

CONSULTATION CONCLUSIONS ON THE GROWTH ENTERPRISE MARKET

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Hong Kong Exchanges and Clearing Limited
香港交易及結算所有限公司

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EXECUTIVE SUMMARY

This report presents the results of a public consultation conducted by the Stock Exchange of Hong Kong Limited (the Exchange), a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited (HKEx) on proposals to reposition The Growth Enterprise Market as a second board, or stepping-stone to the Main Board.

During the consultation process, the Exchange received a total of 11 submissions from market respondents and the majority of responses were broadly favourable to the proposals made, subject to the reservations preferring an alternative market model. In view of the broad market support, the Exchange intends to implement substantially all the proposals outlined in the consultation paper, in a small number of cases with certain clarifications and modifications as set out in this paper (please see the Appendix II for a summary of proposals adopted with or without modifications).

The objective of this paper is to provide new applicants, existing issuers and market practitioners an overview of our conclusions on our market consultation on the proposals relating to GEM, and to give a general direction of the proposed changes that will be implemented by the Exchange in this area.

We have finalised the revised rules to implement the detailed proposals. The rules have been approved by the Board of The Stock Exchange of Hong Kong Limited and the Securities and Futures Commission. Each of the proposed rule changes may have different degrees of impact on new applicants, existing issuers and market practitioners. The rule amendments will become effective on 1 July 2008 (the implementation date).

The transitional arrangements are set out in Part E of this paper. In summary, listing applications received by the Exchange on or before the date of this paper will be processed according to the GEM Listing Rules in force when the application was accepted for vetting. Application and any refreshed application received after this date will be subject to the GEM Listing Rules that are in force on the respective date of listing. These transitional arrangements for new listing applications will not affect continuing obligations and other aspects of the revised GEM Listing Rules, which will become effective immediately on the implementation date save for the grace period of three years from that date to secure compliance with the revised public float obligations.

PART A: INTRODUCTION

1. The Exchange commenced its review of GEM in 2005 after its launch in November 1999, beginning with informal interviews with market participants.
2. In January 2006, the Exchange published a Discussion Paper (Discussion Paper) setting out, for discussion and comment, three different structural options for further development of The Growth Enterprise Market (GEM). As a result of this exercise, the view was taken by the Exchange in consultation with the Securities and Futures Commission (SFC) that the proper way forward is to reposition GEM as a second board, under which GEM would largely retain its existing structure and would be positioned as a stepping stone towards the Main Board.
3. In July 2007, the Exchange published a consultation paper on GEM (Consultation Paper) in which were set out a number of proposed changes to the Rules Governing the Listing of Securities on GEM (the GEM Listing Rules), in order to implement the plans. Over a consultation period of three months, seven responses were received from the market (and four more arrived after the formal consultation closing date of 31 October 2007).
4. The responses received show that some areas of our proposals have attracted slightly more discussion. This report summarises the main points made by the respondents and sets out the Exchange's conclusions and proposed details of their implementation. This report should be read in conjunction with the Consultation Paper.
5. We would like to take this opportunity to thank all those who have shared their views with us during the consultation process.

PART B: OVERVIEW OF MARKET RESPONSE

The respondents

6. In total, 11 sets of submissions (representing the views of 14 persons and entities) were received and the respondents can be grouped into broad categories as follows:

Category	No. of respondents
GEM-listed companies	2
Corporate finance and advisory firms	5 (4 represented by a law firm and 1 in its own name)
Professional organisations	3
Accounting firms	2
Private individuals	2

7. A list of the respondents is provided in Appendix I. The full text of their submissions is available on the HKEx website at http://www.hkex.com.hk/consul/response/GEMcp_r.htm for public reference.

Overview of response

8. We have received positive responses on a number of our proposals while other proposals have triggered more active debate. Five out of 11 submissions expressed preference for an alternative market model for GEM's further development. Of the five submissions, three indicated their favour of London's Alternative Investment Market (AIM) model proposals outlined in the Discussion Paper. In view of the rationale behind the decision not to proceed with the AIM model at this stage in time, which has been fully set out in the Consultation Paper, the ground will not be covered again in this paper.
9. Different views were expressed over practically each one of the proposals in the categories of admission, continuing obligations and transfer to the Main Board. Most of these tend to be in the nature of fine-tuning. There is no dominantly negative response that would lead us to conclude that any of the proposed reforms is so inherently problematic as to merit outright disposal.
10. The responses received have left us with the overall impression that the proposals outlined in the Consultation Paper are in the right direction in terms of providing a blueprint that fits market reality. In particular, the following principles have met with more positive than negative market support:

A. Admission

- new admission requirements for GEM largely in line with Main Board but less stringent
- delegation of listing approval powers to Listing Division
- streamlining the admission process

B. Continuing obligations

- bringing into line GEM and Main Board continuing obligations
- immediate compliance, with grace period for public float

C. Transfer of listing

- streamlining of transfer process from GEM to the Main Board

11. Although the above principles have been received positively, some respondents have given alternative views in relation to the general direction of reforms. For example, one of the respondents expresses reservations whether the proposed reforms in themselves are sufficient to re-activate interest in GEM as a market, and goes on to suggest that more important are developing and promoting GEM's own brand and image and establishing a more robust regulatory regime. That respondent also warns against the danger of GEM aligning itself too closely to the Main Board (and therefore potentially competing with it).
12. It is not viable to accommodate all ideas, but in arriving at our conclusions, we have considered each and every suggestion with diligence and have deliberated before adopting (or not adopting) each. We have decided to adopt the reforms substantially as proposed in the Consultation Paper in view of the broad market support shown, with some fine-tuning, clarifications and minor modifications in response to certain suggestions received.

PART C: PROPOSALS ADOPTED AND DISCUSSION OF SPECIFIC RESPONSES

13. Set out below are the reform proposals and our decision to adopt (with or without modifications) or not adopt each of them, as the case may be. We also discuss in this section some specific comments received which may be of interest to the market, and our views in respect of them. The table in the Appendix II gives a quick summary of this information.

A. Admission (Consultation Questions 1-3)

14. The Exchange has proposed four new quantitative admission requirements:
- positive cash flow from operating profits before changes in working capital and taxes paid of not less than HK\$20 million in aggregate for two preceding financial years
 - market capitalisation of not less than HK\$100 million
 - minimum public float of at least 25% of total issued share capital (subject to adjustment to between 15% and 25% in the case of listing applicants with a market capital of more than HK\$10 billion), and an expected market capitalisation in public hands of HK\$30 million at the time of listing
 - minimum shareholder spread of 100 public shareholders and not more than 50% owned by the three largest public shareholders
15. Three respondents disagree with imposing any quantitative admission requirements. In response to this, we believe that imposing quantitative requirements for new GEM listings is appropriate. A major purpose of the reforms on entry requirements is to reduce the current level of uncertainty in determining whether any given company has a “business of both substance and potential”. We believe the solution to this problem calls for objective, and easy-to-apply principles that would allow the Listing Division to assess eligibility quickly and consistently.
- (i) Cash flow requirement
16. The cash flow requirement comprises two limbs: (1) a two-year trading record period and (2) an operating cash flow of HK\$20 million generated during that period. It follows that, if a company has been in operation for less than two years, the listing requirement will not be satisfied even if during that period the requisite level of cash flow has been generated.
17. In relation to the positive operating cash flow requirement, six respondents welcome it as a less subjective measure than the current “active business pursuits” requirement while four respondents have reservations against it. Amongst the four dissenting respondents, one casts doubt on the cash flow requirement as “arbitrary” and prefers leaving it to the market to judge whether a GEM applicant has a “business of both substance and potential”. Another believes it is not right to have an arbitrary bright-line test for cash flow irrespective of the type of business, industry cycles, prospects and growth potential, etc.

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18. The Exchange believes it is appropriate as cash flow is a good indicator of business viability as compared to, for example, the profit and revenue tests for Main Board companies. As an accounting concept its meaning is clear and confusion in practice can be kept to a minimum. It is also more difficult to be manoeuvred than net profit.
 19. The Exchange believes the proposed level is justifiable, as statistics in respect of 18 GEM listing applicants during the three years from 2005 to 2007 reveal that 16 would have met the proposed \$20 million cash flow requirement.
 20. Under Hong Kong Accounting Standards, reporting of cash flow may be by the Direct Method or Indirect Method. The Exchange will not prescribe either of these but will request that the applicant should submit the Indirect Method cash flow statement to the Exchange, and to disclose the statement in the prospectus (if not already forming part of the accountants' report).
 21. ***Consultation conclusion: the Exchange will adopt the proposed \$20 million operating cash flow requirement based on a two-year trading record requirement.***

(ii) Market capitalisation

22. The Exchange proposed, as a new GEM entry requirement, a market capitalisation of at least \$100 million. There are seven supporting and three dissenting responses. As the \$100 million threshold is just half of the \$200 million requirement for the Main Board, we believe it is appropriate and reasonable. As the high minimum cost for a listing makes it uneconomical for very small companies, companies seeking a listing would tend to have reached a certain size level and maturity. In view of the majority support and the rationale of our proposal, we believe that the proposed level is appropriate.
23. ***Consultation conclusion: the Exchange will adopt the proposed requirement for a market capitalisation of at least \$100 million.***

(iii) Public float

24. The Exchange also proposed, as a new GEM entry requirement, a public float of \$30 million and 25% (or between 15 % and 25% if the issuer has a market capitalisation of more than \$10 billion). One respondent agrees with the formulation except the \$30 million minimum value. Apart from this, there are six consenting and three dissenting submissions. Of the dissenting views, one believes this should be left for the market to determine and another objects to it as a quantitative requirement.
25. The Exchange believes that the proposed formulation is justifiable. Apart from \$30 million being a reduced figure from \$50 million for the Main Board, this formulation exactly reflects the Main Board rule which accords with our general aim of gradually bringing the two sets of listing rules into convergence.
26. In relation to PRC companies, the Exchange will follow the Main Board Listing Rules approach. After the amendments, listing applicants incorporated in the PRC will be given the same treatment as other companies for the purposes of the public float requirement.
27. ***Consultation conclusion: the Exchange will adopt the public float requirement as proposed.***

(iv) Shareholder spread

28. The Exchange proposed as a new GEM admission requirement the following shareholder spread: (1) minimum 100 public shareholders and (2) not more than 50% of the securities in public hands can be owned by the three largest public shareholders. This is a more permissive formulation than the current requirements, which mandate a minimum of 100 shareholders (not being employees) or, where the company has a 12-month history of active business pursuits, a minimum of 300 shareholders with the largest five and 25 holding not more than 35% or 50% respectively of securities in public hands.
29. Of the eight submissions which addressed this question, five are in support and three in opposition. All three dissenting respondents believe that the question is best left to the market.
30. The Exchange believes it is not appropriate, given our general policy of enhancing admission standards and providing liquidity, that the question of shareholder spread be left open. It is more appropriate to devise an articulated standard which also provides a measure of flexibility. In view of this, as well as the majority support shown by the respondents, the Exchange believes its original proposal is appropriate.
- 31. *Consultation conclusion: the Exchange will adopt the proposal for shareholder spread.***

(v) Focused line of business

32. The Exchange has proposed removing the requirement for a focused line of business. There is no dissenting opinion amongst the market responses received.
- 33. *Consultation conclusion: the Exchange will adopt the proposal for removing the requirement for a focused line of business.***

(vi) Management continuity

34. The Exchange has proposed management continuity for the latest two financial years, which is one year less than the equivalent Main Board requirement. Seven of the responses agree with this proposal, three disagree. The Exchange is of the view that management continuity is an important requirement and should be taken forward, as it would be important for investors to know that substantially the same group of individuals have been responsible for achieving the company's trading record (under the proposals, this would mainly mean the two-year operating cash flow). Given the broad support received and our rationale, we believe the proposed requirement is appropriate. We will also clarify that continuity is required until the date of listing to avoid any misunderstanding that the obligation only applies to the two financial year track record period.
- 35. *Consultation conclusion: the Exchange will adopt the proposal of management continuity for two years.***

(vii) Ownership continuity

36. The Exchange has proposed ownership continuity and control for the most recent financial year, which is identical to the Main Board requirement. There is only one dissenting opinion which is based on the principle of "letting the market judge". The Exchange is of the view that ownership continuity for one year is an acceptable proposal given the degree of market support shown, and its consistency with the equivalent Main Board provision. We will also clarify that continuity is required until the date of listing to avoid any misunderstanding that the obligation only applies to the most recent financial year.

37. Consultation conclusion: the Exchange will adopt the proposal of ownership continuity for one year.

(viii) Sponsor and compliance adviser

38. The Exchange proposed to retain the requirement for a sponsor, which has received support from all of the eight responses that address this question and there is no dissenting opinion. The Exchange also proposed maintaining the requirement for engaging a compliance adviser for a minimum of two years after listing.

39. The Exchange has received two responses that suggest reducing this to one year. The Exchange believes maintaining the current two-year requirement for compliance adviser will add value to listed companies' compliance process. We do not intend to shorten the period of engagement at this stage.

40. Consultation conclusion: the Exchange will retain the requirement for a sponsor and the two-year requirement for a compliance adviser.

(ix) Listing Division approval and a streamlined admission process

41. The Exchange proposed that the power to approve GEM listings should be delegated by the Listing Committee to the Listing Division. Out of ten responses which address this proposal, seven are in support and three are opposed to it. Of the dissenting views, one respondent emphasises that the same level of protection should be accorded to investors irrespective of the platform on which a company's shares are listed; another expresses concerns about the loss of independent checks and balances afforded by the Listing Committee approval process; and a third is of the view that the current arrangements seem appropriate and sees no benefit in changing. Another respondent, though generally in agreement with the proposed delegation of powers, observes that the Listing Committee should act as a gatekeeper.

42. Delegation of approval powers by definition means removing the high-level scrutiny by the Listing Committee. However, from an investor protection perspective, there is not necessarily any deterioration as the Listing Division is staffed by professionally qualified and experienced regulatory personnel. This is also in line with international practice in major markets where listing approvals are granted by full-time regulatory professionals. The Listing Division, working closely with the Listing Committee and being guided by it (especially in terms of overall policy), will be well-equipped to ensure continuation of the current market protection standards. Furthermore, the review procedures against the Listing Division's decisions as well as the appeal mechanism against the Listing Committee's decisions will not be affected, so the risk of compromising any standards will in practice be minimal. Pitched against the perceived compromise in regulatory standards are the savings in time and administrative workload which a Listing Division approval process may be expected to achieve.

43. Seven respondents support the proposal to streamline the new admission process. Five respondents suggest there should be time predictability, or setting a reasonable response timeframe, for the GEM listing approval process. Other comments include: more constructive advice and guidance from the Listing Division, that the Listing Division has suitably trained personnel, elimination of fax communication, and the question whether SFC would be consulted on a listing.

44. These comments have been noted. Some have already been taken into account when devising the internal rules and practices for the Listing Division to handle GEM listing approvals. The Exchange's proposals will not alter the Securities and Futures (Stock Market Listing) Rules, nor change the review and appeal procedures under the current listing rules.

45. ***Consultation conclusion: the Exchange will adopt the proposal of delegating approval power of GEM listing applications to the Listing Division.***

(x) Lock-up period

46. The Exchange proposed to replace the current GEM lock-up provisions on initial management shareholders and significant shareholders by adopting the current Main Board lock-up provisions, namely a six-month ban on share sales by controlling shareholders (with disclosure obligations for pledges and charges), and an additional ban on cessation of control in the subsequent six months. This is generally received by the market without objection.

47. Under the new rules, the lock-up provisions of GEM will be aligned with the Main Board. The escrow arrangements, the "excluded securities" and "relevant securities" concepts currently under the GEM lock-up provisions will be removed.

48. ***Consultation conclusion: the Exchange will adopt the proposed lock-up provisions which reflect the Main Board position.***

(xi) Free choice of offering mechanism

49. There is general agreement to this proposal. One respondent suggests listing by way of placing should be disallowed if there is significant public demand, same as Main Board. Under Main Board Rule 7.10, the Exchange may not permit a new applicant to be listed by way of a placing if there is likely to be significant public demand for the securities. There is no similar requirement for GEM.

50. Given that companies listed on GEM will tend to be of a smaller size that attracts relatively less publicity in their initial public offerings, we believe the question of public demand is unlikely to be a major concern in practice. On balance, the Exchange believes it is more appropriate to maintain free choice of offering mechanism.

51. ***Consultation conclusion: the Exchange will adopt the proposal of free choice of offering mechanism.***

B. Continuing obligations (Consultation Questions 4-5)

52. The proposal involves only three notable changes to the continuing obligations on GEM: reducing the bar on fundamental changes in business activity from two years to one year, relaxing the requirements for sufficient operations to align with that of the Main Board, and more stringent public float requirements to align with that of the Main Board. However, some of the responses we received also address other parts of the proposed continuing obligations regime. Set out below are the Exchange's response to some of these comments.

(i) Bar on change of business activity

53. The Exchange proposed reducing the current two-year bar on change of business activity (unless waived by the Stock Exchange or approved by independent shareholders) to one year. One respondent suggests maintaining the current two-year requirement while another

proposed removing the bar altogether. No specific reasons were given in support of these comments. On balance the Exchange believes the original proposal should be adopted.

54. Consultation conclusion: the Exchange will adopt the proposal for a bar on change of business activity before the expiry of one financial year after dealings in the relevant issuer's securities have commenced on GEM, unless waived by the Exchange or approved by independent shareholders.

(ii) Spin-off

55. The Exchange proposed incorporating for GEM the Main Board spin-off requirement of separate listing of assets/businesses of the existing group. There was no dissenting response from the market.

56. The said principle is derived from Practice Note 15 of the Main Board Listing Rules. To implement the spin-off requirements for GEM, a new practice note will be created for the GEM Listing Rules substantially based on Practice Note 15 (with the only significant departure being the removal of Main Board trading record requirements to reflect the positive cash flow requirement for GEM companies listed under the new regime). As a consequential change, requirements have been put in place for independent financial advisers and independent board committee in a GEM spin-off.

57. In a spin-off by a company that has recently transferred from GEM to the Main Board, the three-year waiting period (currently in paragraph 3(b) of Practice Note 15) will commence on the date of listing on GEM, as opposed to the listing on Main Board. Practice Note 15 will be amended to reflect this.

58. Consultation conclusion: the Exchange will adopt the proposal for incorporating the Main Board spin-off requirements for GEM, by the creation of a GEM practice note that is closely based on Practice Note 15 of the Main Board Listing Rules. For companies that have transferred to the Main Board from GEM, the three-year waiting period for Practice Note 15 will commence on the date of the GEM listing.

(iii) Sufficiency of operations and tangible/intangible assets

59. Paragraph 95 of the Consultation Paper says this area of GEM continuing obligations will remain unchanged, whilst the table in paragraph 96 says the proposal is to import the Main Board rule to GEM. For clarification, the Exchange's proposal is to bring the GEM rule in line with Main Board. The following table compares the two current requirements:

GEM Listing Rule	Main Board Listing Rule
Sufficiency of operations 17.26 An issuer must, at all time, carry out, directly or indirectly, a sufficient level of operations to warrant the continued listing of the issuer's securities.	Sufficient operations 13.24 An issuer shall carry out, directly or indirectly, a sufficient level of operations or have tangible assets of sufficient value and/or intangible assets for which a sufficient potential value can be demonstrated to the Exchange to warrant the continued listing of the issuer's securities.

60. Currently, the Main Board Rule 13.24 sufficiency of operations requirement expressly allows an alternative of “tangible assets of sufficient value and/or intangible assets for which a sufficient potential value can be demonstrated”. The equivalent provision in GEM Rule 17.26 does not provide for this alternative. The Exchange’s proposal in paragraph 96 of the Consultation Paper is to bring the GEM Rule in line with the Main Board, which amounts effectively to a relaxation of the former. There are no opposing views in the market responses received.

61. *Consultation conclusion: the Exchange will amend GEM Listing Rule 17.26 to harmonize it with Main Board Listing Rule 13.24.*

(iv) Public float requirement

62. The Exchange proposed aligning the public float requirement as a continuing obligation on GEM with that on the Main Board, i.e. 25% of total issued share capital, or between 15% and 25% of total issued share capital for companies with market capitalisation greater than HK\$10 billion.

63. As described in paragraph 24, six respondents are in support of aligning the GEM public float requirement with that of the Main Board. There were three dissenting views.

64. Given the market support shown, the Exchange believes the general policy of aligning GEM and Main Board Listing Rules is reasonable.

65. *Consultation conclusion: the Exchange will adopt the proposal for the public float requirement as a continuing obligation.*

(v) Independent non-executive directors (INEDs) and other corporate governance requirements

66. The Exchange proposed that the number of INEDs should be maintained at the current level of three. One respondent suggests one instead. From our reading of the submission we believe this counterproposal is again based on a desire to reduce the stringency of the GEM Listing Rules and associated costs. As it is accepted that the GEM continuing obligations should gradually be brought in line with the Main Board, the Exchange does not agree with this counterproposal and maintain our position that the current requirement for three INEDs is appropriate.

67. For the same reason, the Exchange does not agree with one respondent’s view that the requirements for mandatory board committee(s) should be removed.

68. *Consultation conclusion: the Exchange will adopt the proposal of maintaining as before three INEDs and other corporate governance requirements.*

(vi) Annual and half-year reporting of achievement of business objectives

69. The Exchange proposed a new requirement that a GEM company should report on its achievement of business objectives in the first two of its annual reports after listing. One respondent suggests covering this in half-year financial reports as well, for providing more up-to-date information to investors and better transparency. The Exchange concurs with the principle underlying this proposal and deliberated on whether this requirement should be extended to cover half-year financial reports. The Exchange considers it appropriate and reasonable to adopt this suggestion.

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70. The following will be the main disclosure requirements:
- (a) a balanced and concise analysis of the level of achievement;
 - (b) quantitative as well as qualitative analysis based on financial and non-financial information; and
 - (c) a description of the principal risks and uncertainties, and commentary on the directors' approach to them.
71. In addition, the rules will give guidance (not amounting to mandatory provisions) on the information expected. This would include:
- (a) significant developments by key business segments;
 - (b) trends, internal and external environmental and industry factors affecting performance or achievement of business objectives;
 - (c) principal risks and uncertainties (including strategic, operating and financial risks); and
 - (d) key performance indicators.

The rules will give some examples of key performance indicators and specify that issuers should determine and state their own indicators. Issuers are encouraged to use a comparative table for disclosure of achievement of business objective.

72. The requirement for periodic disclosure of achievement of business objectives is referenced to the objectives as stated in the listing document at the time of listing. As a consequential change, the relevant prospectus disclosure requirement will have to be expanded so there will be consistency and comparability.
73. ***Consultation conclusion: the Exchange will adopt the proposal of requiring reporting business objectives achievement for first two years in the annual reports and extend it to half-year reports.***

(vii) Immediate compliance, with grace period for public float

74. The Exchange proposed requiring existing issuers on GEM to comply with the revised continuing obligations with immediate effect, except that in the case of the public float requirement they would be given a "grace period" of three years from the effective date of the new rules to comply.
75. The proposal on immediate compliance (except for the public float requirement) received no objection. One respondent suggests grandfathering for new rules compliance and special treatment status (being an informal label for close monitoring) for non-compliant existing GEM issuers. The Exchange is of the view that apart from the public float requirement (for which a grace period is proposed), grandfathering and special treatment would not be called for as the continuing obligations we have proposed are either (1) retention of the existing GEM provisions, or (2) closer alignment with the Main Board Listing Rules which are in effect same as or less demanding than the existing GEM Listing Rules (these include minimum public float, fundamental change in business activity and sufficiency of operations).

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76. Two submissions suggest a longer grace period for the public float requirement and another suggests dealing on a case-by-case basis with non-compliant issuers after the grace period. The dissenting respondents did not elaborate on their views.
77. The Exchange conducted a study earlier and discovered that approximately 72 companies listed on GEM (based on information as at 31 December 2006) would not be able to meet the public float requirement immediately, the Exchange therefore proposed that there should be a three-year grace period for compliance with this particular rule as this seems an adequate length of time to rectify the shortfall. The Exchange recognises that previous amendments to both Main Board and GEM Listing Rules involved grandfathering of pre-existing public float requirements, but concluded that enhancing the quality of GEM in its entirety without exception is essential for the greater benefit of all GEM issuers and investors alike.
78. ***Consultation conclusion: the Exchange will adopt the proposal of requiring immediate compliance of any new rules once implemented, with a three-year grace period for complying with the public float requirement.***

(viii) Other continuing obligations

79. Paragraphs 94 and 95 of the Consultation Paper summarise other continuing obligation provisions to which no change has been proposed. These include periodical financial reporting, requirements for compliance officer and compliance adviser, disclosure of price-sensitive information and corporate governance requirements. The Exchange has not received any dissenting views from the market in this regard.
80. ***Consultation Conclusion: The position summarised in paragraphs 94 and 95 of the Consultation Paper in relation to other continuing obligations (subject to the clarification stated in paragraph 73 of this paper) will be adopted.***

C. Transfer of listing (Consultation Question 6)

(i) Market capitalisation and public float requirements for transfer

81. The Exchange proposed a streamlined process for transfer of companies from GEM to the Main Board. The proposal was favourably received by the market. One pre-requisite for such transfer is that the applicant meets the Main Board quantitative listing requirements. One respondent suggests deleting the market capitalisation and public float requirements. The Exchange notes in particular the views of one respondent that a GEM company may be unable to meet the Main Board \$200 million market capitalisation and \$50 million public float dollar requirement whilst it remains listed on GEM, simply because of the lack of institutional investors in GEM companies in general.
82. Although removing market capitalisation and public float requirements would simplify the transfer process and result in more GEM companies being able to migrate to the Main Board, we believe this would necessarily mean undue relaxation of Main Board entry requirement and unfairness in treatment between Main Board transfer applicants and new listing applicants. If these requirements for a transfer were removed, some GEM companies would be able to transfer to the Main Board even though they did not meet two of the basic requirements for a normal Main Board listing application, simply because they first obtained a GEM listing. We believe retaining these entry requirements for all Main Board companies (whether directly listed or transferred) is fair and reasonable.

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83. The Exchange will therefore maintain the normal Main Board market capitalisation and public float requirements. A number of Main Board listing requirements, however, will cease to apply in the case of a transfer from GEM to the Main Board. These include the normal listing procedures and listing document (see paragraph 98 below), engagement of a sponsor (see paragraph 86 below), engagement of a compliance adviser and the provision for six-month validity for the accountants' report in a normal listing application.
84. ***Consultation conclusion: the Exchange will adopt the proposal for a streamlined transfer process. The Exchange will not amend the normal Main Board market capitalisation and public float requirements specifically for transfers of listings from GEM.***
- (ii) Independent financial adviser
85. Five submissions suggest accepting directors' assurance of shareholder spread and fulfilment of other relevant admission criteria. This will significantly reduce the work (and hence the cost) for having a third party professional engaged to carry out relevant investigations. It is also suggested that the Listing Division should already be satisfied with the integrity and competence of the directors of a GEM listed company. One other respondent pointed out that the financial adviser is unable to add value because for its confirmation it has to rely on the investigation carried out by the board. In view of the support shown for this suggestion and its effect of significantly streamlining the transfer process, the Exchange will rely solely on directors' assurance rather than requiring confirmation from a financial adviser.
86. ***Consultation conclusion: the Exchange will adopt the requirement for transfer applicants from GEM to meet Main Board admission criteria, but will not require the appointment of a financial advisor or sponsor.***
- (iii) Requirement for two years' listing on GEM and "no material rule breaches"
87. For a transfer of listing from GEM to the Main Board using the streamlined process, we proposed that the company should have been listed on GEM for at least two years. We also proposed that within these two years the company should not have committed any material breach of the listing rules. Out of a total of 10 submissions that addressed this question, four considered this requirement unnecessary.
88. One respondent articulates its objection in the following terms: Imposing a two-year listing and good behaviour record requirement would "penalise" a GEM company which, for example, meets all the Main Board entry requirements but has not been listed on GEM for two years. Such a company will have to wait for one more year to get listed on the Main Board if it is first listed on GEM (which requires a two-year track record); if in fact it is able to satisfy Main Board listing requirements with a three-year track record after waiting for a year.
89. The Exchange has considered this submission and agrees with the rationale behind it. It was not our intended policy to set up an artificial barrier to make it more difficult for issuers preferring to use the second board as a relatively short-term stepping-stone towards reaching the Main Board as its ultimate aim, vis-à-vis those opting for a direct route to the Main Board. If the original proposal of a two-year waiting period on the GEM is maintained, in effect the total period under assessment and scrutiny would be four years, given that the new admission criteria requires two years of operating cash flow plus another two years' listing status.
90. The Exchange therefore concurs with the underlying arguments of the respondents to reduce the waiting period from two years to one year, rendering the total period of financial scrutiny and regulatory assessment three years in total – that is, two years before the GEM listing and
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one year post-listing. This total period of approximately three years would also accord with the trading record period requirements of the Main Board.

91. Part and parcel of the waiting period is the “good behaviour record period”. In consequence of reducing the former from two years to one year, we will also reduce the latter from two years to one year. As disciplinary proceedings often take time to reach a conclusion, we will phrase this requirement broadly so that if a GEM issuer becomes the subject of disciplinary investigations for serious breach of rules (including serious potential breaches) within the 12 months preceding its application for transfer to the Main Board, the Exchange has the discretion to put the application on hold while the investigation is in progress. “Serious breach” is a commonly used concept in the Exchange’s enforcement activities. Examples of factors to be taken into consideration when determining whether a breach is serious or not are discussed in the article titled “The Stock Exchange’s Strategy for Enforcing the Listing Rules” published in the October 2004 issue of the newsletter “Exchange”.

92. ***Consultation conclusion: the Exchange will adopt the proposal for a history of listing on GEM but will modify the relevant period from two calendar years to the period until it has published its annual accounts for the first full financial year since its listing. We will also require, as a prerequisite for transfer of listing, that the applicant is not under disciplinary investigations by the Exchange for serious rule breaches or potential serious rule breaches during the preceding 12 months.***

(iv) Independence and competition

93. Under the current GEM Listing Rules, companies that are listed on GEM did not have to demonstrate at the time of listing their independence from controlling shareholders. Upon transfer to the Main Board, the independence requirement in paragraph 27A of Appendix 1A will be triggered. This approach was endorsed in a Listing Decision and will continue to apply under the revised rules for transfers of listing.

94. To ensure there is no lowering of standards for transfers to the Main Board, a transfer applicant will have to comply with the stepped-up requirements (including the more extensive disclosure requirements) under Main Board Listing Rule 8.10 in relation to competing businesses of a controlling shareholder or director. Such disclosure has to be included in a long-form announcement or circular (if applicable) to be issued by the applicant.

(v) Shareholders’ approval

95. A respondent suggests that a transfer of listing should be subject to shareholders’ approval. We are mindful of the additional time and costs this will entail. Also, given that the continuing obligations of listing on the two boards are converging, it is difficult to envisage how a transfer of listing may give rise to different shareholder protection concerns that will merit a mandatory requirement for shareholders’ approval. We will not impose a requirement for shareholders’ approval.

96. ***Consultation conclusion: We will not require shareholders’ approval for an application for transfer of listing from GEM to the Main Board.***

(vi) Processing of transfer application by the Listing Division and approval by the Listing Committee

97. One respondent suggests that transfers of listing without fund-raising should be approved by the Listing Division without having to refer to the Listing Committee. We have reservations about adopting this suggestion at the moment. It has always been possible to obtain a listing

on the Main Board without fund-raising and, under the current regulatory framework, whether or not there is any public fund-raising at the time of listing have no direct bearing on whether approval powers can be delegated from the Listing Committee to the Listing Division. Indeed, it is possible for a company newly transferred to the Main Board to carry out a fund-raising exercise very soon afterwards. Further, while the listing approval power for GEM will be delegated to the Listing Division, the same authority for Main Board listing continues to rest with the Listing Committee for the time being, hence it is not appropriate to create a dichotomy by delegating approval power to the Division for a certain type of Main Board listing approval.

98. The proposed formulation for a transfer of listing from GEM to the Main Board is for the Listing Division to process and administer the application, with the Listing Committee giving final approval. The streamlined process will take the form of announcement(s) with supporting documentation (including the listing application form, directors' declarations and undertakings, etc.). As far as possible, the application will be considered on the basis of publicly available information and the compliance record of the applicant throughout the time of its listing on GEM.
99. To start the listing transfer application process, the applicant will submit a bundle of documents to the Listing Division. These will include the following minimum content:
- (a) a formal application for listing (in a new standard form which is closely based on the existing Form C1 for Main Board listings);
 - (b) a new Main Board standard form declaration (confirming compliance with all applicable listing requirements) signed by every director and supervisor;
 - (c) a prescribed checklist (in aid of checking the applicable listing requirements) signed by every director and supervisor;
 - (d) an advanced draft public announcement of the transfer;
 - (e) the initial listing fee (at 50% discount to the normal Main Board listing fee);
 - (f) directors' Form B (in the case of PRC issuers, Form H) and supervisors' Form I declarations under Main Board Listing Rules;
 - (g) copies of relevant corporate or regulatory approvals (if any); and
 - (h) working capital sufficiency statement for the next 12 months.
100. On the same day, the applicant will be required under the GEM Listing Rules to publish a short announcement informing the public of the application. This is not expected to contain substantial details and no content requirements will be included in the rules.
101. When the application is being considered by the Exchange, the applicant may be requested to supply additional information. There will be a continuous monitoring process to ensure the applicable Main Board listing requirements are met up to and at the time of listing. The listing will be approved by the Main Board Listing Committee under a streamlined process; and shortly after approval has been obtained, the long-form announcement (a draft of which must have been pre-vetted by the Exchange) must be published complying with the content requirements imposed under the rules. This long-form announcement must contain at least the following information:

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- (a) a prescribed form Exchange disclaimer;
 - (b) directors' responsibility statement;
 - (c) confirmation of fulfilment of all pre-conditions to transfer of listing;
 - (d) reasons for the transfer of listing;
 - (e) a statement that the following documents are available for public inspection on HKEx's website and the applicant's own website: the director's report and annual accounts for the latest financial year, latest half-yearly (or summary thereof) or quarterly report, constitutional documents, any prospectuses and circulars issued in the preceding year, and announcements and other corporate communications as required by the Listing Rules;
 - (f) a statement that approval has been granted by the Exchange for the issuer's securities to be listed on the Main Board and de-listed from GEM, together with the date on which dealings will commence on the Main Board and terminate on GEM;
 - (g) the company's stock codes on GEM and the Main Board;
 - (h) a statement on CCASS eligibility;
 - (i) a statement of any listing of options, warrants etc, that will be transferred together with the underlying securities;
 - (j) information on any competing or potentially competing business of a controlling shareholder or director of the applicant (being the same level of disclosure as that required for a normal Main Board IPO applicant);
 - (k) the names of the directors; and
 - (l) any other information as required by the Exchange.

102. Consultation conclusion: We will adopt the proposal for transfer applications to be processed by the Listing Division and approved by the Listing Committee.

(vii) Main Board rules exemptions for transfers

103. We proposed that companies that have successfully transferred from GEM to the Main Board should be exempt from the following restrictions applying to Main Board listing applicants:

- the ban on new share issues within 6 months of listing;
- the ban on fundamental changes in principal business activities within one year of listing;
- the ban on the controlling shareholder selling its shares within six months of listing (and requirement to disclose any pledges of charges of shares within 12 months of listing); and
- the ban on changes in control during the subsequent six months.

104. None of the respondents has made a comment in relation to this proposal.

105. Consultation conclusion: We will adopt the proposed relaxations from lock-up requirements for companies successfully transferred from GEM to the Main Board.

(viii) Transfers of infrastructure, mineral and investment companies

106. For the Main Board, there is a specific regime for listing infrastructure, mineral or investment companies. For these companies some listing criteria may be relaxed (e.g. a shorter trading record period can be accepted), whilst additional requirements are imposed for disclosure and technical reporting. For listed issuers on GEM, GEM Rule 11.14 contains limited exemptions (shorter trading record – currently period of active business pursuit) for infrastructure and mineral companies. There are no requirements for GEM listing applicants to make additional disclosure in their listing document, comply with industry-specific listing criteria, or commission any expert reports.

107. Infrastructure, mineral and investment companies must generally comply with the relevant requirements of Main Board Rule 8.05B(2) or Chapter 18 or 21 upon application for transfer to the Main Board. The Exchange will require such companies to comply with (a) all the applicable listing qualifications and (b) all the disclosure requirements relevant to these companies under the said provisions.

108. In terms of disclosure, the Exchange will require the applicant to issue a circular containing all relevant information (including any report or statement required normally required to be made by professional adviser(s) in a listing document), with such modifications as the Exchange may determine. The circular must be available online and in hard copy form and be distributed to its shareholders in the same way as an annual report or other corporate disclosure documents.

(ix) Transfers of options, warrants and similar rights

109. Both GEM and Main Board Listing Rules provide that the Exchange will normally apply the same listing requirements for warrants as underlying securities.

110. Normally, listing of warrants on GEM will be automatically transferred if the underlying securities are transferred (but not vice versa). Where this causes practical difficulties, the Exchange will have discretion to allow the warrants to remain listed on GEM until expiry.

(x) Waivers and shareholders approval already obtained

111. Where a successful transferee has obtained a waiver or approval from shareholders under GEM Listing Rules, such as under Chapters 17 (continuing obligations) or 19 (transactions) previously, certain of these continuing obligations may not need to be re-complied with. Where the Exchange is satisfied that there has been no change in the facts and circumstances as when such waivers were first granted, full re-compliance with the equivalent provisions under the Main Board Listing Rules is not necessary. *(Note: The 3-year grace period for compliance with the minimum public float requirement as described under paragraph 74 to 77 above is not regarded as a waiver.)*

(xi) Refund of GEM annual listing fee and 50% discount of initial listing upon transfer

112. If an issuer transfers its listing from GEM to the Main Board during a term in respect of which the annual listing fee has been pre-paid, the portion pre-paid in respect of the remainder of the year in which the listing is transferred will be refunded. The amount to be refunded will be 1/12 of the total pre-payment for each full calendar month remaining in the 12-month period to which the pre-payment relates. Regardless of the day of the month on which the listing is transferred, the annual listing fee will not be refunded in respect of that month. Also, the initial listing fee for the Main Board will be at 50% discount.

D. Long-term amalgamation of GEM and Main Board Listing Rules and other comments (Consultation Questions 7-8)

113. We proposed a gradual approach to the unification of GEM and Main Board rules and practice. Proposed rule amendments to both boards arising from the unification exercise will be subject to public consultation.
114. Five respondents support this long-term direction. Two disagreed as they consider that GEM should be an alternative board. Two considered that merging the rules or not does not matter.
- 115. Consultation conclusion: We will adopt the proposal on gradual unification of GEM and Main Board Listing Rules.*

PART D: ADDITIONAL RULE AMENDMENTS

116. Subsequent to the public consultation process, three additional issues have arisen during the preparation of the rule amendments. The following are additional initiatives by the Exchange which were not set out in the Consultation Paper.

A. Independence

117. Under current Main Board Listing Rules, an applicant is implicitly required to demonstrate and disclose its ability to carry on its business independently of the controlling shareholder and its associates. The Main Board requirement is in paragraph 27A of Appendix 1A of the Main Board Listing Rules. This has not been replicated in the GEM Listing Rules in view of the difference in nature of prospective listing applicants for the Main Board and GEM.

118. Under the revised GEM regime, applicants are expected to be more mature. In the interest of further alignment between the Main Board and GEM Listing Rules, and as stated in broad terms in paragraph 101 of the Consultation Paper, the independence requirement will be reflected in GEM. The Exchange believes this will be an important step towards enhancement of corporate governance standards and reduction of conflicts of interest.

B. GEM characteristics statement

119. Currently, GEM Rule 2.20 requires any listing document, circular and periodic financial reports issued pursuant to the GEM Listing Rules to contain a standard statement on the characteristics of GEM. This includes a warning that GEM has been established as a market designed to accommodate potentially high investment risk companies, including those without a track record or profitability. Potential investors are also informed that the greater risk profile means GEM is a market more suited to professional and sophisticated investors.

120. As a result of the present exercise, GEM will be re-positioned as a second board for Hong Kong listings. The trading record requirements for listing will be quantified, some of the continuing obligations will be stepped up, and the GEM Listing Rules will be gradually aligned with the Main Board Listing Rules. In view of this, the Exchange has revised Main Board Rule 2.20 to remove the wording which reflected the original positioning of GEM at the time of its launch in 1999. Similar changes concerning the characteristics of GEM have also been made to Rules 2.12 and 2.13.

C. No longer required to give announcements and notices to gazetted newspapers for information purposes

121. Under GEM Rule 16.06, a GEM issuer is required, at the same time as any announcement or notice required under the GEM Listing Rules is submitted for publication on the GEM website, to send the announcement or notice in hard copy or electronic format, for information purposes, to all English language gazetted newspapers and all Chinese language gazetted newspapers.

122. There is no corresponding requirement in the Main Board Listing Rules.

123. Under the Electronic Disclosure Project and in particular with effect from 25 June 2008 (from which date every Main Board and GEM issuer will be required to have its own website for the purpose of publishing announcements, notices or other documents), the issuer's own website and websites operated by HKEx (i.e. hkex.com.hk, HKExnews.hk and, in the case of GEM

issuers, hkgem.com) are to be the principal source of regulatory information for investors with regard to issuers.

124. It should therefore no longer be necessary for a GEM issuer to provide gazetted newspapers with copies of its announcements or notices. Accordingly, the Exchange has revised GEM Rule 16.06 to remove this requirement.

PART E: IMPLEMENTATION AND TRANSITIONAL ARRANGEMENTS

125. The rule amendments have been finalised and approved by the Board of The Stock Exchange of Hong Kong Limited and the Securities and Futures Commission. The rule amendments will become effective on 1 July 2008.
126. For listing applicants submitting their application form for listing (Appendix 5A to GEM Listing Rules) on or before the date of publication of these Consultation Conclusions (2 May 2008), the listing qualifications and requirements under the existing GEM Listing Rules shall apply. For applicants submitting their application form after the date of publication of these Consultation Conclusions, the applicable listing qualifications and requirements shall be those that are in effect on the date of listing.
127. These transitional arrangements for new listing applications will not affect continuing obligations and other aspects of the revised GEM Listing Rules, which will become effective immediately on the implementation date save for the grace period of three years from that date to secure compliance with the revised public float obligations.
128. The finalised English rule amendments are available separately on HKEx's website. The finalised Chinese rule amendments will follow shortly.

APPENDIX I: LIST OF RESPONDENTS

GEM-listed companies

Tong Ren Tang Technologies Co. Ltd.
Glory Mark Hi-Tech (Holdings) Ltd

Corporate finance and advisory firms

Anglo Chinese Corporate Finance, Ltd
Quam Ltd
Sommerley Ltd
Tai Fook Capital Ltd
(the above represented by Charltons Solicitors & Notaries)
Deloitte & Touche Corporate Finance Ltd

Professional organizations

The Chamber of Hong Kong Listed Companies
Hong Kong Stockbrokers Association
Hong Kong Institute of Certified Public Accountants

Accounting firms

CCIF CPA Ltd
PricewaterhouseCoopers

Private individuals

趙大君先生
Mr. Robin Fox

APPENDIX II: SUMMARY OF PROPOSALS ADOPTED (WITH OR WITHOUT MODIFICATIONS)

Original Proposal	Listing Committee's Decision	Rule Reference
<i>Admission requirements</i>		
1. Adjusted cash flows from operating profits before changes in working capital and taxes paid of HK\$20m in aggregate for the preceding two financial years	Adopt	New GEM 11.12A
2. Market capitalisation of at least HK\$100m	Adopt	New GEM 11.23(6)
3. Public float of at least HK\$30m and 25% (or 15%-25% if the issuer has a market capitalisation of >HK\$10b, i.e. as for Main Board)	Adopt	New GEM 11.23(9)
4. Minimum 100 public shareholders, ≤50% owned by 3 largest public holders	Adopt	Old 11.23(2)(b) kept intact New GEM 11.23(8)
5. Drop the requirement for a focused line of business	Adopt	Old GEM 11.12 deleted
6. The latest two financial years under substantially the same management	Adopt	New GEM 11.12A(3)
7. Ownership continuity and control for the most recent financial year	Adopt	New GEM 11.12A(2)
8. Retaining the requirement for a sponsor	Adopt	Old GEM 6A.02 kept intact
9. Drop the existing requirements of lock-up periods on management/significant shareholders and replace with the same requirements of lock-up periods for controlling shareholders as for the Main Board	Adopt	Old GEM 13.16-13.17 repealed New GEM 13.16A
10. Free to decide the offer mechanism, underwriting is not compulsory	Adopt	No change – deleted GEM 11.12(3)(d) for minimum \$1 offer price
<i>Admission process</i>		
11. Delegation of listing approval authority from the Listing Committee to the Listing Division, with right of appeal to the Listing Committee	Adopt	GEM 3.05 amended GEM 3.37 keep intact

Original Proposal	Listing Committee's Decision	Rule Reference
<i>Continuing obligations</i>		
12. Existing financial reporting requirements remains unchanged	Adopt	No change
13. Existing information disclosure requirement remains unchanged	Adopt	No change
14. Existing other corporate governance requirements remains unchanged	Adopt	No change
15. Align the public float requirements as that for the Main Board, i.e. 25% of total issued share capital, or 15%-25% of total issued share capital for companies with market capitalisation > HK\$10b	Adopt, <i>subject to the outcome of the Main Board review of public float requirement</i>	Revised GEM 11.23(9) and (10)
16. Retain the requirement for a compliance adviser until after the dispatch of the annual report for the second full financial year after listing	Adopt	GEM 6A.19 kept intact
17. Reduce the 2-year bar on fundamental change in principal business activity to one year after listing	Adopt	Revised GEM 17.25 Revised GEM 19.88
18. Relax the requirement of sufficient operations to “sufficient operations or tangible assets or intangible assets”	Adopt, in line with Main Board and <i>clarify in the consultation conclusions</i>	Revised GEM 17.26
19. The requirement for pre-vetting of certain types of announcements remains unchanged	Adopt	No change
20. Require immediate compliance with the revised continuing obligations, with a grace period of 3 years for public float requirement	Adopt, <i>subject to the outcome of the Main Board review of public float requirement</i>	Immediate compliance implicit in effective date of rules New note 8 to GEM 11.23 Note to new GEM 17.38A
21. Require reporting of the achievement of business objectives in the first two annual reports after listing	Adopt and <i>extend the reporting to half-yearly reports</i>	New GEM 18.08A Revised GEM 14.19
<i>Requirements for a transfer to the Main Board</i>		
22. Meeting Main Board admission requirements	Adopt	New Main Board 9A.02(1)
23. Listing status on GEM for two years	Reduce the two-year requirement to <i>one year</i>	New Main Board 9A.02(2)

Original Proposal	Listing Committee's Decision	Rule Reference
24. No material rules breaches for two preceding years	Reduce to <i>one year and clarify in the rule amendments</i>	New Main Board 9A.02(3)
25. Exempt successful applicants from GEM to the Main Board from certain restrictions applying to new Main Board applicants — 6-month ban on new share issues, 1-year ban on fundamental changes in principal business activities, lock-up for controlling shareholders, 6-month ban on changes in control	Adopt	New Main Board 10.07(4) New Main Board 10.08(5) Revised Main Board 14.89
<i>Transfer process to the Main Board</i>		
26. No sponsor is required	Adopt	New Main Board 9A.03(2)
27. Require an announcement by the issuer, to be pre-vetted by the Listing Division and approved by the Listing Committee	Adopt, no shareholders' approval required	New Main Board 9A.08 Note to new GEM 9.26
28. Not require the confirmation by a financial adviser of information which are not already the subject of public disclosures, and rely on directors' assurance	Adopt	Checklist and Forms J & K do not require financial adviser's signature
<i>Merger of Listing Rules</i>		
29. Gradual unification of GEM and Main Board Listing Rules	Adopt	Ongoing process