



By email (response@hkex.com.hk)

6 November 2023

Our Ref.: C/CFC, M138587

Corporate and Investor Communications Department
Hong Kong Exchanges and Clearing Limited
8th Floor, Two Exchange Square
8 Connaught Place
Central
Hong Kong

Dear Sirs,

[Re: Consultation Paper on GEM Listing Reforms](#)

The Hong Kong Institute of Certified Public Accountants (“the Institute”) welcomes the opportunity to provide comments on the Consultation Paper on GEM Listing Reforms (“CP”). We sought the comments from, in particular, the Institute’s Corporate Finance Committee (“CFC”).

As mentioned in the CP, the number of new listings and funds raised on GEM have significantly dropped since 2019. In particular, no new companies were listed on GEM in 2022 and the funds raised by existing companies on GEM amounted to only HK\$2.7 billion. From the Hong Kong Stock Exchange (“the Exchange”)’s point of view, this may be due, largely, to the Covid-19 pandemic-related disruptions to businesses and alternative options of venues for small and medium enterprises (“SMEs”) to list in the Mainland, e.g., the third stock exchange, launched by Beijing Stock Exchange.

It is clear that reform of the GEM is essential. In our response to the Consultation Paper on The Main Board Profit Requirement (21 January 2021), we noted the following:

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.

We noted that targeted measures had already been taken to deal with shell companies and added:

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.

We note from the CP that a range of different stakeholders were engaged by the Exchange to provide comments about the proposed GEM listing reforms. Among the issues raised by those stakeholders as factors that may have made the GEM unattractive to potential issuers are the following:

- **Initial eligibility tests** - The minimum eligibility thresholds for listing on GEM currently are too high. The requirement for GEM applicants to provide a track record of positive operating cash flow may also prevent the listing of SMEs with high growth potential, without such a track record, mainly because their cash was used up primarily on their research and development (“R&D”).
- **Listing costs** - The listing costs on GEM, in particular the initial listing and compliance costs, are often disproportionately high compared with the amount of funds to be raised by listing on the GEM.
- **Removal of the GEM Streamlined Transfer Mechanism** – In 2018, the GEM Streamlined Process was removed by the Exchange in order to tackle shell activities. However, this also discourages potential issuers from listing on GEM. Given the costs of listing can still be high for SMEs, potential issuers may prefer to remain private until such time as they can meet the eligibility criteria for listing directly on the Main Board (“MB”).
- **Undue and rigid continuing obligations** – Some consider that the GEM Listing Rules impose undue and rigid continuing obligations (e.g. connected transaction requirements) that discourage GEM issuers from pursuing healthy business growth. They suggest that issuers be given more freedom to engage in legitimate post-listing activities.

Against the above background, in principle, the Institute supports the Exchange’s proposals to reform the GEM, which seek to address some of key issues identified by the stakeholders.

At the same time, we believe it to be important at the outset to articulate clearly the vision and ultimate objectives for the GEM going forward. In proposing to reintroduce a streamlined process for GEM issuers to transfer to the MB, it seems that the Exchange may be basically reverting to the pre-2018 situation, without taking a step back and reviewing the positioning of the GEM against the background of other significant changes that have taken place since then, including the establishment and/or development of other oversea junior boards.

In our view, the Exchange should elaborate further its views on, for example:

- Whether the GEM is intended to be primarily a stepping stone to the MB for early stage companies looking for funding, which aim to list on the MB once



they achieve a sufficient level of growth and maturity; or mainly a liquid and vibrant market aimed at local and overseas SMEs, to encourage active trading in good quality SMEs (which could be, e.g., start-up companies in the new technology sector or SMEs engaging in traditional industries with growth potential).

- Whether certain types of companies are preferred targets, e.g. innovation & technology (“I&T”) companies, to lend support Hong Kong’s ambitions to be an I&T centre. The proposed new listing route for R&D companies suggests that this may be part of the thinking.
- What types of investors will the reformed GEM be aimed at – institutional investors, private equity, corporates, professional investors, retail investors? If all investors are equally welcome, what is the target mix, as this may also have a bearing on what kind of corporate governance safeguards are needed, and the extent to which regulatory requirements on listing and continuing obligations can be relaxed.
- With reference to other junior markets in the Mainland and overseas, how can the GEM differentiate itself, either in its overall positioning, or, if it is competing head on for the same business, its attractiveness?
- What key performance indicators should be adopted to measure its success and over what period?

The above is not an exhaustive list, but reflects just some of the issues that need to be considered and articulated.

While we appreciate that the Exchange seeks to continuously review the listing framework in Hong Kong and identify areas where the current regime could be strengthened and expanded, we also hope the Exchange will examine whether the listing regimes meet the expectations of investors and issuers, i.e., are effective in attracting companies to raise funds and investors to invest in Hong Kong, to maintain and enhance Hong Kong's competitiveness as an international financial centre. Some CFC members suggest that a higher-level discussion is called for in order to develop a blueprint or a strategic plan for the future of Hong Kong's securities markets, rather than implementing reforms in a more reactive and piecemeal way.

Ultimately, as indicated in the Chief Executive's Policy Address 2023, a fundamental concern in the current environment is how to boost Hong Kong's overall stock market liquidity. In this regard, we also take note of the Legislative Council motion passed on 19 October to review the listing regime for SMEs.

We hope that, with the benefit of feedback from a diverse range of stakeholders, including that from the Institute in this submission, the Exchange will, as stated in paragraph 41 of the CP, continue to implement innovative listing reforms that cater for the evolving needs of a broad range of issuers and investors; that encouraging and facilitating SME listings will continue to be a key priority, and that the Exchange will remain committed to providing a supportive environment where SMEs can thrive, ultimately contributing to the continued prosperity of both Hong Kong and the global economy.



Hong Kong Institute of
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Our detailed responses to the questions raised in the CP are contained in the Appendix.

If you have any questions on this submission, please feel free to contact me at the Institute by telephone on 2287 7084 or email <peter@hki CPA.org.hk>.

Yours faithfully,

Peter Tisman
Director, Advocacy & Practice Development

PMT/NCL/pk

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Consultation Paper on GEM Listing Reforms (“CP”)**I. 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?

Please give reasons for your views.

In principle, members of the Hong Kong Institute of CPAs’ Corporate Finance Committee (“CFC members”) agree that alternative eligibility tests should be introduced to enable the listing of high growth enterprises substantively engaged in research and development (“R&D”) activities. However, as advised in our cover letter, we believe that the Exchange needs to elaborate further on its overall vision and objectives for the future of the GEM, such as whether it is reverting to being primarily a stepping stone for early stage companies looking for funding, which aim to list on the main board (“MB”) once they achieve a sufficient level of growth and maturity, or whether it is mainly a platform aimed at local and overseas small and medium enterprises (“SMEs”), to encourage active trading in good quality SMEs (which could be, e.g., start-up companies in the innovation and technology sector or SMEs engaging in traditional industries with growth potential). It should also be made clear what kind of investors are being targeted.

Some CFC members also noted, as set out in Table 7 of Appendix II of the consultation paper (“CP”), that other selected exchanges, such as the Beijing Stock Exchange (“BSE”), provide different eligibility tests, tailored to different types/ needs of potential issuers. Meanwhile, there are no specific tests adopted by AIM and Catalist in London and Singapore, respectively. We, therefore, suggest that the Exchange consider whether additional routes to listing should be considered, offering a wider range of eligibility criteria, and/ or whether thresholds should be relaxed, to increase the attractiveness of GEM to potential issuers.

Please also refer to our responses to questions below.

Question 2 - If your 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?

Please give reasons for your views.

We consider that there is a discrepancy between the thresholds for the market capitalisation requirement and revenue requirement for the alternative eligibility test, which could affect the viability of the proposed reform. In particular, a company engaged in R&D with a market capitalisation (“market cap”) of HK\$250 million only, in general, would not be able to meet the proposed revenue threshold of HK\$100 million in aggregate over the previous two financial years. In contrast, an R&D company able to generate revenue of at least HK\$100 million in aggregate over the two financial years would be expected to have a market capitalisation much larger than HK\$250 million. It should be quite mature and have already raised several rounds of pre-initial public offering (“IPO”) funding. Such a company may already be able to meet the existing GEM cash flow test.

The proposed price-to-sales (“P/S”) ratio or revenue multiple of only 5x can be compared with the proposed P/S of 32x for specialist technology companies seeking to list on the MB, as put forward in the Exchange’s October 2022 consultation.

It is suggested that the Exchange carry out further research on the eligibility tests on other comparable markets and revisit the above figures.

We also consider that the requirement for R&D expenditure of at least HK\$30 million, in aggregate, over the two-year financial track record period, plus a minimum expenditure ratio of 15% for each of the two financial years, implying total operating expenditure of HK\$100 million per year, excluding financial costs and cost of sales, may not be realistic. This seems to be a relatively high level of operating expenditure for such companies. We would suggest, instead, a requirement for either R&D expenditure of HK\$30 million or an expenditure ratio of 15%, whichever is the higher, or, alternatively, dropping the 15% expenditure ratio altogether.

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 reason for your views.

We agree with the proposal, which aligns the requirements with the MB and majority of the selected overseas junior markets, to increase the attractiveness of GEM.

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.

Some CFC members feel that the thresholds could be lowered generally, e.g., the cash flow and, possibly, the market cap, requirements, especially having regard to the listing requirements on other competing overseas junior boards, like Nasdaq, AIM and Catalist. However, this is also linked to the issue of the future direction and objectives of the GEM, what kind of companies and investor base it is seeking to attract, etc., and how Hong Kong's secondary market can differentiate itself. At the same time, so long as it continues to be, to a large extent, a retail investor market (paragraph 43 of the CP quotes the average proportion of issued shares held by retail investors as 40.3%), and the legal and regulatory avenues for redress for retail investors remain limited, there will be a need for investor protection commensurate with this. Of course, there are various different means of protecting investors and we have, for example, argued for a requirement for listed companies to have a full-time, qualified accountant ("QA") on the board, or at least in the top senior management. This would be similar to the requirement for a QA introduced when the GEM was first set up in 1999, which was later reworded and also incorporated into the MB listing rules ("MBLR") in 2004, only to be removed from both boards in 2009 (see the response to question 9, below).

There are also other corporate governance ("CG") measures and checks and balances that could be put in place to compensate for a reduced level of upfront requirements and a lower level of "hands-on" intervention from the regulators at the time of listing. The latter has regularly come in for criticism from market practitioners for being overly cautious, sceptical and sometimes heavy-handed.

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.

We agree with the Exchange's proposals.

II. Continuing Obligations

A. 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?

Please give reasons for your views.

We agree with the Exchange's proposal to remove GEM's compliance officer requirement, as set out in paragraph 85(a) of the CP, in order to reduce the overall compliance burden. We agree that, generally, directors in GEM issuers should have sufficient knowledge and experience, similar to directors of MB listed issuers and, furthermore, consider that they should take more responsibility for their own compliance with rules and regulations.

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.

We 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 CP.

As, generally, GEM companies these days are quite well established, the removal of the compliance adviser requirements should not have a significant adverse impact on their CG performance.

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.

We have no specific comments.

B. 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?

Please give reasons for your views.

We accept the Exchange's proposal to change the quarterly financial reporting requirement to a recommended best practice for GEM issuers. This will reduce their compliance costs and make the GEM more competitive as a listing venue, bearing in mind also that this is, by no means, a standard requirement on secondary or other stock markets around the world.

Nevertheless, understandably, some stakeholders may still see this as step back in CG terms. For this and other reasons, as noted above, we would argue for the introduction of a requirement along the lines of the rule that existed in the GEMLR for almost a decade, between 1999 and 2008 (and the MBLR for 2004-08), for issuers to engage a QA as a full-time executive director on the board, or at least in the top senior management. With the many

changes that have taken place since that time in the business and regulatory environment, we believe that the arguments for removing the requirement in 2008, including the existence of other checks and balances that were already, or would be, put in place, are no longer persuasive.

In any event, the CG role that we envisage for the QA nowadays would be significantly more extensive, in keeping with the increased expectations on listed companies from investors, regulators and the wider community. This role would cover:

- Overseeing the accounting and financial reporting functions, including, looking ahead, the vital area of the financial aspects of environmental, social and governance reporting, and advising the board and audit committee on these matters. This should be viewed in the context of the recent promulgation of investor-focused, international sustainability disclosure standards (“ISS”) under the International Financial Reporting Standards framework. (As the HKICPA will become the standard setter for ISS in Hong Kong, on top of its role as the standard setter for financial reporting, the Institute is investing considerable efforts into capacity building among our members).
- Playing a broader role in strengthening companies’ systems of risk management and internal control, covering also sustainability risks and opportunities, and together with the company secretary, the CG framework as a whole. Good CG must be an integral element in safeguarding and ensuring Hong Kong’s future as an international financial centre, capital market and business hub.
- Providing support to the board in other important and emerging areas, where an international consensus and norms are developing quickly – such as anti-money laundering/ counter-terrorist financing and tax governance.

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?

Please give reasons for your views.

Members of the CFC generally agree with the proposed changes, in order to align the requirements for the MB and GEM, and to add to the overall attractiveness of the GEM by making compliance less onerous. At the same time, similarly to our response to Question 9, we note that some stakeholders, particularly institutional investors, may see this as a weakening of CG disclosure obligations. Therefore, we would suggest that consideration be given to imposing alternative CG requirements, such as engaging a QA.

III. Transfers to the Main Board

A. 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?

Please give reasons for your views.

We agree fully that a streamlined mechanism should be reintroduced to enable qualified GEM issuers to transfer their listing to the MB, without treating this an entirely new IPO. This can help encourage more ambitious, growth-orientated SMEs to apply for listing on GEM, with a

view to applying to transfer to the MB once they have reached a certain level of maturity. As explained in the CP (paras. 27-28), the rationale for abolishing the previous GEM Streamlined Process, i.e., to tackle concerns over shell listings and reverse takeovers, etc., no longer applies.

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.

We agree with removing the requirement for the appointment of a sponsor for the purpose of a streamlined transfer, for the reasons set out in the CP, in order to facilitate the transfer process without adding unduly to the level of risk. The impact on the sponsor sector should not be substantial, as fees for assisting transfers from one board to another are generally not high relative to the potential liabilities.

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.

We agree with this proposal, in order to facilitate the transfer process. Given other information disclosure requirements, the proposal should strike an acceptable balance between market development and investor protection.

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.

While we understand the proposed track record requirements, as a trade off for removing the requirement for a sponsor and publication of a “prospectus-standard” listing document, etc., CFC members consider that one or two full years after listing on the GEM should be sufficient, given that the preparation and vetting of prospectuses and financial statements for the GEM are no less stringent than for a MB listing. If a three-year track record post-listing is mandated, this would mean, when added to the two-year track record prior to listing, a minimum of five years of operations, in total, before being able to transfer to the MB via this route. This may be considered too long.

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.

In principle, we do not have a strong view on the proposal for a minimum daily turnover threshold and volume weighted average market capitalisation, to demonstrate adequate liquidity for a streamlined transfer applicant, as set out in paragraphs 120 to 133 of the CP. We note that the BSE also has a volume-based requirement for transfers to the STAR Market and ChiNext Market, although this uses a different basis, namely share-trading volume.

However, CFC members considered that, in practice, the proposed level of the Minimum Daily Turnover threshold for the Daily Turnover Test would not provide any useful evidence of genuine liquidity or of the quality of the issuer, as it could easily be manipulated by “manufactured” transactions (e.g., using related-party transactions or engaging agents to conduct transactions). This could encourage more artificial trading on the market. As such an alternative approach may need to be considered.

CFC members were of the view that the focus should be on ensuring that the liquidity of the GEM as a whole is improved.

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.

Please refer to our response to Question 15.

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.

We agree with this proposal from a CG perspective.

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.

We agree with this proposal from a CG perspective.

B. 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?

Please give reasons for your views.

While we agree with efforts to reduce compliance costs overall, work will still need to be done to review applications for streamlined transfer from the GEM to the MB, which should not be ignored. Under the circumstances, we would not agree that the Exchange should fully exempt GEM transferees from the MB initial listing fee. However, as the cost incurred should be much lower than that for reviewing a new MB IPO application, we suggest offering a discount on the MB initial listing fee for GEM transferees.

Hong Kong Institute of CPAs
6 November 2023