16 December 2022

By email: response@hkex.com.hk

Consultation Paper on a "Listing Regime for Specialist Technology Companies"

Dear Sir or Madam,

The Asian Corporate Governance Association (ACGA) is a non-profit membership association founded in 1999. We conduct research on corporate governance and ESG in 12 markets in Asia-Pacific and advocate at the regulatory and corporate level across the region to improve standards and practices. ACGA is entirely funded by a network of 113 member firms from 20 markets, of which 70% are institutional investors with more than US$40 trillion in assets under management globally.

We welcome the opportunity to respond to the consultation paper *Listing Regime for Specialist Technology Companies* published in October 2022. ACGA will limit its response to a few high-level comments.

The consultation

Hong Kong Exchanges and Clearing (HKEX) is proposing a new listing regime for 'specialist' technology firms. It plans to significantly lower Main Board entry requirements to accommodate two categories: commercial companies with "meaningful revenue" and pre-commercial firms at the research and development (R&D) stage who "present high growth potential" but have yet to generate significant revenue.

The goal is to augment Hong Kong's standing on global IPO tables by attracting a greater quantity of listings. To date in 2022, Hong Kong has also introduced a new listing regime for Special Purpose Acquisition Vehicles (SPACs) and further reduced entry thresholds for secondary issuers and weighted voting rights (WVR) companies under the same premise.

ACGA is disappointed that market development in Hong Kong has proceeded on such a narrow track during 2022. Fundamental changes in market structure are being driven solely by IPO opportunities. This has not coincided with an equally rigorous focus on the quality of Hong Kong's secondary market and an attempt to address systemic issues therein. Against this backdrop, it is difficult to see the virtue in this latest proposal at this juncture, given the inherent risks.

Market quality: still a "premier" board?

The 172-page consultation paper seeks responses to 55 questions. Not one of these questions asks whether the market believes such a regime should be put in place: it does not ask *if* the regime is desirable; instead it is an exercise in *how* it should best be implemented. It assumes market consensus. Yet we note that even the keenest advocates

of listing pre-commercial tech companies in Hong Kong have stated a preference for a separate board, or "China's Nasdaq.'' Indeed, this appeared to be the position of HKEX in 2017 in its "New Board Concept Paper'' consultation where it described the Main Board as one "for the largest companies that can meet the highest standards.'' A desire was at the time expressed to preserve and enhance the Main Board as its "premier" offering and "not include the targeted issuers that carry risks that are new and different.'' HKEX wished to avoid confusion as to the board's "purpose and perception.'' Given the apparent lack of unanimity in views, it is discouraging that there was no opportunity to debate the pros and cons of adopting this proposed regime. A further understanding of how HKEX believes it has mitigated the concerns it raised in 2017 over market quality would have been beneficial.

We understand that Hong Kong wishes to excel in the global IPO league tables but the risks of this particular proposal are prolific, the hazards well-documented in the consultation paper itself. How to value these specialist tech firms? A risk of speculation and manipulation as the market weighs up a company's chance of success. Companies who decide to pivot to new business models if the original plan does not pan out. The high likelihood of share price volatility or trading illiquidity post-IPO. The lack of a competent authority to judge a company's progress as it develops its products. The inability to test the veracity of claims being made by firms on their technical capabilities, commercial viability, and ultimately their product. A lack of revenue which leaves companies reliant on equity or debt financing, and at higher risk of corporate failure. The possibility that companies seeking extra funds will heavily dilute their shares after they float.

This proposed regime, with its myriad risk factors, does not augur well for the overall quality of the market which notably still lags its global peers in terms of liquidity (in 2019 it was noted by then Securities and Futures Commission (SFC) executive director Julia Leung that possible causes behind these relatively lower trading volumes "is related to perceived problems with the listed companies,'' including dubious rationales for listing, manipulative activities and extreme price swings.) The proposal also holds up the existing biotech listing regime as an example of the benefits that can be brought to the market, yet the HSI Biotech Index is currently down 21.46% this year, against a drop in the Hang Seng Index of 17.3%. While the 52 biotech companies account for 7.1% of all issuers, they account for just 1.4% of market capitalization and 1.7% of annual trading turnover (September 2022 figures). The listing regime for biotech companies moreover benefits from regulation by a competent authority, which allows a frame of reference to judge the value of these companies. No such opportunity is available with the specialist tech firms.

The consultation also assumes a steady flow of PRC companies tapping Hong Kong's capital markets as they de-list from, or steer clear of the United States. Given recent developments by auditors in the US to inspect audits of Chinese issuers, and the fact that companies weigh up a variety of factors in choosing a listing destination, this may be a false premise.

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Regulatory uncertainty and outsourced standards

Under the proposals, suitability judgments for these companies will be left to the Listing Committee. ACGA reiterates the same point it made in 2018 prior to the regime for biotech companies and WVR being introduced: the Listing Committee is an intermediary-driven body working under extreme time pressure and comprised of pro-cyclical professional interests. Is the Listing Committee in a position to robustly analyze technical capabilities, commercial viability and R&D programmes? How are they to judge that milestones are appropriate or that the appropriate patent has been applied for? Regulators will be required to assess compliance with opaque criteria, which will make for a very subjective process. This creates uncertainty. The sanctioning powers of HKEX are moreover limited.

ACGA is also concerned with the emphasis placed on the "sophisticated investor" as a yardstick of quality at these specialist tech firms. The Exchange seeks to give investors extra comfort by relying on post IPO lock-up periods and third party investments by "pathfinder" sophisticated investors, such as funds, asset management firms and large-scale companies. It appears to be that such investors are increasingly being used as a proxy for suitability in Hong Kong. We would argue that such an investment by a sophisticated investor only shows a desire to make money, not that an R&D product is a suitable investment for others.

Perhaps a better case could have been made for this regime had there been progress in enhancing recourse for minority shareholders in Hong Kong. When trying to compete for global IPOs this is a feature which is consistently overlooked: the playing field is in no way level for investors in Hong Kong compared to the US and other markets when attempting to enforce their rights.

If we can assist any further, please do not hesitate to get in touch.

Best regards,

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