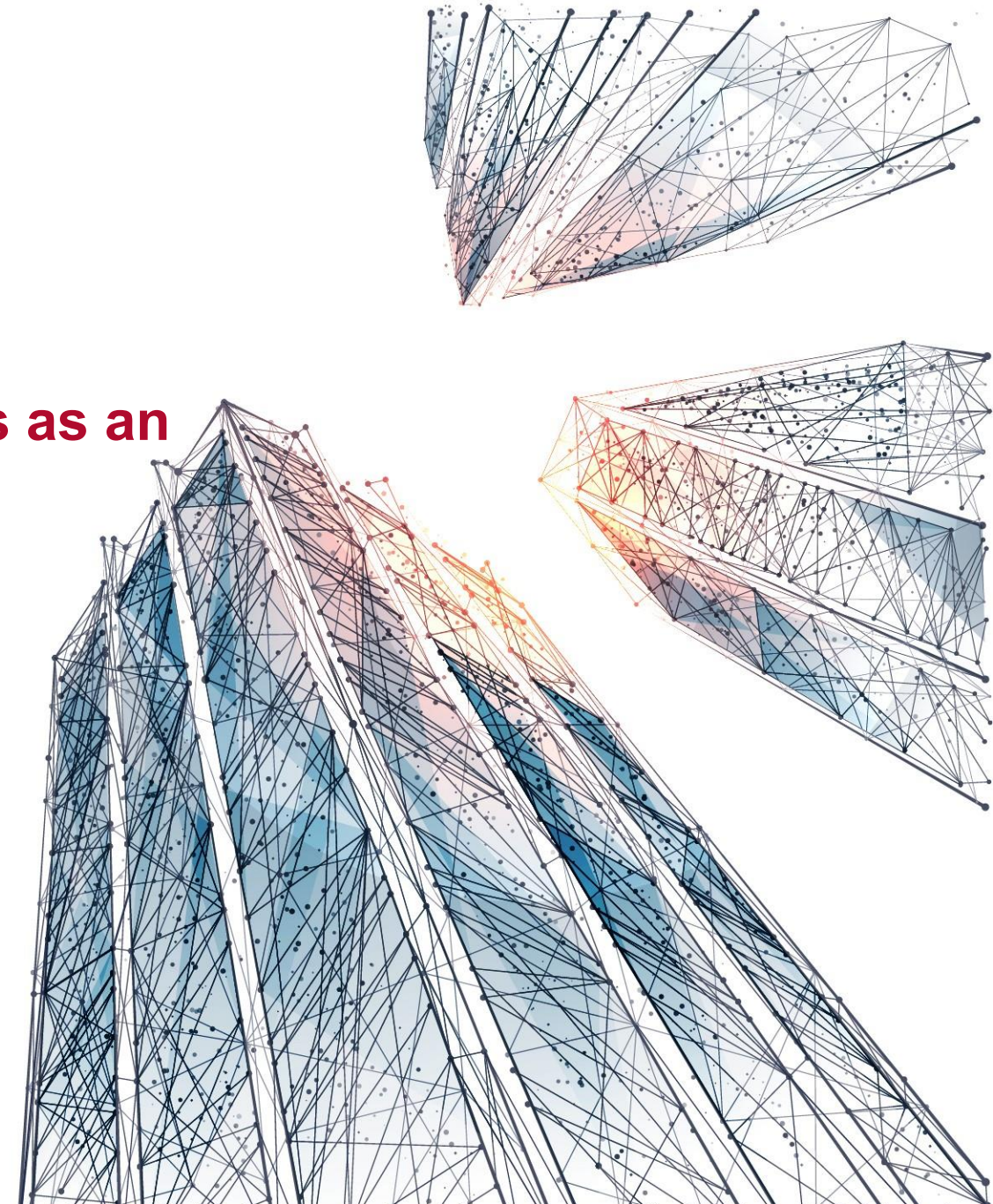
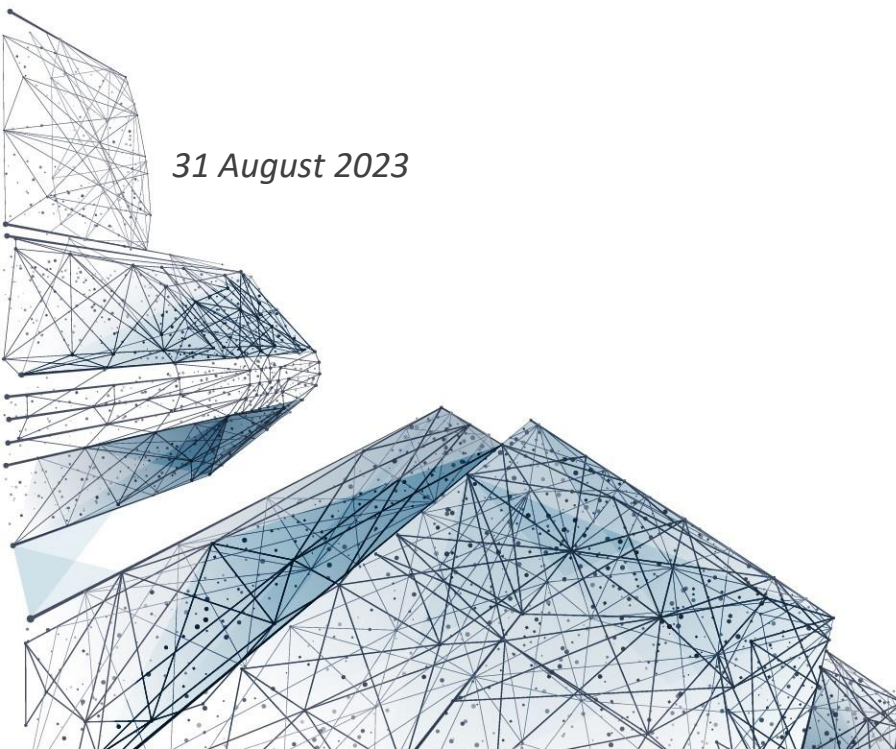


# Boosting Market Liquidity and Diversity: Enhancing Hong Kong's Competitiveness as an International Capital Formation Centre

31 August 2023



# Executive summary



## Observations

**Maintaining ample market liquidity across different asset classes is invariably beneficial to a robust financial system**

**Changing market dynamics and investor demand**  
More investors are exploring exposure to emerging investment opportunities and private market investments as a means of diversifying their portfolios and improving investment outcomes

**Nurturing innovative capability with an effective market structure** becomes more crucial to a financial centre to stay relevant in the fast-evolving global financial landscape.

**Addressing financing gaps of small-cap/mid-sized businesses and pre-revenue companies**



## Recommendations

### Primary recommendation:

- Introducing a professional investor-only market to facilitate market innovation and sustainable growth of emerging investment products and alternative asset classes

### Short-to-medium term measures:

- Exploring synergies between Hong Kong's GEM and other markets ;
- Reviewing the stamp duty on stock transactions ;
- Developing a strategic framework to promote investor education and financial literacy towards non-traditional/emerging asset classes

# Enhancing market liquidity and diversity across financial sector

## The importance of market liquidity and diversity



**Maintaining market liquidity is critical to its continuous success**

- Key consideration of resource allocation and risk management within a financial market

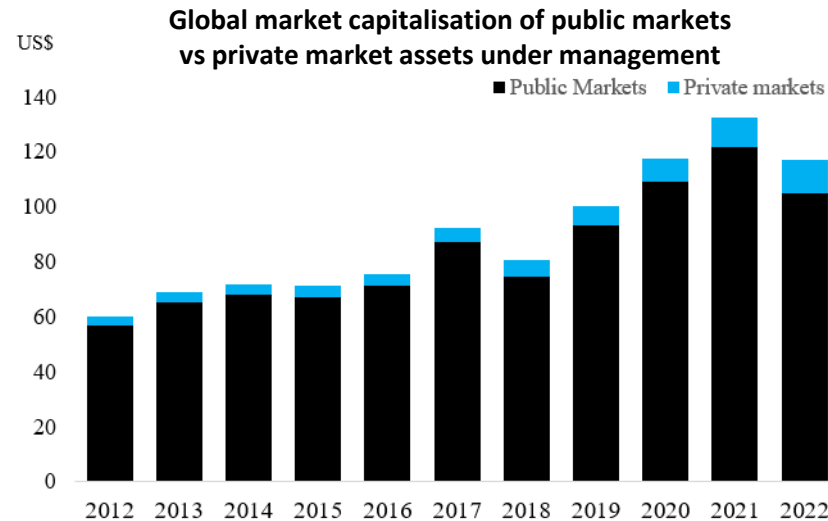
**Healthy level of market liquidity supports the stability of a financial market and promotes greater participation**

- Reduce transaction costs for investors and lower capital raising costs for issuers

**Availability of diverse investment offerings and the appeal of such markets to investors are undeniably interconnected**

- An extensive selection of product offerings can cater an array of investors, each with their own distinct trading strategies, risk appetites, and investment horizons.

## Private market growth has significantly increased over the last decade

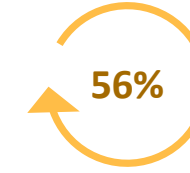


- Access to a vast amount of capital and opportunities under a comparatively light-touch regulatory approach
- Favourable to start-ups and emerging companies

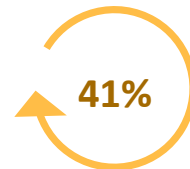
## Family Offices tend to shift asset allocations to alternative investment products and emerging markets



believed that illiquid assets would offer more impressive returns



engaged in virtual assets and blockchain-related trading



will shift their focus to other alternate investments, such as PE (direct investments) in the next five years

- 35% would consider funds/funds of funds of PE



# Challenges and opportunities investing in private markets

## Challenges investing in private markets

- **Higher costs and time-consuming procedures** for the launch and secondary trading of private market assets involved in onboarding investors and conducting KYC and AML checks
- **Inefficient price discovery** as rely on issuers and investors' own over-the-counter (OTC) networks for the trading of unlisted securities
- **The inefficiencies in due diligence caused by the absence of a sponsor requirement** for trading via OTC
- **More fragmented projects** and requires extra effort and expenses to gather credible information for assessment
- **The absence of abundant liquidity in the secondary market** has prompted industry players to turn to unconventional financing options

## Development of private markets in other jurisdictions

Various securities exchanges have, independently or through partnerships with digital platforms, tapped into the market

### Nasdaq

- Established Nasdaq Private Market through acquisition
- A digital channel designed to cater to private companies seeking capital and secondary market trading
- A cumulative transaction value exceeding US\$43 billion in 2022

### Singapore Exchange

- Engaged through backing ADDX, an accredited-investors-only digital securities exchange
- A transaction value of US\$150 million in 2021

### London Stock Exchange

- 2022 – announced partnership and investment in Floww, a digital infrastructure that offers a marketplace for private capital raising
- By 2024 - launch the "Intermittent Trading Venue", a platform designed to facilitate the auction of shares in private companies, thereby creating liquidity for their secondary securities

# Financing Challenges Facing Small-cap/Mid-sized Companies

## Challenges facing small-cap/mid-sized companies

**Small- and medium-sized enterprises (SMEs) represent over 98% of all business establishments in the city**



### Underperformance of GEM

- As of 2022 - total market capitalisation for the GEM: **HK\$85 billion (- 21% YoY); 0.2% of the Main Board's** market capitalisation
- **No new listings** on the GEM in 2022, with the last new listing taking place in 1Q2021

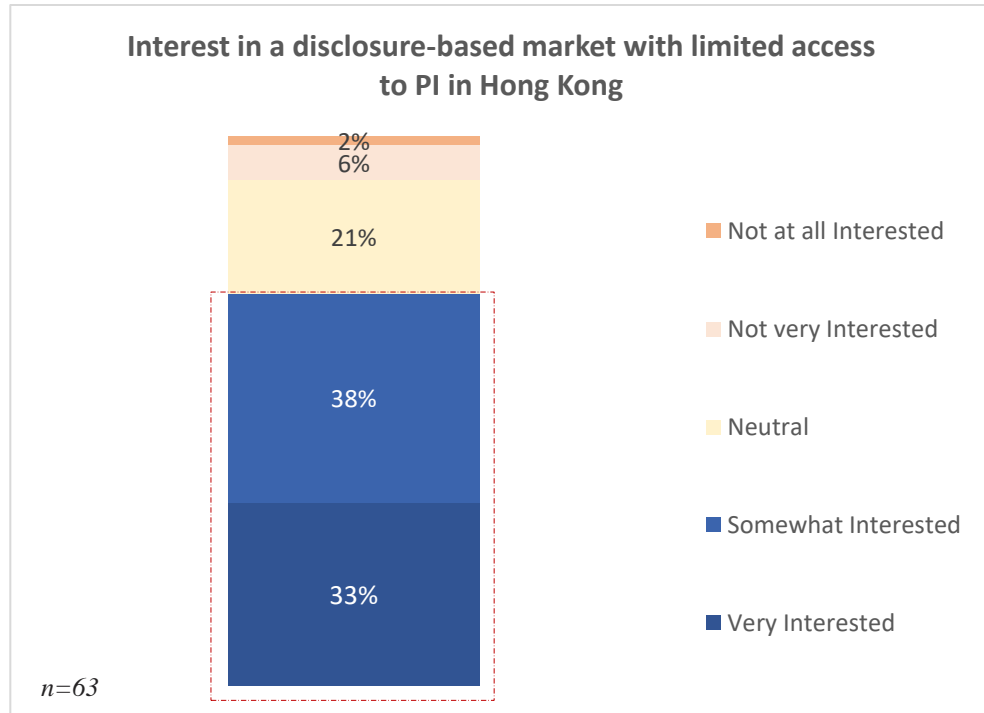
**Costs associated with equity financing are prohibitively high for small-cap/mid-sized issuers that are with limited resources**

- The requirement to appoint a GEM sponsor
- Mandatory quarterly reporting requirements
- For all 9 recent listings on GEM in 2020 & 2021, on average, **listing expense accounts for more than 50% of their expected gross proceeds** from the offerings.

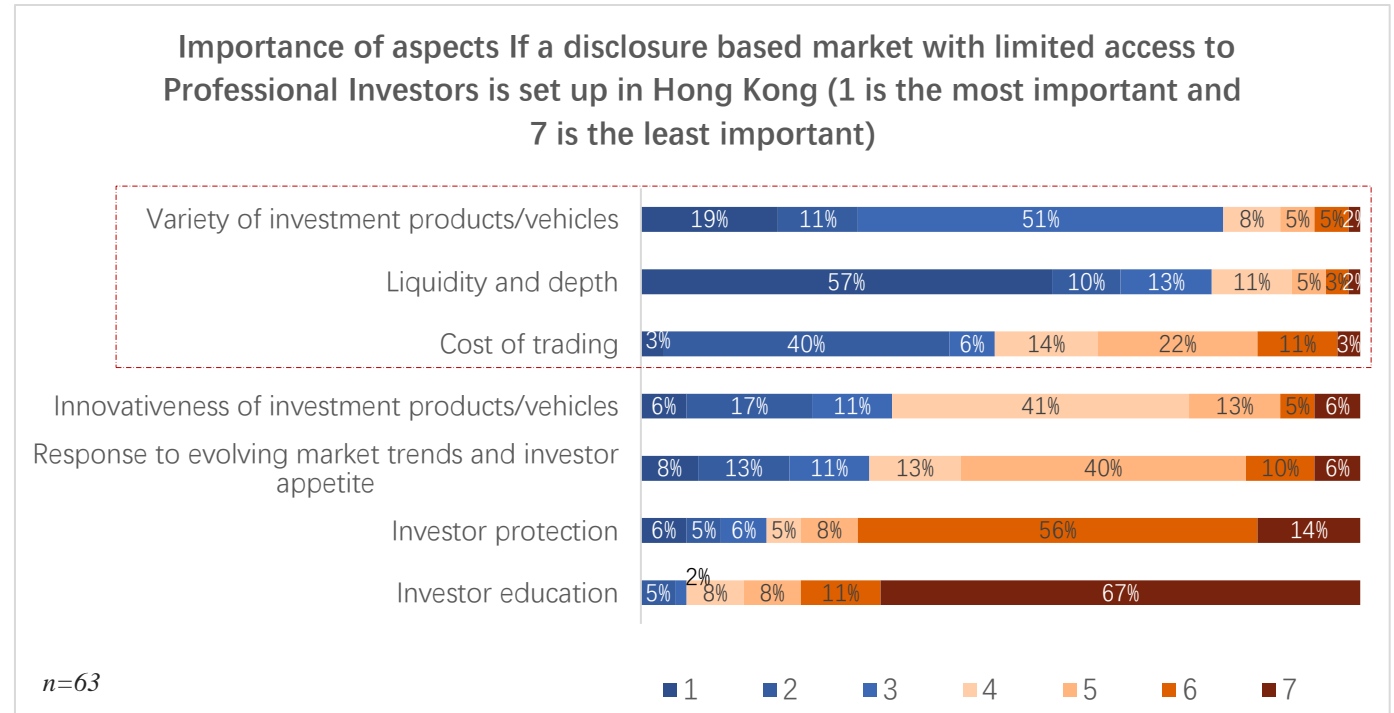
## Benchmarking practices for small-cap/mid-sized companies financing in different jurisdictions


<p><b>China</b></p>	<ul style="list-style-type: none"> <li>• Beijing Stock Exchange (BSE) established in 2021 to serve the fundraising needs of innovation-oriented SMEs</li> <li>• As of June 2023, there were 204 listed stocks on the BSE, with a total market capitalisation of RMB266.8 billion</li> </ul>
<p><b>Europe</b></p>	<ul style="list-style-type: none"> <li>• Established multilateral trading facilities with varying listing requirements to accommodate the diverse needs of start-ups and SMEs               <ul style="list-style-type: none"> <li>➤ <b>Euronext Growth</b> - high-growth SMEs</li> <li>➤ <b>Euronext Access and</b> - less stringent regulations to serve as entry points for start-ups and SMEs</li> <li>➤ <b>Euronext Access+</b> - gateway to other Euronext markets, respectively</li> </ul> </li> </ul>
<p><b>Canada</b></p>	<ul style="list-style-type: none"> <li>• TSX Venture               <ul style="list-style-type: none"> <li>➤ Two-tier listing category</li> <li>➤ Targets for start-ups and small/mid-sized companies</li> </ul> </li> <li>• In 2022, 161 new listings and 1,713 issuers</li> <li>• Disregarding the ticket size, listing activities closely resemble that of the Toronto Stock Exchange, which recorded 113 new listings and a total of 1,789 issuers during the same period</li> </ul>

# Interests towards a disclosure-based PI only market (Survey conducted by FSDC Policy Research Team)



- The majority of the survey respondents (71%) expressed interest in a disclosure-based PI-only market in Hong Kong
- Supportive to the market - provide them with exposure to a wider range of products
- Hesitations / concerns - about the vulnerability of the new market and associated risks.



- When considering a new market, the **top three important attributes that constitute attractiveness** include:
    - A broad set of investment options
    - Sufficient liquidity and market depth
    - Reasonable trading costs, respectively
- 

# Primary recommendation - A new professional investor-only market

## Challenges facing products that are perceived to be of higher risk level

- Often restricted to PIs
- Absence of an established and credible trading platform recognised by local and international PIs

### Challenges faced by Investment products perceived to have high risk level

Denied retail access to instrumental risk diversification tools (e.g. PE)

PIs and product originators – difficult to expect any greater liquidity of such products

Without amply liquidity, unsafe for retail investors



## Primary Recommendation

### New PI-only market for both primary and secondary markets

- An efficient marketplace, providing ample liquidity for trading activities
- To facilitate market innovation and sustainable growth of emerging investment products and alternative asset classes
- Respond more promptly and effectively by operating in a more flexible manner
- To lead and not to merely follow

Potential Products  
PE funds, Bonds and Securitisation Products

Ultimately, investors should be given the ability to access a bigger range of investment options

# Recommendations - Exploring synergies between Hong Kong's GEM and other markets



## Exploring synergies between Hong Kong's GEM and other markets

### Connectivity with Mainland

Since the official launch of Stock Connect scheme in 2014

**Northbound ADT (in 2022)**  
**RMB100bn**  
**80%**  
daily turnover of the stock market

**Southbound ADT (in 2022)**  
**HKD32bn**  
**25%**  
daily turnover of the stock market

- In June 2023, **HKEX signed a MOU with the Beijing Stock Exchange** to establish a long-term cooperation aimed at supporting cross-listings is a positive development



- **Potential collaboration and synergy between the BSE and GEM**
- **Potential expansion of the Stock Connect scheme** to encompass the BSE and GEM collaboration

### Connectivity with other potential markets

- **Fostering connectivity with other regional capital markets** to solidify Hong Kong's role as a pre-eminent capital formation centre
- Expanding the scope of the **existing mutual market access schemes**
- **Drawing inspiration from multilateral trading facilities** such as Euronext Growth, Euronext Access, and Euronext Access+
- Upon the revitalisation of GEM being explored by the Government, a **dedicated approach** to strengthen market oversight and the efficiency of the GEM



# Recommendations - Reviewing the stamp duty on stock transactions



## Reviewing the stamp duty on stock transactions

### Enhance competitiveness of Hong Kong's tax regime

#### Important to ensure alignment with international norms

Stamp duty is one of the few forms of taxation on financial instrument transactions

#### As market development measures

ETFs, debt securities, derivative warrants, and callable bull/bear contracts, and transactions relating to dual-counter stocks made by dual-counter market makers are exempt from stamp duty

#### Lowering trading friction to enhance market liquidity and provide a strong foundation for future improvements or innovations

Potentially attracting more private and public funds.

Names of Stock Exchange	World Ranking	Asia Ranking	Market Capitalisation USD (in trillions) (Jun 2023)	Stamp Duty Rates
US (NYSE Euronext)	1		24.8	Nil
US (Nasdaq)	2		21.3	Nil
China (Shanghai)	3	1	6.8	Effective on 28 Aug 2023, the rate is reduced to 0.05% (seller only) Previous rate was 0.1%
Europe (NYSE Euronext)	4		6.7	Nil
Japan (Japan Exchange Group)	5	2	5.8	Nil
China (Shenzhen)	6	3	4.7	Effective on 28 Aug 2023, the rate is reduced to 0.05% (seller only) Previous rate was 0.1%
Hong Kong	7	4	4.3	0.26% (0.13% Buyer) (0.13% Seller)
India	8	5	3.3	0.00001% - 0.015%
UK (London Stock Exchange Group)	9		3.2	0.5% (buyer only)
Canada (Toronto)	10		3.0	Nil

# Recommendations - Promote investor education and financial literacy towards non-traditional/emerging asset classes



## Developing a strategic framework to promote investor education and financial literacy towards non-traditional/emerging asset classes

- Limiting access to certain investment vehicles to PIs only is merely the initial step in Hong Kong's market development.
- The ultimate goal is to raise the market's awareness and knowledge of innovative products, and fostering a comprehensive ecosystem

### Major drivers to evolving financial market development

- Advancement of digital technology
- Burgeoning market connectivity
- Springing up of innovative investment products across the globe

### Notable changes

- **Regulatory arbitrage**  
universal accessibility of offshore investment platforms to the public
- **More opportunities to engage with offshore trading platforms brought by increasing connectivity among global financial markets**  
gaining access to a diverse array of products, including emerging or private market opportunities that are **yet to be regulated in Hong Kong**

### Comprehensive capacity building

- Extensive training, upskilling, and reskilling efforts
- Education at universities to continued training for intermediaries and professional practitioners.  
E.g. the Pilot Green and Sustainable Finance Capacity Building Support Scheme

### Investor education and financial literacy

- Improve investment behaviour and build investors' confidence
- Investors' awareness and knowledge of new investment products and embedded risks should be raised even those products are not yet available to them
- Support investors in making informed and appropriate investment decisions

# Q&A