

**By Hand and by Email (response@hkex.com.hk)**

16 December 2022

Hong Kong Exchanges and Clearing Limited  
8/F, Two Exchange Square  
8 Connaught Place  
Central  
Hong Kong

Dear Sir/Madam,

**CONSULTATION PAPER ON LISTING REGIME FOR SPECIALIST TECHNOLOGY COMPANIES**

CFA Society Hong Kong has reviewed the proposed listing regime for specialist technology companies (STC) and welcome the proposals in principle. Overall, implementation of the proposed regime would help attract STCs to list in Hong Kong.

While we agree the proposed listing regime in principle, there are a number of issues that should be addressed to ensure the proposed regime is competitive among the competitors.

**1. Definition of STC (Q1-Q4)**

In general, we agree with the list of Specialist Technology Industries and the respective acceptable sectors set out in paragraph 4 of the Draft Guidance Letter. Yet, we would like to reiterate that it is very important for the Exchange to update the guidance on the Specialist Technology Industries and acceptable sectors regularly.

For instance, EV and their related business sectors had been included in the list. However, some of the EV related sectors, particularly those mainly engaged in EV design and assembly, are not performing and they can hardly satisfy the “high growth potential” benchmark currently. Given that the relevant core technology stakeholders (e.g., semi-conductor and energy storage) in the supply chain had already been covered, these relatively non-performing sectors should be removed from the list during the periodic review.

We agree that the Exchange should retain the discretion to reject an application for listing from an applicant within an acceptable sector if it displays attributes inconsistent with the principles referred to in paragraph 101 of the Consultation Paper. The discretion is necessary for the Exchange to retain certain flexibility and be the gatekeeper to reject those unsuitable applications. Despite this, the regime should be transparent on the basis for the rejection, and ensure such core principles are consistently applied.

**2. Commercial and Pre-Commercial Companies as listing candidates (Q5-Q7)**

We support both Commercial and Pre-Commercial Companies be allowed for listing on the Exchange, which is in line with the practice of the STAR market. Since the risk



inherent from investing in Pre-Commercial Companies is relatively higher than that of Commercial Companies, we agree that more stringent requirements be applied to Pre-Commercial Companies for their listing applications.

We do not have objection for allowing all investors, including retail investors, to subscribe for, and trade in, the securities of Pre-Commercial Companies as long as they are properly informed about the risk factors of these investments. In addition, we consider that proper education for retail investors on the risks associated with investments in STCs is important as an investor protection measure.

In view of the risk level associated with the investments in STCs, we believe SFC and HKMA should provide clear guidance to financial intermediaries on the suitability requirements to ensure the retail investors have the high risk tolerance and appropriate investment horizon (e.g. 3 to 5 years or longer) should they wish to invest in these companies.

### **3. Capitalization requirements of the listing applicants (Q8 - Q9)**

We have reservation on the proposed capitalization requirements as they appear to be too high for both Commercial and Pre-Commercial companies.

In order to make the listing regime competitive, we should not be overly stringent in the capitalization requirements against our competitors. For instance, the capitalization requirements for Commercial and Pre-Commercial Companies in the STAR market are currently RMB5 billions and RMB10 billions respectively only.

### **4. Revenue growth (Q10-Q12)**

We agree with the proposed requirements.

### **5. R&D expense requirements (Q13-Q15)**

The ability to innovate through tireless R&D has been recognized as one of the critical success factor for STCs. We therefore have no objection to imposing a requirement on the listing applicants in the proposed regime that STCs must have been engaged in R&D of its Specialist Technology Product(s) for a minimum of three financial years prior to listing.

As for the ratio of R&D investment to the total expense ratio, we are of the view that it should only be used as a general reference and the Exchange should have the flexibility to allow deviations from this general reference when the applicants have legitimate grounds for the deviation. For example, a Pre-Commercial company is in the course of commercialization of its product(s) such that it had incurred relative substantial marketing expenses and that leads to the R&D expense falling short of the general reference ratio.

Per paragraph 141(a), R&D investment for the relevant financial year would be calculated on an incur basis. Accordingly, an amount that has been capitalized as intangible assets would still be accounted for in the period it is incurred. As the expense capitalization requirements are quite stringent and the estimated useful life of the intangible assets varies, we consider it fair to account for R&D investment on an incur basis. And we agree to the formula for calculating the total operating expenditure as

stated in paragraph 141(d) as the formula effectively avoid double counting or omission in calculating the total operating expenses.

Despite the above, we would appreciate it if the Exchange can provide more guidance on the qualifying cost of R&D conducted by other on the company's behalf (paragraph 141(b)(ii)) and; the amortization of intangibles used in R&D activities (paragraph 141(b)(iv)) as these two amounts are easy to subject to manipulation.

**6. Ownership continuity (Q16-Q17)**

We agree that the listing applicants under the proposed regime should have management and ownership continuity for a designed period before going public. In fact, this requirement is also important for other listing applicants in the main board and the biotech sector. We are of the view that imposing management continuity requirement for the Main Board listing regime and ownership continuity requirements for the biotech listing regime on STCs should be sufficient.

**7. Sophisticated Independent Investors (SIIs) (Q18-Q22)**

We note that the SII requirement also applies to the biotech regime. However, only one SII is required in the biotech regime. While STCs may not have relevant industry regulator(s) to oversee their activities like the listing applicants in the biotech regime such that imposing a requirement for two SIIs for STCs could be a sensible move, securing two SIIs with the same requirements may not be easy in practice. It could be worthwhile to explore the possibility of imposing tier requirements such that the 2<sup>nd</sup> SII would be subject to less stringent requirements.

**8. Funding requirements for Pre-Commercial Companies (Q23-Q27)**

We agree with the proposals in principle. Firstly, investors are expecting more than average returns when they invest in STCs such that it is important that the Pre-Commercial Companies have clear plans to bring their STC products to commercialization and achieving the Commercialization Revenue Threshold. Secondly, the requirement for a credible path for product commercialization appears to be reasonable and that is currently in place for the biotech listing candidates.

We are indifferent to the examples proposed in paragraphs 176 to 179 (including the definition of "highly reputable customer").

As for the funding gap, we are of the view that the listing candidate should raise sufficient funds till their STC product commercialization stage when they go public. We assume question 26 refers to situations which are unforeseen to the listing candidates and that lead to the funding gap. In this connection, it would be helpful if the listing candidates can identify these potential unforeseen situations, estimate the funding gaps and how they will service these funding gaps. This additional information would help the potential investors to make the final investment decision.

The 125% funding requirement stated in question 27 is the same for the biotech regime and appears to be reasonable as well.

**9. Share allotment to Independent Institutional Investors (Q28-Q34)**

We agree to the proposals in principle.

Independent Institutional Investors are important in price discovery process. Ensuring a fair allotment to the listed shares to these investors would encourage them to invest sufficient resources in research and analysis, and hence, contribute significantly to the robust price discovery process. We agree that independent Institutional Investors should be given a minimum allocation of offer shares in the IPO of STCs.

On the other hand, minimum allocation does not mean phasing out the claw back mechanism for the proposed STC regime entirely. Studies<sup>1</sup> indicate that the claw back mechanism helps minimize the chance that the retail investors would end up buying over-priced shares in the IPO issues. Therefore, we are of the view that we should maintain the right equilibrium on the allocation ratio between the Independent Institutional Investors and other investors.

Excluding corporate professional investors and individual professional investors in the definition of Independent Institutional Investors seems to be reasonable as they might not have the research resources nor the investment process in place to provide meaningful contribution to the robust price discovery mechanism.

**10. Free float and public float requirements (Q35-Q36)**

Yes, we agree with the proposals and such measures also align with our viewpoint on the importance of investor protection.

**11. Disclosure of information (Q37-Q38)**

Yes, we agree with the proposals as proper and sufficient disclosure of Pre-Commercial Companies are imperative for both institutional and retail investors to make well-informed decisions.

**12. Participation of existing shareholders in the IPO (Q39-Q40)**

We in general agree with the proposals, but if the existing shareholders are allowed to take part in the IPO, there should be mechanisms to avoid conflict of interest and the existing shareholders taking information advantage.

**13. Post listing requirements (Q41-Q48)**

The lock-up period for controlling shareholders of a STC appears to be too long when comparing to other markets and listing regime. The lock-up period of the biotech regime is only 6 months. The US market also applies a 6-month lock-up period for the controlling shareholder. There should be legitimate grounds for the prolonged lock-up period for the controlling shareholders. Likewise, we need justifications for other lock-up period mentioned in the session. Otherwise, the proposed STC regime might not be competitive when comparing to those of other exchanges.

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<sup>1</sup> Underwriters' allocation with and without discretionary power: Evidence from the Hong Kong IPO market by Mazouz, K, Mohanmed, A Saadouni, B et al (2017)

The key persons described in paragraph 242 appears to be a comprehensive list and we agree that they should be subject to disposal restrictions of their holdings after listing.

**14. Cessation of application of continuing obligations (Q49 – Q54)**

We agree with the proposals.

Given the risk and unique nature of STCs, it may be worthwhile to consider strengthening the qualification and experience requirements for INEDs; and requiring INEDs to disclose their views and positions on the STCs (i.e., similar to the current requirements under Chapter 14A – INEDs' confirmation for connected transactions).

**15. Removal of designation as Pre-Commercial Companies (Q55)**

We have no objection for the Pre-Commercial Companies to change its markers from "PC" (as in "Pre-Commercial") to the markers for Commercial Companies as long as the companies can demonstrate that they should no longer be regarded as Pre-Commercial Companies. However, in view of the fact that the inherent risk of STC may be higher than issuers in traditional business sectors, we are of the view that even Commercial Companies should carry identifiable stock markers to alert the investors the nature of the underlying stocks.

Should you have any questions on our above comments, please do not hesitate to contact the undersigned.

Yours faithfully,  
For and on behalf of  
CFA Society Hong Kong

Eric Chiang  
Managing Director

