

Corporate & Commercial

Proposed Changes to Hong Kong's Growth Enterprise Market and Main Board Listing Requirements

Introduction

On 16 June 2017, The Stock Exchange of Hong Kong Limited (the “**Exchange**”) issued two papers on proposals to reform the current Hong Kong listing regime:

1. the New Board Concept Paper – with proposals to establish a new board distinct from Main Board and GEM with an aim to attract new economy companies to Hong Kong; and
2. Consultation Paper on the Review of the Growth Enterprise Market (GEM) and Changes to the GEM and Main Board Listing Rules” (the “**Paper**”) – with proposals to impose higher entry criteria for both the Main board and GEM to ensure they reflect currently acceptable standards in the market and address recent concerns on the quality and performance of GEM applicants and listed issuers.

This newsletter focuses on the Paper, provides an overview of the current requirements and the proposed changes as discussed in the Paper.

Overview of the Paper

The Paper sets out four areas for review:

1. GEM's position as a “stepping stone” to the Main Board;
2. GEM admission requirements and delisting mechanism;
3. the open market requirement; and
4. proposals to amend certain Main Board listing requirements to preserve the Main Board's position as a market for larger companies that can meet Hong Kong's highest market standards.

GEM's position as a “stepping stone” to the Main Board

Current Requirements

The Main Board Listing Rules allows GEM issuers to transfer to the Main Board (“**GEM Transfer**”) without the need to delist from GEM and apply for new listing under the Main Board provided that they can fulfil the Main Board listing requirements. GEM issuers can apply for a GEM Transfer after it has published at least one financial year of financial statements after its GEM listing and have not been involved in any disciplinary investigations

for breach 12 months before the transfer. GEM Transfer applicants can then use a streamlined process, where the applicant does not need to appoint a sponsor to conduct due diligence and issue a listing document.

Proposed Changes

The Exchange proposes to make the following changes:

1. to re-position GEM as a stand-alone board for small to mid-size companies, and remove the streamlined process for the transfer of a GEM listing to the Main Board. This means GEM Transfer applicants will be required to appoint a sponsor to ensure appropriate due diligence is carried out and issue a listing document;
2. to require all GEM Transfer applicants to have published and distributed at least two full financial years of financial statements after their GEM listings;
3. to require all GEM Transfer applicants to have not been subject to any disciplinary investigations by the Exchange in relation to a serious breach or potentially serious breach of any Listing Rules for 24 months before they can be considered for a GEM Transfer; and
4. to rename “Growth Enterprise Market” and 創業板 to “GEM” to better reflect the nature of GEM issuers.

GEM Admission Requirements and Delisting Mechanism

Current Requirements

A GEM listing applicant is required to have a track record of at least two financial years and should meet the following admission requirements:

1. a positive cash flow of at least HK \$20 million for that two year period;
2. an expected total market capitalisation of at least HK \$100 million; and
3. a public float value at the time of listing of at least HK \$30 million.

The GEM Listing Rules impose a post-IPO lock-up period on the controlling shareholders of GEM listing applicants so that they cannot dispose of any of their equity interests in a GEM issuer for the first six months after listing. For the next six months, they may dispose of their equity interests but should retain control.

Applications to list on GEM are currently approved or rejected by the Listing Department of the Exchange under delegated authority from the Listing Committee (“**Delegated Authority**”).

In relation to delisting, the Exchange may currently, if it considers it necessary for the protection of investors or the maintenance of an orderly market, at any time cancel the listing of any securities under any circumstances including those set out in GEM Listing Rule 9.04,

or continuous suspension for a prolonged period without the issuer taking adequate action to obtain a restoration of the listing. The Exchange is required to give a notice ordinarily of six months to a GEM issuer to require it to remedy or submit to the Exchange proposals to remedy the matters that gave rise to the Exchange's proposal to cancel the listing before exercising its right to cancel a listing on GEM.

Proposed Changes

In relation to GEM admission requirements, the Exchange proposes to make the following changes:

1. to increase the cash flow requirement from at least HK\$20 million to at least HK\$30 million;
2. to increase the minimum market capitalisation requirement from HK\$100 million to HK\$150 million;
3. to increase the post-IPO lock-up on controlling shareholders of GEM listing applicants from one year to two years such that the controlling shareholders cannot dispose of: (i) any of their equity interests in a GEM issuer within the first year of listing; and (ii) any interest in the following year that would result in them ceasing to be a controlling shareholder; and
4. unwind the Delegated Authority and return the power to approve or reject GEM listing applications to the Listing Committee.

The current GEM track record requirement under the GEM Listing Rules (i.e. two financial years) would be retained.

The Exchange is also inviting suggestions on other potential quantitative tests for GEM admission to improve the overall quality of GEM listings.

Regarding delisting requirements, the Exchange considers that the current delisting mechanism for GEM is generally effective and therefore does not require fundamental changes. The Exchange is planning to consult the market regarding revisions to the delisting policy of both Main Board and GEM at a later date.

Open Market Requirement

Current Requirements

The GEM Listing Rules explains that there must be an adequate spread of holders of the listed securities at the time of listing. The number will depend on the size and nature of the issue, as a guideline, the equity securities in the hands of the public should, as of the time of listing, be held among at least 100 persons (including those whose equity securities are held through Central Clearing and Settlement System). Not more than 50% of the securities in

public hands at the time of listing can be beneficially owned by the three largest public shareholders. The total securities of an issuer held by the public (on all regulated market(s) including the Exchange) at the time of listing must be at least 25% of the issuer's total number of issued shares and the class of securities for which listing is sought must not be less than 15% of the issuer's total number of issued shares, having an expected market capitalisation at the time of listing of not less than HK\$30 million.

At the moment, public offering is not mandatory for GEM listing applicants. Applicants can choose to conduct a placing-only offering, or a combination of placing and public offering. With regard to any securities proposed to be placed by a new applicant, no preferential terms or treatment as to price or otherwise may be afforded to any placee unless adequate disclosure of such terms or treatment is made in the listing document.

Proposed Changes

The Exchange proposes:

1. to introduce a mandatory public offering mechanism of at least 10% of the total offer size for all GEM IPOs;
2. to align the GEM Listing Rules on (1) placing to core connected persons, connected clients and existing shareholders, and their respective close associates; and (2) the allocation of offer shares between the public and placing tranches and the clawback mechanism, with the relevant requirements under the Main Board Listing Rules; and
3. to increase the minimum public float value of a GEM issuer's securities from HK\$30 million to HK\$45 million.

Main Board Listing Requirements

The proposed amendments to the GEM Listing Rules set out in the Paper, if adopted, will mean that the GEM listing requirements will be closer to or exceed the equivalent requirements of the Main Board. The Exchange therefore proposed to amend certain Main Board requirements to preserve the Main Board's position as a market for larger companies.

Current Requirements

The current Main Board profit requirement requires a listing applicant to achieve HK\$30 million aggregate profit in the first two years of its three year track record period and HK\$20 million in the final year. At time of listing, there is also a minimum market capitalisation of at least HK\$200 million and minimum public float value of at least HK \$50 million public float value (representing 25% of the current minimum market capitalisation requirement of HK\$200 million).

Controlling shareholders of Main Board applicants also face a post-IPO lock-up period where they cannot dispose of any of their equity interests in a Main Board issuer for the first six months after listing. For the next six months, they may dispose of their equity interests but should retain control. Other Main Board listing requirements pertaining to shareholders detail that an applicant must have a minimum of 300 public shareholders, and that the three largest shareholders should not hold more than 50% of the public shares.

Proposed Changes

The Exchange proposes:

1. to increase minimum expected market capitalisation from HK\$200 million to HK\$500 million;
2. to increase minimum public float value from HK\$50 million to HK\$125 million; and
3. to extend the post-IPO lock-up requirement on controlling shareholders from one year to two years (to match the proposals for GEM issuers).

The current profit requirement to determine eligibility to list on the Main Board will be retained. However, the Paper seeks the views of respondents for determining whether or not the profit requirement is still a relevant test.

There will also be no changes to the current rules regarding minimum number of shareholders or shareholder spread.

The Exchange further seeks the market's view on whether the proposals for the Main Board should be considered independently and should not be dependent on the outcome of the GEM proposals.

Interim Measures for Main Board Applications

All applications for listing on the Main Board will continue to be processed in accordance with the current Main Board Listing Rules. If the proposals in the Paper are adopted, the proposed changes are expected to come into effect approximately six months after the Paper ("**Amendment Effective Date**"). All listing applications submitted on or before such Amendment Effective Date will be processed under the current Main Board Listing Rules (with only one refreshed listing application permitted after the Amendment Effective Date).

Transitional Arrangements for GEM Transfers

For GEM issuers and GEM applicants, the Exchange proposes to put in place the following transitional arrangements in relation to GEM Transfers, to allow sufficient time for them to comply with the more stringent rules for GEM Transfers if the proposals in the Paper are adopted.

1. For GEM Transfer applications submitted on or before the Amendment Effective Date, they will be processed under the current GEM streamline process and their eligibility will be assessed in accordance with the current Main Board Listing Rules (with only one refreshed listing application permitted after the Amendment Effective Date).
2. For GEM listed issuers and GEM applicants which have submitted a valid GEM listing application at the date of the Paper and successfully listed on GEM subsequently, during a period of three years from the Amendment Effective Date:
 - a. their eligibility will be assessed in accordance with the current Main Board Listing Rules; and
 - b. with regards to GEM transfer process:
 - i. where there is a change in their principal businesses and/or controlling shareholders since listing on GEM, they will be required to appoint a sponsor to conduct due diligence and publish a prospectus-standard listing document as if they are new Main Board listing applicants;
 - ii. where there is no change in change in their principal businesses and/or controlling shareholders since listing on GEM, they will only be required to publish a GEM Transfer announcement with key disclosures including a concise update of the applicant's activities for the last full financial year and up to announcement date; and appoint a sponsor to conduct due diligence for the last full financial year and up to announcement date.

Conclusion

The consultation period for the Paper will end on 18 August 2017 and the Exchange aims to publish its consultation conclusions paper in late 2017. The proposed changes to both GEM and Main Board Listing Rules, if adopted, are expected to come into effect approximately six months after the date of the Paper, which is, by mid-December 2017.

The Exchange acknowledges that since the proposals in the Paper, if adopted, will raise the admission requirements, and there may be an influx of listing applications and GEM Transfer applications while the consultation is ongoing. Companies should be prepared that the Exchange's vetting period for Main Board listing applications and GEM transfer applications may be longer during this period as a result of such possible influx.

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Important: The law and procedure on this subject are very specialised and complicated. This article is just a very general outline for reference and cannot be relied upon as legal advice in any individual case. If any advice or assistance is needed, please contact our solicitors.

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