, to obtain a copy of the data, and to correct any data that is inaccurate. You may also request us to inform you of the type of personal data held by us. All data access requests shall be made using the form prescribed by the Privacy Commissioner for Personal Data ("**Privacy Commissioner**") which may be found on the official website of the Office of the Privacy Commissioner or via this link: <https://www.pcpd.org.hk/english/publications/files/Dforme.pdf>

Requests for access and correction of personal data or for information regarding policies and practices and kinds of data held by us should be addressed in writing and sent by post to us (see the "Contact Us" section below).

A reasonable fee may be charged to offset our administrative and actual costs incurred in complying with your data access requests.

### **Termination or cancellation**

Should your account or relationship with us be cancelled or terminated at any time, we shall cease processing your personal data as soon as reasonably practicable following such cancellation or termination, provided that we may keep copies of your data as is reasonably required for archival purposes, for use in relation to any actual or potential dispute, for the purpose of compliance with applicable laws and regulations and for the purpose of enforcing any agreement we have with you, for protecting our rights, property or safety, or the rights, property or safety of our employees, and for performing or discharging our functions, obligations and responsibilities.

### **General**

If there is any inconsistency or conflict between the English and Chinese versions of this Privacy Policy Statement, the English version shall prevail.

### **Contact us**

By Post:

Personal Data Privacy Officer  
Hong Kong Exchanges and Clearing Limited  
8/F., Two Exchange Square  
8 Connaught Place  
Central  
Hong Kong

By Email:

[DataPrivacy@hkex.com.hk](mailto:DataPrivacy@hkex.com.hk)

## Part A General Information of the Respondent

(1) Please state whether your response represents your personal or your company/ entity's view by checking (☑) the boxes below and filling in the information as appropriate:

Company/ Entity view

Company/ Entity name*: Hong Kong Institute of Certified Public Accountants	
Company/ Entity type*: <input type="checkbox"/> Listed Company <input type="checkbox"/> HKEX Participant	
<input type="checkbox"/> Investment Management Firm <input type="checkbox"/> Corporate Finance Firm	
<input type="checkbox"/> Law Firm <input type="checkbox"/> Accountancy Firm	
<input checked="" type="checkbox"/> Professional Body/ Industry association	
<input type="checkbox"/> Others (Type: _____)	
Contact person*: Mr	Peter Tisman
Title: Director, Advocacy and Practice Development	
Phone no.*: 2287 7084	Email address: peter@hkipa.org.hk

Personal view

Respondent's full name*: Mr/ Ms/ Mrs	_____	
Phone no.*: _____	Email address: _____	
Among the following, please select the one best describing your position*:		
<input type="checkbox"/> Listed Company Staff	<input type="checkbox"/> HKEX Participant Staff	<input type="checkbox"/> Retail Investor
<input type="checkbox"/> Investment Management Staff	<input type="checkbox"/> Corporate Finance Staff	<input type="checkbox"/> Lawyer
<input type="checkbox"/> Accountant	<input type="checkbox"/> Others (Type: _____)	

**Important note:** All fields marked with an asterisk (\*) are mandatory. HKEX may use the contact information above to verify the identity of the respondent. Responses without valid contact details may be treated as invalid.

(2) Disclosure of identity

HKEX may publish the identity of the respondent together with Part B of this response to the members of public. Respondents who do not wish their identities to be published should check the box below:

I/ We do not wish to disclose my/ our identity to the members of the public.

\_\_\_\_\_  
Signature (with Company/ Entity Chop if the response represents company/ entity view)

## Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please reply to the questions below on the proposed change discussed in the Consultation Paper downloadable from the HKEX website at:

<https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/November-2020-MB-Profit-Requirement/Consultation-Paper/cp202011.pdf>

Where there is insufficient space provided for your comments, please attach additional pages.

**Capitalised terms have the same meaning as defined in the Consultation Paper unless otherwise stated.**

1. Do you agree that the Profit Requirement should be increased by either Option 1 (150%) or Option 2 (200%)? Please give reasons for your views.

Yes

No

You may provide reasons for your views.

While we agree on the importance of an effective gatekeeping role to facilitate the listing of high-quality companies and those with good potential for growth, for a number of reasons, we do not agree with the proposed approach under either Option 1 or 2. Our reasons include the following:

- The proposal seems to discriminate against small- and medium-sized enterprises ("SMEs"), particularly those in so-called "traditional industries". The assumption appears to be that many of these applicants are shell companies that seek a listing only in order to sell the listing status afterwards, and that abusive conduct may also have occurred to enable them to list in the first place (as outlined in paragraphs 4-6 of the consultation paper ("CP")). These are sweeping assumptions that do not recognise that there are many good-quality companies with a smaller market capitalisation ("small cap companies") that need external funding to boost their future growth and development.
- As an international financial and trade centre, Hong Kong's capital market should accommodate the listing of a diverse range of companies, based on size, background, industry, etc., to cater for the varying needs and risk appetites of investors. The proposed substantial increase in the Main Board Profit Requirement ("PR") would end up driving local and other SMEs with good potential away from Hong Kong.
- Listing on the Growth Enterprise Market ("GEM") as suggested (paragraph 10 of the CP) is not seen as a viable alternative in most cases. The GEM is perceived as being an inactive market in terms of new listings and also volatile market, due to the relatively low level of trading. Many funds are not permitted by their mandates to invest in it.
- Changes to the listing eligibility requirements of this nature, which are likely to have a substantial overall impact, should not be made in isolation and without a clear strategy and blueprint for future development of Hong Kong's capital market as a whole, which should be the subject of a more extensive consultation.
- Any concerns about shell companies should be addressed and, to a large extent, have already been addressed, by more targeted measures.
- Concerns about specific cases of PR applicants with seemingly high price to earnings ("P/E") ratios compared with their peers, should be dealt with by a more rigorous application of the gatekeeping function, and stronger enforcement post-listing where there is suspected to have been deliberate or reckless misrepresentation in a listing applicant's prospectus or filings with the Exchange.
- We do not think that the market is calling for this change, particularly not at the time of a steep downturn in the economy and record high rates of unemployment. A change of this nature could have significant implications for the business of some market practitioners.

Please also refer to the Appendix for our further comments.

2. Besides the proposed increase in the Profit Requirement, is there any other alternative requirement that should be considered? Please give reasons for your views.

Yes

No

You may provide reasons for your views.

In terms of addressing any residual concerns about shell companies, as we have indicated in the response to Question 1, more targeted measures should be adopted. These could include taking action against firms/ practitioners that have a history of involvement in the creation of shell companies. As regards encouraging good-quality listings while avoiding a blanket exclusion of many small cap companies, as we have suggested, a more holistic approach needs to be adopted, and one which takes account of Hong Kong's competitive position vis-a-vis other markets, including the Mainland's A-share market. This could include considering matters such as:

- introducing a tiered structure for the Main Board, similar to the example of the London Stock Exchange, with standard and premium listings, with the latter being required to meet additional listing requirements and post-listing corporate governance requirements, etc.;

- introducing a tiered structure for the GEM, with higher-tier companies being able to transfer more easily to the Main Board;

- on a more practical level, implementing more gradual increases to the PR and reviewing the profit allocations in the first and second years versus the third year of the track-record period, to cater for smaller technology and new economy companies, which tend to invest heavily in growth in their early years;

- combining a cashflow test with a lower PR, as an alternative to a PR alone, if concerns remain about the impact of a perceived gap between the minimum PR and the minimum expected market capitalisation upon listing.

3. Do you agree that the Exchange should consider granting temporary relief from the increased Profit Requirement due to the challenging economic environment? Please give reasons for your views.

Yes

No

You may provide reasons for your views.

If, based on the overall response to this consultation, the Exchange still intends to implement the proposals to increase the PR, we agree that temporary relief from the increased PR should be granted due to the challenging economic environment in 2020, and even prior to that for some businesses. In addition, in view of the ongoing economic uncertainty, the Exchange should continue to monitor the latest situation and, if necessary, extend the temporary relief into the financial year 2021. In addition, if changes to the PR were to proceed, despite the concerns expressed by various sectors of the market, consideration should be given to introducing more incremental changes.

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? Please give reasons for your views.

- Yes
- No

You may provide reasons for your views.

We would agree broadly with the conditions suggested by the Exchange for temporary relief, were the proposal to proceed. However, given the uncertainty faced by some industries, and the potential knock-on effect in relation to other sectors, due to the pandemic, there could be challenges for sponsors and reporting accountants to sign off on a profit forecast to be disclosed in the listing document, as required by the condition proposed in paragraph 55(e)(iii) of the CP.

- End -

**Hong Kong Institute of CPAs' supplementary comments on the Consultation Paper on the Main Board Profit Requirement ("CP")**

**Question: Do you agree that the Profit Requirement should be increased by either Option 1 (150%) or Option 2 (200%)? Please give reasons for your views.**

We supplement our comments in the response to Question 1 in the questionnaire with the additional points below.

The Exchange proposes increasing the Profit Requirement ("PR") for Initial Public Offering ("IPOs") on the Main Board due to the following reasons:

- Subsequent to the publication of the conclusions on the *Consultation Paper on Review of the Growth Enterprise Market (GEM) and Changes to the GEM and Main Board Listing Rules* (June 2017)("2017 Consultation"), the Market Capitalisation Requirement ("MCR") for IPOs on the Main Board was increased from HK\$200 million to HK\$500 million, while the PR remained unchanged. The Exchange noted that, afterwards, the number of listing applications from small cap companies which marginally met the PR increased, whilst, after listing, a number of them failed to meet the profit forecasts that they had filed with the Exchange as part of their listing applications. This led the Exchange to be concerned about the reasonableness of their valuations.
- In particular, from a regulatory perspective, the Exchange is concerned whether these small cap issuers' valuations were simply reverse engineered to meet the MCR, with a view to manufacturing potential shell companies for disposal after listing. According to the Exchange, if the valuation achieved by an issuer upon listing is not genuinely supported by the market, the issuer's share price may decrease significantly shortly after listing, which could result in losses to investors and hurt investors' confidence in the shares. Inadequate market demand may also lead to thin trading and low liquidity of the shares, making the relevant shares more susceptible to speculative trading and excessive market volatility post listing. This is not in the interest of the investing public, and will affect the overall quality of the Main Board listings.
- The Exchange considers that the key issue is the misalignment of the PR with the MCR and, hence, proposes to increase the PR.

## **The Institute's reasons for objecting to the proposal**

While we acknowledge the importance of having good-quality IPOs and preventing abuses of the listing procedure, we do not believe that increasing the PR by 150% or 200% under Options 1 or 2, respectively, is the right way to deal with this issue, for the reasons explained further below.

- The proposal seems to discriminate against SMEs, particularly those in so-called "traditional industries" and does not recognise that there are many good-quality small cap companies that need external funding to boost their future growth and development. Some members of the Institute's Corporate Finance Advisory Panel are directly involved in the listing of small cap companies and take issue with the assumption that many of these companies have ulterior motives in listing. They maintain that the companies that they help to list do not sell their listing status afterwards and often want to access international capital in order to grow.
- Listing on the Growth Enterprise Market ("GEM") as suggested (paragraph 10 of CP) is not seen as an attractive alternative in most cases. Listings on the GEM are relatively sparse, and it is seen as being an inactive and not very liquid market, as well as being volatile, due to the relatively low level of trading. Furthermore, many funds are not permitted by their mandates to invest in it. One of the questions raised in the 2017 Consultation was as follows:

*Do you agree with the proposal to re-position GEM as a stand-alone board and hence remove the GEM Streamlined Process for GEM Transfers and re-introduce the requirements to (a) appoint a sponsor to conduct due diligence for GEM Transfers; and (b) publish a "prospectus-standard" listing document such that GEM Transfer applications are treated as a new listing application (without requiring the applicant to conduct an offering)?*

We responded at that time:

*"The current proposal is to change the GEM into a board for SMEs. However, it is not uncommon that a smaller company initially listed on GEM will grow to meet the admission requirements of the Main Board and there may be good reasons for it to migrate to the Main Board. If GEM listed issuers are discouraged from migrating to the Main Board due to the stringent requirements and process and the high transaction costs involved (as they will be treated as new Main Board*

*listing applicants), we are concerned that the proposals would discourage the listing of companies on GEM and reduce the liquidity of stocks trading, turning GEM into an inactive board.*

*We are of the view that a streamlined process for GEM transfer should be retained. The existing transfer process should be reviewed and enhanced but not to the extent equivalent to treating the transfer as a Main Board new application.”*

Unfortunately, that advice was not heeded and concerns that we expressed at that time seem to have materialised. The simplified transfer protocol was subsequently removed in 2018, which has created an additional burden for companies that want to transfer to the Main Board from the GEM at a later stage. Meanwhile, the level of activity on the GEM is relatively low. We note that, for example, there were only 8 IPOs on the GEM in 2020, with total funds raised of HK\$554.3m ([https://www.hkgem.com/statistics/e\\_default.htm?ref=5%3A](https://www.hkgem.com/statistics/e_default.htm?ref=5%3A)).

- In our view, further changes to the listing eligibility requirements of this nature, which are likely to have a substantial impact on market applicants and practitioners, should not be made in isolation and without a clear strategy and blueprint for the future development of Hong Kong's capital market, as a whole, which should be the subject of a more extensive consultation. We have raised a similar issue before. We would refer you to the “[Report on Improving Corporate Governance in Hong Kong](#)” (December 2017) issued by the Institute (co-authored by Syren Johnstone and Say H. Goo), which advocated the need to identify the overarching objectives that should drive the future development of the Hong Kong market, and suggested that an expert group be set up to help in this process (Recommendation E4.9.3).
- Concerns about shell companies’ listing primarily with a view to selling the listing status afterwards should be addressed by more targeted measures. This has already been happening and the Exchange has implemented various measures to tackle the creation of shell companies, e.g. tightening the rules in relation to “reverse takeovers”/ “backdoor listings”, change of ownership of listed issuers and continuing listing criteria (e.g. the proposals in the *Consultation Paper on Backdoor Listing, Continuing Listing Criteria and other Rule Amendments* (June 2018) and the *Consultation Paper on Delisting and other Rule Amendments* (September 2017)). We understand that the Securities and Futures Commission also works with the Exchange on tackling shell creation activities. The Exchange,

as mentioned in paragraph 23(b) of the CP, revised Guidance Letter HKEX-GL68-13A (Guidance on IPO vetting and suitability for listing) in April 2018 to curb shell creation activities. We believe that, together, these regulatory actions have successfully discouraged the manufacturing of shell companies and that the market for these activities has already diminished significantly.

- Paragraph 3 of the CP indicates that, where a new applicant only marginally meets the minimum thresholds under the PR and given the revised MCR, which was raised in 2018 from HK\$200 million to HK\$500 million, this has effectively increased the applicant's implied historical P/E ratio from 10 times to 25 times. Since then, the Exchange says that it has seen an increase in listing applications from small cap companies that only marginally meet the PR and have relatively high historical P/E ratios as compared with those of their listed peers. These small cap issuers are typically small- or mid-sized companies in traditional industries. In particular, the PR applications submitted by small cap issuers in 2018 recorded significantly higher historical P/E ratios, which, the Exchange believes, was in response to the increased MCR. Under the proposal, Option 1 - increasing the PR by 150%, would reduce the implied historical P/E ratio of applicants meeting only the minimum thresholds under the PR and the MCR to 10 times, which, the CP points out, is in line with the situation before the change of MCR in 2018; and Option 2 - increasing the PR by 200% would reduce the implied historical P/E ratio of such applicants to 8.
- However, in our view there is nothing magical about P/E ratios of 8 -10 and it is not uncommon for new companies with potential for growth to have a higher ratio. No concerns were raised about having an implied historical P/E ratio of 25 times in the 2017 Consultation and it was also noted (in Chapter 5, paragraph 9) that, in 2016, the Listing Committee had decided that there did not appear to be compelling reasons to change the PR or replace it with a minimum cash flow requirement.
- In the Consultation Conclusions to the 2017 Consultation, the Exchange noted (at paragraphs 105-108) that 77% of the respondents that supported the proposal to retain the PR also agreed to retain the current level of profit under the PR. The Exchange concurred at that time that no change to the current level of profit under the PR was necessary and indicated (at paragraph 119) that the PR and revised MCR requirements were minimum standards that set the floor for the profits and market cap that applicants must have if they wanted to list on the Main Board,

adding that it was not unreasonable to require an applicant to have a higher implied historical P/E ratio if it was close to meeting only the minimum requirements. This would indicate that the market had a high degree of faith in the applicant's future prospects.

- It seems somewhat inconsistent, therefore, that the Exchange should now be raising concerns about a P/E ratio of 25, which it perceives as being suspiciously high in the case of many small cap companies. While we accept that there may be instances where there are legitimate grounds for doubt, these should be dealt with by a more rigorous application of the gatekeeping function, and stronger enforcement where there is suspected to have been deliberate or reckless misrepresentation in a listing applicant's prospectus or filings with the Exchange.

Comparing the situation with NASDAQ and NYSE, these markets have standalone PR and market cap requirements as listing options (CP, paragraph 41). As regards NYSE, all IPOs need to have a market value of publicly-held shares of at least US\$40 million, while shares held by directors, officers, or their immediate family members and other concentrated holdings of 10% or more are excluded in calculating the market value of publicly-held shares. On this basis, if, for example, a controlling shareholder owns 51% of the shares of an IPO applicant upon listing with the remaining 49% being held by unconnected shareholders, each with shareholding of below 10%, the required market cap of the applicant at the time of listing would be US\$81.6 million (i.e. US\$40 million/49%), implying an historical P/E ratio of 40 times, based on the final year minimum profit requirement of US\$2 million.

- We note that the aggregate market cap at the time of listing of all those Hong Kong PR applications submitted between 2016 and 2019 that were listed but which would have been ineligible under Option 1, was approximately HK\$184 billion, accounting for only 3% of the aggregate market cap of Main Board issuers newly listed between 2016 and 2019, as compared with HK\$2,675 billion for eligible applications (CP, paragraph 9(b)). However, in our view, as an international financial and commercial centre, Hong Kong should encourage the listing of companies with diverse backgrounds, in terms of size, background, industry, etc., to cater for a range of investors and provide opportunities for fund raising by local SMEs, among other applicants. This is in line with government policies on fostering the growth of the SME sector and diversifying the economy. It should also be appreciated that today's mega corporations and blue chip

companies will often have evolved from companies that were SMEs when they were first listed. Listing provided opportunities and a platform for them to grow, expand their investor base, and access international investors and funding. They also benefited from the disciplines of the market to improve their corporate governance standard and compliance, on the way to becoming what they are now.

- We would argue that the Exchange has a responsibility to consider the corporate finance needs of all types of companies, not just those in “hot” sectors. This may be even truer in Hong Kong than in some other markets, given that the Exchange enjoys a de facto monopoly in Hong Kong. In view of the listed status of Hong Kong Exchanges and Clearing Ltd. (“HKEX”), it is even more important that the Exchange should be seen to be evenhanded and not appearing to favour only “new economy” and large companies, leaving SMEs in “traditional industries” behind, while noting that, in aggregate, at the time of listing, they represent only a small percentage of the market cap of IPOs. In its 2019 CSR Report (page 18), HKEX states: “As the global markets leader in the Asian time-zone, we are aware of the vital role that we play in supporting and enabling the sustainable development of financial markets and society as a whole”. Specifically, in relation to delivering its promises on the broad objectives to address particular United Nations Sustainable Development Goals (“UNSDGs”), and aiming to address UNSDGs 8 (on decent work and economic growth) and 9 (industry, innovation and infrastructure), under the heading “Innovation and Entrepreneurship”, HKEX states as its aim: “To position Hong Kong as a market that supports business, in particular the fintech and biotech sectors, through the full life-cycle of growth”. While highlighting the fintech and biotech sectors, at this time, may be understandable, this should not be to the exclusion of supporting other types of entrepreneurship and businesses and through their full life-cycle of growth, given, especially, the overarching objectives to support and enable the sustainable development of financial markets and society as a whole.

It is also worth noting that, where appropriate, the listing requirements may be, and in some instances have been, modified to broaden the gateway for new economy companies to raise funds in the Hong Kong capital market (e.g. the introduction of Chapter 18A of the Listing Rules for biotech companies).

- The Exchange seeks to rationalise the proposal to increase the Main Board PR (at paragraph 11 of the CP) on the basis also that:

*“The increase in the Profit Requirement will further distinguish between issuers listed on GEM and the Main Board and is in line with our objective of positioning the Main Board as the main market to attract sizeable companies that can meet high market standards. The proposal will therefore improve the overall quality of Main Board issuers, which will be conducive to promoting post-listing liquidity. This will also increase investors’ confidence in the market and strengthen Hong Kong’s position as an international financial centre”.*

However, as we argue above, size and quality are not one and the same thing. While the Exchange highlights that a substantial proportion (63%) of small cap companies making PR applications between 2016 and 2019, and which would have been ineligible under Option 1, failed to meet the profit forecasts that they filed as part of their listing applications, as Table 4 in the CP indicates, a significant proportion (40%) of listing applicants that would have been eligible under Option 1 also failed to meet their profit forecasts. Table 3, meanwhile, shows that, for applicants that would have been ineligible under Option 1 and which failed to meet their profit forecasts, the percentage failing to meet their forecasts by 30% or more was actually higher (24%) for issuers with a market cap above HK\$700 billion at the time of listing than for those with a market cap of below HK\$500 billion (21%). While, it is true, that, overall, the percentage failing to meet their forecasts was significantly higher for the latter group (78%) compared with the former group (53%), in fact, for those companies with a market cap of below HK\$500 billion that failed to meet their profit forecasts, the profit shortfall was less than 30% for 57% out of the total of 78%, which compares favourably with the figure of 29% out of 53% for the larger cap group of companies. Clearly, the picture is more complex than the CP suggests.

- According to information provided in paragraphs 43 and 44 of the CP, both Option 1 and Option 2 will result in the Exchange having the highest profit requirement on an aggregated basis for the three-year track record period of the selected markets, as compared with being third under the current PR (lower than NYSE and NASDAQ). In fact, as indicated in paragraph 42, the PRs of NYSE and NASDAQ are based on pre-tax profits while that of Hong Kong is post-tax. Hong Kong’s PR specifically excludes the profit contribution of associates and joint ventures, while NYSE and NASDAQ do not explicitly require such exclusion. On this basis, it may not be the case, even now, that Hong Kong’s current PR is always lower than these other markets.

- Increasing the PR further is likely to push many high-quality companies away from Hong Kong and some practitioners say that they would have no choice but to advise clients to seek a listing elsewhere, if they cannot list on the Main Board to raise capital in Hong Kong. It may also affect spin offs of valuable subsidiary businesses by existing listed holding companies. The PR route is overwhelmingly the principal route for companies to list on the Main Board (Table 1 of the CP), yet had the proposed rule change been in place already, this would have eliminated, on average 62%, of the PR applications submitted between 2016-2019 (i.e., 462 applications). Although around 30% of these applicants would not have been eligible anyway under the current regime, because they relied on the previous MCR of HK\$200 million, this still means that 43% of applications eligible under the current regime would have been eliminated. This scenario is likely to be exacerbated by the fact that many local companies have seen annual income and profit drop significantly over the past two years due to the specific situation in Hong Kong, as well as the global impact of the Covid-19 pandemic.

Therefore, if the proposal proceeds, it could cause a significant number of small- and mid-sized investment banks to decrease the number of their IPO deals by 50% or more. Market practitioners including sponsors, lawyers, reporting accountants and other professional parties whose business focuses on IPOs in Hong Kong will be adversely affected, at the time of a steep downturn in the economy and with historically high levels of unemployment. Although the CP indicates, at paragraph 59, that the effective date of the rule change will not be earlier than 1 July 2021, the international consensus seems to be that 2021 could be another tough year for economies around the world, despite the rolling out of vaccination programmes to fight the pandemic in some jurisdictions. Therefore, in addition to the various other grounds for objection, this would not be an opportune time to introduce the proposed change.

- In the final analysis, we do not think that the market is calling for the proposed change to the PR at this time, nor that a convincing case has been made to move ahead with the proposal.
- While the market might be more receptive to incremental changes in the PR and, possibly, a review of the profit allocation over the three-year track record period, the Institute remains of the view that any changes should be considered only as part of a more holistic review. We see that other major markets appear to embrace diversity and inclusion in order to develop the breadth and depth of the market

and we should do likewise. Hong Kong needs to consider the overall objectives and strategic direction of the capital market, which should include revisiting the role of the GEM and assessing our competitive position vis-a-vis other regional and international markets (including the Mainland's A-share market). In the questionnaire, we suggest certain other issues that could be considered as part of this process.

*Hong Kong Institute of Certified Public Accountants*  
*January 2021*