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30 May 2006

Corporate Communications Department
Hong Kong Exchanges and Clearing Limited
12/F One International Finance Centre
Central
Hong Kong

Dear Sirs

Re: Discussion Paper on the Growth Enterprise Market

Following the IT bubble and the Asian financial crises, the regulatory regime for the GEM board has deviated significantly from its original construct more towards that of the main board. In a way with the quarterly financial reporting requirement, it looks even more stringent than the latter. The GEM board is now in limbo with few new listing applicants and limited liquidity. Prohibited by its high listing and maintenance costs and insufficient interest from the investors, the capital raising capability which is the single most important function of a capital market is lacking. No wonder the future of the GEM board is now called into question.

As quoted from a former member of the GEM Working Group which was charged with the responsibility of overseeing the establishment of the Board, the Board is meant to provide a capital raising platform for young, innovative and creative enterprises to grow their different models of business to become substantial listed companies. For all the good intention we all know that failing rate is bound to be high. That is why the market was originally intended to cater for institutional and professional investors. It was designed on the concept of a buyers' beware, disclosure-based, single line of business and flexible board. With the setting in of company failures, bubble and crises, participation of retail investors and the outcry of investor protection, the GEM board has been subjected to numerous bombardments and interventions from all directions including among others the regulators as well. It was a scene of too many cooks spoiled the broth. The GEM board is now listless and directionless with diminishing value and purpose and there is a high rate of deflection for performing companies to seek listing on the main board.

Having reviewed the pitfall of the GEM board, we do believe that we should still maintain an alternative board to cater for growth enterprises with diversified business models. However, in order to make it work, radical changes need to be introduced to return it to its former attraction. While our regulators have kept tightening up on rules governing our Growth Enterprise Market, the Alternate Investment Market, our counterpart in London has been working in the opposite direction providing a regime which is lightly regulated, easy-to-get-listed and placing greater reliance on nominated advisers on compliance of issuers. An important feature in the AIM regime is the permission of market making in order to create sustainable interest in listed issuers.

The AIM has now become the most successful market for growth enterprises thus far and a choice market for an increasing number of PRC companies. In order to revert the trend a new strategy

needs to be adopted for GEM to ensure that Hong Kong remains a market of choice not only for main board capital raising but for the GEM as well.

Question 1 : Is there a need for a growth company market in Hong Kong ?

We do feel a need for a growth enterprise market in Hong Kong. There are more than half a million SMEs in Hong Kong and over 7 million companies in the PRC. All local governments would like to see these fledgling companies groom into major enterprises to ensure continued economic growth. A more diversified capital market would definitely be most welcome by all concerned.

Question 2 : If so, should the market primarily serve local Hong Kong companies, or should it target Mainland-based companies or regional / international companies ?

We are of the view that the growth market should embrace companies of all jurisdictions and we believe the less restriction the better which is in alignment with our election as the world's freest economy. With the proposed change in our Companies Ordinance to encompass extra-territorial jurisdiction over foreign companies listed in the Hong Kong Stock Exchange, the regulatory concern over continuous compliance of Listing Rules by oversea listed companies would be removed.

Question 3 : At what stage of development should companies be admitted to the growth market – at start-up stage, or at a more mature stage ?

The current admission criteria of 2-year active business pursuit with no profit and assets requirement seem to be at too low a threshold which have contributed to a high rate of failures. In order to strike a right balance, we are inclined to support the introduction of minimum asset size and minimum revenue to prove that the business model is effective in generating a sustainable level of cash flow.

Question 4 : What should be the core investor group for the growth company market – retail, professional and / or institutional ? Should the growth company market be restricted to professional and institutional investors only ?

We believe that the GEM board should be a disclosure-based market catering to all investor groups. Whatever restrictions put in place to ring-fence it just to professional and institutional investors will be bound to fail in the long run.

Question 5 : Depending on your answers to the foregoing questions, what kind of regulatory regime would be appropriate for the growth company market ? In particular, should growth companies have low-cost access to public capital, or should they, because of their higher risk, be required to comply with procedures that dictate relatively higher costs than those for Main Board companies ?

The regulatory regime for the GEM should be one which is lightly regulated, disclosure-based, buyers' beware, caveat emptor and with enhanced responsibility placed on sponsors. The regime

should be modeled very much in similar direction as the AIM regime.

Needless to say GEM board companies should be afforded low-cost access to public capital and the regulators should not over burden themselves with GEM company failures and investor protection concerns. Afterall it would be very dangerous for regulators with or without intention to create moral hazards for the investing public.

Question 6 : Bearing in mind your responses to Q1 – Q5 above, please comment on the suitability of the following possible structural options for a growth company market in Hong Kong :

- (a) GEM as a second board
- (b) GEM and the Main Board to merge into a single board :
 - (i) universal single board – GEM and the Main Board to merge into a single board, with no distinction between them;
 - (ii) tiered single board – GEM and the Main Board to merge into a single board with the growth market forming the lower tier and the existing Main Board the upper tier. Further tiers might be introduced as well.
- (c) New alternative market – GEM to merge into the Main Board, and a new market with an enhanced regulatory regime to be launched for growth companies.
- (d) Others – do you have any other suggested structural options for GEM ?

We support option (c) meaning to establish a new alternative market which is lightly regulated with enhanced responsibility vested with the sponsors overseeing listing compliance of issuers so long as they remain listed on the Hong Kong Stock Exchange.

Question 7 : Based on your preferred structural option for GEM, do you have any specific views or recommendations concerning the following ?

- (a) the targeted issuers (eg type of business, stage of development) and investors (eg retail, professional, institutional)
- (b) the regulatory approach
- (c) the initial listing requirements and the listing process
- (d) the process of ongoing regulatory supervision
- (e) the disclosure and corporate governance requirements
- (f) the roles of sponsors and other professionals

Other than disclosure and corporate governance requirements, we are of the view that most of the issues raised in your questions has been addressed.

Since the GEM has all the time been designed as a disclosure-based market, we believe it should remain as such. We do not see any cost implication imposing additional company disclosures on the HKEx and the company's own websites. As for corporate governance requirements, these should largely be based on the provisions of the New Code of Corporate Governance introduced on 1st January 2005.

Question 8 : If you consider that there is no need for a growth company board in Hong Kong, what should be done with GEM and its existing issuers ?

We believe strongly that there is a need for a growth enterprise market in Hong Kong.

Question 9 : What, if anything, should be done with delisted companies ? Should there be a separate market for trading these companies ?

We do not see the necessity for such a market. We do not have a strong view against it either but would recommend a separate consultation if the market does call for such.

Question 10 : Do you have any suggestions to raise the profile of companies listed on the growth company board ?

We do not see the necessity to do anything to raise the profile of companies of the GEM board. With the right platform, appropriate regulatory requirements and business model, the investing public will recognize the value of these companies over time. Any untoward interventions to suit one's selfish desires will only kill the market in the long run.

Question 11 : Should more information be provided on growth companies ? If so, what information, and who should provide it ?

As a disclosure-based market, we welcome more information to be provided by the growth companies listed on the Exchange but these must be relevant information helping investors to make informed decision. For listing applicants the prospectuses should be more compact containing only useful information for the investors whether or not they will subscribe shares in these companies.

Question 12 : Should market making be permitted on the growth company board ? If so, what should be the obligations of and incentives provided to market makers ?

For growth-enterprises company, market making is definitely helpful in providing the necessary liquidity to nurture these companies into more substantial companies in the long term. The AIM model also allows market making. In order to let the market making mechanism take hold, it should be made voluntary at the beginning.

Best regards



Peter S H Wong
Chairman

Corporate Governance Policies Committee

cc Mr Herbert Hui / Council Members of HKIoD / Ms Carlye Tsui /
Corporate Governance Policies Committee Members of HKIoD