

Hong Kong Capital Markets Update

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HKEX's consultation on GEM Listing Reforms

On 26 September 2023, the Stock Exchange of Hong Kong Limited (the "Exchange") published a [consultation paper](#) ("Consultation") seeking market feedback on proposed changes to the GEM Listing Rules. The deadline for submissions is 6 November 2023.

Main Proposals

New alternative eligibility test – "Market capitalisation/ Revenue/ R&D test"

- Introduce a new financial eligibility test **targeting high growth enterprises** that are **heavily engaged in R&D activities**. GEM listing applicants using this new test must have:
 - an adequate **trading record of at least two financial years**;
 - an expected **market capitalisation of at least HK\$250 million** at the time of listing;
 - revenue of at least HK\$100 million in aggregate** for the two most recent audited financial years, **with year-on-year growth** over the two financial years; and
 - incurred **R&D expenditure of at least HK\$30 million in aggregate** for the two financial years prior to listing, where the R&D expenditure incurred for each financial year must be **at least 15% of its total operating expenditure** for the same period.

Removal of mandatory quarterly reporting requirement

- Align GEM's periodic reporting requirements with those for Main Board issuers** by removing the mandatory quarterly reporting requirement for GEM issuers.

New streamlined transfer mechanism

- Implement a **streamlined transfer mechanism with modified eligibility requirements**.
- An **overview comparison** between the proposed requirements under the streamlined approach for a transfer of listing from GEM to the Main Board and the existing requirements are set out in **Table 1 below**.

Background

Since 2019, the number of new listings and funds raised on GEM have significantly declined and there were no new GEM listings in 2022. The Exchange believes that the COVID-19 pandemic and alternative SME listing venues in the Chinese Mainland are the factors that contributed to this decline. As facilitating SME listings is a key priority for the Exchange, which is committed to providing a supportive environment where SMEs can thrive and ultimately contribute to the continued prosperity of both Hong Kong and the global economy, it has engaged with a broad range of stakeholders to hear their concerns regarding GEM and develop proposals to address those concerns.

The stakeholders commented that (i) the positive operating cash flow requirement for GEM applicants may prevent the listing of companies with high growth potential that do not have such a track record because they are engaged heavily in R&D; (ii) the cost of listing outweighed the benefit to do so for many potential GEM applicants as the listing expenses were often disproportionately high when compared to the funds raised and the higher compliance costs relative to the Main Board issuers; (iii) the removal of the streamlined transfer mechanism in 2018 had dissuaded issuers from listing on GEM and instead incentivised them to remain private until they are eligible to go for listing on the Main Board directly; and (iv) the high listing eligibility requirements and continuing obligations should be maintained to help ensure investor protection.

Main proposals

To address the key issues identified during the stakeholder engagement, including the feedback on the importance of investor protection, the Exchange has developed proposals for GEM reforms. The main proposals are summarised below.

(1) New alternative eligibility test

The Exchange agrees with stakeholder comments that GEM's current eligibility requirements may prevent the listing of companies with high growth potential that do not have a sufficient track record of positive operating cash flow for the current listing requirements as they are engaged heavily in R&D. Therefore, it is proposed to create a path to listing for such companies as their growth potential may offset the additional risks of investing in small-cap companies.

For this purpose, the "Market capitalisation/ Revenue/ R&D test" is proposed to be introduced for high growth enterprises that are heavily engaged in R&D activities, with the details set out on page 1. The Exchange believes that this new test has the potential to attract technology and research-driven growth companies from the new economy to Hong Kong, the Greater Bay Area and beyond. These companies are increasingly becoming a key driving force of economic growth.

The Exchange is also mindful of its duty to act in the best interests of the market as a whole, and in the public interest, and to ensure that investors should have and can maintain confidence in the Hong Kong markets. This is also consistent with stakeholder comments regarding the importance of investor protection. Consequently, the Exchange does not propose to remove requirements that may compromise that duty, such as the removal or lowering of the existing operating cash flow requirement for listing on GEM or the removal of the requirement that an applicant engage a sponsor or publish a listing document for the purpose of its listing on GEM.

(2) Removal of mandatory quarterly reporting requirement

To help address stakeholder concerns regarding the ongoing compliance costs of a GEM listing, the Exchange proposes to align GEM's periodic reporting requirements with those for Main Board issuers by removing the mandatory quarterly reporting requirement for GEM issuers. Given that GEM listing applicants nowadays are usually well-established companies with a long history of operations at the time of their application, there may be less of a need to require the GEM issuers to report more frequently than the Main Board issuers.

The Exchange acknowledged that its proposals will not significantly reduce the cost of an application to list on GEM, but they should result in a reduction in the cost of maintaining a GEM listing and the cost of transfer to the Main Board.

(3) New streamlined transfer mechanism

In February 2018, the GEM streamlined transfer mechanism was abolished following a public consultation in light of comments that "the process may provide an opportunity for regulatory arbitrage between the Main Board and GEM which potentially impacts the overall quality of the Hong Kong market". It was noted, amongst other concerns, that the GEM streamlined transfer mechanism "may have led to an increase in the number of potential shell companies listed on GEM".

However, due to market quality reforms implemented by the Exchange and the SFC in the past years, these shell activities have largely ceased. Therefore, in response to SME stakeholders' concerns, the Exchange proposes to implement a streamlined transfer mechanism with modified eligibility requirements. The proposed requirements for a streamlined transfer, compared against the existing requirements, are set out in Table 1 below:

	Existing requirements	Proposed requirements under the streamlined approach for a transfer of listing from GEM to the Main Board
A. Qualifications for transfer	<p>The transfer applicant must:</p> <p>(a) meet all the qualifications for listing on the Main Board;</p> <p>(b) have published its financial results for the first full financial year commencing after the date of its initial listing on GEM; and</p> <p>(c) in the 12 months preceding the transfer application and until the commencement of dealings in its securities on the Main Board, not have been the subject of any disciplinary investigation by the Exchange in relation to a serious breach or potentially serious breach of any Listing Rules.</p>	<p>The transfer applicant must:</p> <p>(a) meet all the qualifications for listing on the Main Board;</p> <p>(b) comply with the Exchange's requirement in respect of its financial results for the three full financial years as a GEM listed issuer prior to its transfer, with (i) ownership continuity and control, and (ii) no fundamental change in its principal business, throughout that period;</p> <p>(c) have reached the Minimum Daily Turnover Threshold# on at least 50% of the trading days over the Reference Period* (the "Daily Turnover Test");</p> <p>(d) have a volume weighted average market capitalisation over the Reference Period* that could meet the minimum market capitalisation requirement for listing on the Main Board (the "Volume Weighted Average Market Capitalisation Test"); and</p>

	Existing requirements	Proposed requirements under the streamlined approach for a transfer of listing from GEM to the Main Board
		(e) (i) not have been held to have committed a serious breach of any Listing Rules in the 12 months preceding the transfer application and until the commencement of dealings in its securities on the Main Board; and (ii) not be the subject of any investigation by the Exchange, or any ongoing disciplinary proceedings under Chapter 3 of the GEM Listing Rules, in relation to a serious breach or potentially serious breach of, any Listing Rules as at the date of the transfer application and the date when dealing in its securities commences on the Main Board.
B. Sponsor appointment/ due diligence	A sponsor must be appointed at least two months before the submission of a transfer application.	A transfer applicant will <u>not</u> be required to appoint a sponsor to conduct due diligence for its transfer.
C. Publication of a listing document	A transfer applicant is required to issue a “prospectus-standard” listing document to ensure appropriate due diligence is performed and full disclosure is made (without being required to conduct an offering).	A transfer applicant will <u>not</u> be required to issue a “prospectus-standard” listing document. A transfer applicant will only be required to submit certain application documents as required by the Exchange.
D. Transfer announcement	Not applicable	The transfer applicant will be required to publish an announcement as soon as practicable before the intended date dealings in the issuer’s shares on the Main Board are expected to commence. Such announcement should be pre-vetted by the Listing Division.

Either HK\$100,000 or HK\$50,000, subject to the consultation result

* 250 trading days immediately preceding the transfer application and until the commencement of dealings in its securities on the Main Board

Other proposals

Additional proposals from the Exchanges include the alignment of a post-IPO lock-up period for controlling shareholders, GEM compliance officer and compliance adviser requirements with those of the Main Board, and an exemption from the Main Board initial listing fee for GEM transferees.

If you have any questions about the matters discussed in this publication, please feel free to contact the following capital markets partners.

Paul Lau

Partner, Head of Capital Markets and Professional Practice
KPMG China
+852 2826 8010
paul.k.lau@kpmg.com

Louis Lau

Partner, Capital Markets Group
KPMG China
+852 2143 8876
louis.lau@kpmg.com

Mike Tang

Partner, Capital Markets Group
KPMG China
+852 2833 1636
mike.tang@kpmg.com

Terence Man

Partner, Capital Markets Group
KPMG China
+86 10 8508 5548
terence.man@kpmg.com

Elton Tam

Partner, Capital Markets Group
KPMG China
+852 2978 8188
elton.tam@kpmg.com

kpmg.com/cn

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