



Hong Kong

June 2017

## CHANGES TO THE GEM RULES AND MAIN BOARD RULES PROPOSED BY THE HKEX

### Introduction

The Stock Exchange of Hong Kong (the **Exchange**) published a Consultation Paper on the Review of the Growth Enterprise Market (**GEM**) and Changes to the GEM and Main Board Listing Rules (**Consultation Paper**)<sup>1</sup> on 16 June 2017. The Exchange is proposing to amend the GEM and Main Board Listing Rules to impose higher entry criteria for both boards and address recent concerns on the quality and performance of GEM applicants and listed issuers. The Consultation 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 on the Main Board requirements.

The Exchange is also consulting separately on proposals to establish a new board distinct from the Main Board and GEM to attract new economy companies to the Hong Kong market. These proposals are set out in the Exchange's New Board Concept Paper<sup>2</sup> of 16 June and envision a new board with two distinct segments: New Board PREMIUM and New Board PRO. New Board PREMIUM would provide a listing venue for

new economy companies that meet the Main Board's financial eligibility and track record requirements but have non-standard governance structures, such as weighted voting rights structures, which prevent them listing on the Main Board. New economy companies listed in New York, including Mainland companies such as Alibaba Group Holding Limited, would be able to seek a secondary listing on New Board PREMIUM. This segment would be open to retail and professional investors and would be subject to a regulatory regime similar to that governing the Main Board. New Board PRO, on the other hand, would cater for start-up and earlier stage new economy companies and would be open only to professional investors. For further information on the New Board Concept Paper, please see Charltons' newsletter "HKEx Consults on Proposed New Board for New Economy Companies"<sup>3</sup>.

Responses to the Consultation Paper and the New Board Concept Paper are required to be submitted by 18 August 2017.

### Key Changes to the GEM Rules

- Removal of the streamlined process for transfers from GEM to the Main Board with transitional arrangements
- Increase in the minimum cash flow requirement from HK\$20 million to HK\$30 million in the two financial years before listing

<sup>1</sup> Exchange Consultation Paper on the Review of the Growth Enterprise Market (**GEM**) and Changes to the GEM and Main Board Listing Rules <https://www.hkex.com.hk/eng/newsconsult/mktconsult/Documents/cp2017062.pdf>

<sup>2</sup> <http://www.hkex.com.hk/eng/newsconsult/mktconsult/Documents/cp2017061.pdf>

<sup>3</sup> <https://www.charltonslaw.com/hkex-consults-on-proposed-new-board-for-new-economy-companies/>

- Increase in the minimum expected market capitalisation from HK\$100 million to HK\$150 million and in the minimum public float value from HK\$30 million to HK\$45 million
- Introduction of a mandatory public offering mechanism of at least 10% of the total offer size
- Extension of the post-IPO lock-up on controlling shareholders from one to two years

### Key Changes to the Main Board Rules

- Increase in the minimum expected market capitalisation from HK\$200 million to HK\$500 million and in the minimum public float value from HK\$50 million to HK\$125 million
- Extension of the post-IPO lock-up on controlling shareholders from one to two years, if appropriate

### Background

The Exchange believes that GEM's "stepping stone" positioning has achieved limited success, and among other things, the streamlined process introduced on 1 July 2008 (**GEM Streamlined Process**)<sup>4</sup> may provide an opportunity for regulatory arbitrage and potentially impacts the overall quality of the Hong Kong market. There are views that GEM's lower admission requirements, compared with those of the Main Board, are being exploited by poorer quality companies to gain easy access to the Main Board by listing first on GEM, and by other companies which seek to profit from their position as listed shells. The Exchange has therefore reviewed GEM's position as a "stepping stone" to the Main Board, as well as its admission requirements, with the aim of improving the overall quality of GEM listings.

The Exchange is also concerned that the shares of many GEM issuers lack an open market and that their shareholdings are concentrated among a small group of shareholders, which results in the shares not being freely tradeable on the Exchange and sharp price movements. The Exchange considers that GEM's optional placing-only offering mechanism, low minimum number of shareholder requirement (100 public shareholders),

<sup>4</sup> Streamlined process introduced on 1 July 2008 where GEM issuers can transfer to the Main Board if they meet the Main Board admission requirements, without the need to appoint a sponsor and to issue a listing document

low minimum public float value of securities (HK\$30 million) and low minimum market capitalisation (HK\$100 million) requirement are the underlying causes of these concerns.

If the Consultation Paper's proposed amendments to the GEM listing requirements are adopted, they will mean that the GEM listing requirements will be closer to or exceed the equivalent requirements of the Main Board. The Consultation Paper thus also reviews and proposes 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

Under the current requirements, the Main Board Listing Rules allow GEM issuers to transfer to the Main Board without de-listing from GEM and to apply for a new listing on the Main Board, provided that they meet the Main Board listing requirements.<sup>5</sup> Moreover, the Main Board Listing Rules provide that an issuer may only apply for a transfer from GEM to the Main Board (**GEM Transfer**) if it has published and distributed one full financial year of financial statements after the date of its initial listing. GEM Transfer applicants are not required to engage a sponsor to conduct due diligence and issue a listing document under the GEM Streamlined Process.

In view of the background and the current requirements, the Exchange proposes to make the following changes:

- a) re-positioning GEM as a stand-alone board:
  - i) remove the "stepping stone" mechanism and the GEM Streamlined Process for GEM Transfers. GEM Transfer applicants will be required to appoint a sponsor and issue a "prospectus standard" listing document to ensure appropriate due diligence is performed and full disclosure is made (without requiring the applicant to conduct an offering). The application fee for a GEM Transfer will be the same as that for new listing applications to the Main Board;
  - ii) require all GEM Transfer applicants to have published and distributed at least two full financial years of financial statements after their GEM listings; and

<sup>5</sup> Main Board Listing Rule 9A.02(1)

- iii) 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 (instead of the current requirement of 12 months); and
  - b) renaming the “Growth Enterprise Market” and 創業板 to “GEM” by amending GEM Listing Rules 2.12 and 2.20 to better reflect the nature of GEM issuers.
  - c) extend the post-IPO lock-up on controlling shareholders to prevent their disposal of: (i) any equity interest 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
  - d) 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 would be retained.

## GEM admission requirements and delisting

Under the current requirements, a GEM applicant is required to have a trading record of at least two financial years and positive cash flow from operating activities in the ordinary course of business of at least HK\$20 million for that two-year period.<sup>6</sup> The applicant’s expected market capitalisation at the time of listing is required to be at least HK\$100 million while the expected market capitalisation of its publicly-held equity securities should be at least HK\$30 million at the time of listing.<sup>7</sup>

The GEM Listing Rules impose a post-IPO lock-up on the controlling shareholders of a listing applicant which prevents them from disposing of their equity interest: (a) within six months from the date of listing; and (b) within the next six months if the disposal would result in them ceasing to be controlling shareholders.<sup>8</sup>

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**).<sup>9</sup>

The Exchange proposes to make the following changes to the current GEM admission requirements:

- a) increase the cash flow requirement from at least HK\$20 million to at least HK\$30 million;
- b) increase the minimum market capitalisation requirement from HK\$100 million to HK\$150 million;

The Exchange is also inviting suggestions on other potential quantitative tests for GEM admission.

With respect 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<sup>10</sup> under any circumstances including those set out in GEM Listing Rule 9.04, or where an issuer has been continuously suspended for a prolonged period without it taking adequate action to obtain a restoration of the listing.

As of 31 December 2016, there were only three GEM issuers (1% of a total 260 GEM issuers) whose securities had been suspended from trading for three months or longer. The Exchange therefore considers the current delisting mechanism for GEM to be effective and not in need of fundamental change. The Exchange is also proposing to consult the market on revisions to the delisting policy of both the Main Board and GEM at a later date.

## Open market requirement

Under the current requirements, an adequate spread of holders of the listed securities is required at the time of listing. The number of holders depends on the size and nature of the issue but, as a guideline, there should be at least 100 public shareholders (including those who hold equity securities through the Central Clearing and Settlement System).<sup>11</sup> No more than 50% of the publicly-held securities at the time of listing can be beneficially owned by the three largest public shareholders.<sup>12</sup> At least 25% of the issuer’s total number of issued shares must be held by the public at the time of listing and the class of securities for which listing is sought must not

6 GEM Listing Rule 11.12A(1)  
7 GEM Listing Rule 11.23(2)  
8 GEM Listing Rule 13.16A(1)  
9 GEM Listing Rule 3.05

10 GEM Listing Rule 9.14  
11 GEM Listing Rule 11.23(2)  
12 GEM Listing Rule 11.23(8)

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.<sup>13</sup>

There is no mandatory public offering mechanism for GEM listing applicants under the current regime and applicants have the option of conducting placing-only offerings or combining a placing and public offering. Where GEM securities are to be placed, there are prohibitions on preferential terms or treatment as to price or otherwise being given to any placee unless adequate disclosure of such terms or treatment is made in the listing document.<sup>14</sup>

The Exchange proposes the following changes:

- a) require a mandatory public offering mechanism of at least 10% of the total offer size for all GEM IPOs;
- b) align GEM requirements with Main Board requirements:
  - i) on placing to core connected persons, connected clients and existing shareholders, and their respective close associates; and
  - ii) on 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
- c) increase the minimum public float value requirement of a GEM issuer's securities from HK\$30 million to HK\$45 million.

## Proposals on the Main Board requirements

If the Consultation Paper's proposals with respect to GEM are adopted, the GEM listing requirements will be closer to or exceed the equivalent requirements of the Main Board. The Exchange therefore proposes to make certain changes to the Main Board requirements.

The current Main Board profit test requires a listing applicant to demonstrate 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 (the **Profit Requirement**).<sup>15</sup> A listing applicant that chooses to meet the profit test is also required to have a minimum market capitalisation at listing of HK\$200 million.<sup>16</sup>

A listing applicant is currently required to ensure that there is an open market in the securities for which listing is sought, which will normally mean that at least 25% of the issuer's total issued shares should be held by the public.<sup>17</sup> The minimum market capitalisation at the time of listing of the publicly held securities must be at least HK\$50 million (25% of the current minimum market capitalisation requirement of HK\$200 million).<sup>18</sup>

The existing post-IPO lock-up restricts controlling shareholders of a listing applicant from disposing of their equity interest: (a) within six months from the date of listing; and (b) within the next six months if they would cease to be controlling shareholders as a result.<sup>19</sup>

The Exchange has proposed the following changes to the Main Board listing requirements:

- a) increase the minimum market capitalisation requirement at the time of listing for Main Board applicants from at least HK\$200 million to at least HK\$500 million;
- b) increase the minimum public float value requirement from HK\$50 million (25% of HK\$200 million) to HK\$125 million (25% of HK\$500 million) for Main Board applicants; and
- c) extend the post-IPO lock-up requirements to match the proposals for GEM issuers so that controlling shareholders cannot dispose of any equity interest in the Main Board issuer within the first year of listing and cannot dispose of any interest in the subsequent year if they would cease to be controlling shareholders as a result of the disposal. The Exchange notes that the concerns in relation to potential shell companies raised in the Exchange's Guidance Letter HKEX-GL68-13A "Guidance on IPO vetting and suitability for listing", particularly in relation to controlling shareholders selling down their interest shortly after listing, may not arise for many Main Board issuers given their large size and the proposed increase in the market capitalisation

<sup>13</sup> GEM Listing Rule 11.23(9)

<sup>14</sup> GEM Listing Rule 13.02(1)

<sup>15</sup> Main Board Listing Rule 8.05(1)

<sup>16</sup> Main Board Listing Rule 8.09(2)

<sup>17</sup> Main Board Listing Rule 8.08(1)(a)

<sup>18</sup> Main Board Listing Rule 8.09

<sup>19</sup> Main Board Listing Rule 10.07(1)

requirement. The Exchange is therefore seeking views on whether it is appropriate to extend the post-IPO lock-up requirements for Main Board issuers.

In respect of the Profit Requirement, the Exchange seeks views on: (i) whether the Profit Requirement should still be used to determine eligibility to list on the Main Board or whether alternative tests should replace it; and (ii) if the Profit Requirement is to be retained, whether any change in the level of profit should be made.

The Exchange further seeks views on whether the proposals for the Main Board should be considered independently of the outcome of the GEM proposals.

## Transitional arrangements

In order to minimise the impact on stakeholders, the Exchange will put in place the following transitional arrangements in relation to GEM Transfers for GEM issuers and GEM applicants to allow them sufficient time to comply with the more stringent rules if the proposals in the Consultation Paper are adopted:

- a) all GEM Transfer applications submitted on or before the date on which the proposed Listing Rule amendments come into force (if adopted) (**Amendment Effective Date**), will be processed under the current GEM Streamlined Process and their eligibility for the Main Board will be assessed in accordance with the Main Board Listing Rules in force at the date of the Consultation Paper. Only one refreshed transfer application will be allowed to be submitted after the Amendment Effective Date under this arrangement; and
- b) all GEM listed issuers and GEM applicants who have submitted a valid application for listing on GEM at the date of the Consultation Paper and successfully list on GEM subsequently will be given a period of three years from the Amendment Effective Date to apply for a transfer to the Main Board. Their eligibility for the Main Board will be assessed in accordance with the Main Board Listing Rules in force at the date of the Consultation Paper and the following transitional GEM Transfer arrangements:

- i) applicants who have changed their principal businesses and/or controlling shareholders since listing on GEM will be required to appoint a sponsor to conduct due diligence and publish a “prospectus standard” listing document as if they are new listing applicants to the Main Board; and
- ii) (ii) applicants who have not changed their principal businesses and/or controlling shareholders since listing on GEM will only need to prepare GEM Transfer announcements covering key areas. These applicants will also be required to appoint a sponsor to conduct due diligence in respect of the applicants’ activities during the most recent full financial year up to the date of the GEM Transfer announcement to ensure that the information it contains is accurate, complete and not misleading. The sponsor will be required to conduct due diligence in relation to the disclosures in the GEM Transfer announcement in accordance with the standards set out in paragraph 17 of the SFC’s Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission and the principles set out in paragraph 2 of Practice Note 21 to the Main Board Listing Rules.

Applications for listing on the Main Board which are submitted before the Amendment Effective Date will be processed in accordance with the Main Board Listing Rules in force at the date of the GEM Consultation Paper. Only one refreshed listing application will be allowed to be submitted after that date.

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