



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

8 November 2007

By fax (2524 0149) and by email (GEMconsultationpaper@hkex.com.hk)

Our Ref.: C/CFC, M52833

Corporate Communications Department
Re: Consultation Paper on GEM
Hong Kong Exchanges and Clearing Limited
12/F., One International Finance Centre
1 Harbour View Street, Central
Hong Kong

Dear Sirs,

Consultation Paper on the Growth Enterprise Market

The Hong Kong Institute of Certified Public Accountants has considered the above-referenced consultation paper, which puts forward proposals for further developing the Growth Enterprise Market ("the GEM") as a second board and positioning it as a stepping stone to the Main Board.

The Institute believes that the GEM is not attractive to investors and to companies, probably because there is relatively little trading activity on the GEM and, therefore, any proposals to re-activate interest in this market need to identify and address the underlying issues. In this regard, we have reservations as to whether the current proposals to introduce new quantitative requirements for listing on the GEM, and streamline the process and procedures for transfers of listings from the GEM to the Main Board, will be effective.

We would reiterate the view expressed in our 27 April 2006 submission to Hong Kong Exchanges and Clearing Ltd. ("HKEx"), in response to the 2006 consultation on the proposed way forward for the GEM. In principle, we would favour retaining the GEM as a second board, but not positioning it primarily as a stepping-stone to the Main Board. Instead, more effort and resources should be invested in developing and promoting the GEM's own brand/image and establishing a more robust regulatory regime.

Notwithstanding the fact that the approach proposed in the current consultation paper does not represent the Institute's preferred approach, on the basis that it is considered by the HKEx and the SFC to be the best way forward for the GEM, we have provided, in an Appendix to this letter, comments on the more detailed questions set out in the consultation paper.



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We hope you find our comments to be helpful. If you have any questions on this submission or wish to discuss it further, please do not hesitate to contact me at the Institute on [REDACTED].

Yours faithfully,

A handwritten signature in black ink, which appears to read 'Peter Tisman'. The signature is written in a cursive, flowing style.

Peter Tisman
Director, Specialist Practices
Hong Kong Institute of Certified Public Accountants

PMT/ML/ay
Encl.

**Comments from Hong Kong Institute of CPAs in response to the
Consultation Paper on the Growth Enterprise Market (GEM)**

Q1. Do you agree with, or have any suggested modifications to, the following proposed admission requirements for GEM:

On the basis that the GEM is to be positioned as a stepping-stone to the Main Board, in principle, the initial listing requirements for GEM should be aligned more closely to those of the Main Board to facilitate transfers.

(a) Positive operating cash flow from operating activities of HK\$20 million in aggregate for the latest two financial years?

Do not agree.

We believe that it is not right to have an arbitrary bright-line test for cash flow, irrespective of the type of business, industry cycles, prospects/growth potential or other characteristics pertaining to a particular business, to judge whether a company's business is viable or not. It is not necessary for the GEM to target companies with specific backgrounds or with a certain minimum cash flow, or prescribe any particular stage of development for a company to be admitted for listing on the GEM. We propose that any smaller companies with a suitable business with reasonable growth prospects should be allowed to list on the GEM and gain access to the capital market so as to raise funds for their business development and expansion.

(b) The latest two financial years under substantially the same management?

Agree.

(c) Market capitalisation of at least HK\$100 million?

Agree.

(d) Public float of at least HK\$30 million and 25% (or 15%-25% if the issuer has a market capitalization of more than HK\$10 billion)?

Agree.

(e) Ownership continuity and control for the most recent financial year?

Agree.

(f) A minimum of 100 public shareholders?

Agree.

(g) Retaining the present free choice on offering mechanism and underwriting?

Agree.

(h) Retaining the requirement for a sponsor?

Agree.

(i) Reporting on achievement of business objectives in first two annual reports after listing?

Agree.

(j) Keeping the requirement for GEM issuers to retain a compliance adviser (until after the dispatch of the annual report for the second full financial year after listing)?

Agree.

(k) Reduction of the bar on fundamental changes in business activity by one year, i.e., from two years after listing to one year?

Agree. We consider that more guidance should be provided by the HKEx to clarify what would be regarded as fundamental changes in business activity. In addition, we would suggest that the requirement for listing applicants to have "one focused line of business" should be reviewed.

Q2. Do you agree that GEM listing applications should be approved by the Listing Division on its own, without the involvement of the Listing Committee?

Agree. However, it should not be implemented until the Listing Division has hired suitable personnel or provided appropriate training to the existing personnel to undertake this task.

Q3. Do you have any suggestions on further streamlining the new admission process for GEM?

We propose that the Listing Division be more active in providing guidance to practitioners who consult it on a particular issue, e.g., suitability of listing of a business new on the Hong Kong market. As listing on the GEM and migrating to the Main Board are expensive exercises, we believe that if the Listing Division could provide constructive advice and more definitive views on its interpretation of admission, or other Listing Rule requirements, this would help to attract more companies to list on the GEM.

In addition, we suggest that listing prospectuses should be required to contain only information that is relevant to investors. As such, it is suggested that representations made to the Listing Division during the vetting process, such as various legal opinions on matters which are not relevant for investors, or why a particular business is considered to be suitable for listing, should not be required to be disclosed in a listing prospectus.

Expediting the vetting and approval process of listing applications to enable a listing applicant to have more certainty as to the timing for the whole listing process would help to attract more companies to list in Hong Kong, both on the GEM and the Main Board.

Q4. Do you agree with the proposed revised continuing obligations for GEM?

Agree.

Q5. Do you agree that existing GEM issuers should be required to comply with the proposed revised continuing obligations (except the public float requirement) immediately? Is the proposed three-year "grace period" for complying with the public float requirement appropriate?

We agree that existing GEM issuers should be required to comply with the proposed revised continuing obligations (except the public float requirement) immediately, and a three-year "grace period" for complying with the public float requirement is considered to be appropriate.

Q6. Transfer from GEM to Main Board.

(a) Do you agree with the following criteria for transfer of listing from GEM to the Main Board: (i) meeting Main Board admission requirements; (ii) listing status on GEM for two years; (iii) no material rule breaches for two preceding years?

We agree that the criteria for the transfer of a listing from GEM to the Main Board should be meeting Main Board admission requirements and having no material rule breaches for two preceding years. The two-year waiting period is considered to be unnecessary.

(b) Do you agree that the process for transfer of qualified companies from GEM to the Main Board should be streamlined?

Agree.

(c) Do you agree that the process of transfer should be treated as an announcement by the issuer, to be pre-vetted and approved by SEHK's Listing Committee?

Agree.

(d) Should HKEx require confirmation by a licensed financial adviser of the company's compliance with Main Board admission requirements (such as shareholder spread) where such compliance is not evident from already-published information? Or should HKEx seek to rely directly upon the assurances of the directors?

We propose that, rather than simply requiring a licensed financial adviser to give a blanket confirmation of a company's compliance with all the relevant Main Board admission requirements, consideration should be given to asking the most appropriate persons to confirm compliance with specific admission requirements. For example, lead managers or underwriters should confirm matters relating to the number of places, their independence, etc.; directors of the issuer should confirm matters relating to the business.

We would reiterate the view that we expressed previously, that sponsors, professional advisers, etc., who are not involved in the day-to-day management of the company, and who may not have access to all the relevant information about the company, should be answerable primarily for their own misconduct or negligence in performing any due diligence work that is clearly within their sphere of expertise and/or reasonable responsibility. At the same time, there should also be safe harbour rules for sponsors and advisers who perform their roles with due competence and act in good faith.

(e) Do you have any other suggestions in respect of the transfer process?

We would suggest that for transfers to the Main Board without additional fund raising, the transfer should be permitted subject only to the approval of the Listing Division, that is, it should not be necessary to reproduce all the admission documents (listing prospectus, legal opinions, accountants' reports, revaluation reports, etc.).

Q7. Do you agree that the Main Board and GEM Listing Rules should eventually be merged into a single rule book?

No. As the Main Board and GEM are two separate markets, it would cause confusion if the listing rules of the GEM and the Main Board were merged into a single rule book.

Q8. Do you have any other comments or suggestions on the further development of GEM as a second board?

There needs to be clearly articulated policy for the small to medium-sized company sector. The Institute continues to hold the view that, for GEM to be successful in the long run, it should be positioned as an alternative board for companies with good prospects but which may not meet the criteria for listing on the Main Board. In order to improve the attractiveness of GEM as a market for raising capital, and for GEM-listed companies to continue their presence in the market, the GEM should endeavour to develop its own branding rather than align itself too closely with the Main Board and should, to some extent, compete with the Main Board. As such, it would be more appropriate for GEM to be operated independently from the Main Board, e.g., as a subsidiary of the Stock Exchange managed by a separate governing board and management team, and operated by a distinct team of staff separate from those directly involved in the Main Board.

The Institute believes that there is scope for more effort and resources to be devoted to promoting the GEM to potential markets and listing candidates, as well as to professional and institutional investors, and to the public. It is believed that listing of more internationally-recognised companies on the GEM would help improve its overall profile and standing.

The current proposal to position GEM essentially as a stepping-stone to the Main Board, could foster the view that GEM-listed companies are somehow of a lower quality, which would in turn encourage good companies seek to migrate to the Main Board at the first opportunity, leaving only the less-well-performing companies as the long-term constituents of the GEM. While this may be an inevitable and acceptable consequence of adopting the stepping-stone model, it could nevertheless create a negative image for the GEM as a market in its own right and reflect badly on those companies that, for whatever reason, did not wish to transfer to the Main Board, or were not able to do so within a certain period of time.

Furthermore, we note the view of HKEx and the SFC that, given the different market structure in London and Hong Kong, "it is too early to adopt the AIM model in Hong Kong" (i.e., the lighter regulatory approach adopted by the Alternative Investment Market operated by the London Stock Exchange, which received strong support from market practitioners in Hong Kong during the 2006 consultation on the GEM). However, taking the route now being proposed could pre-empt the development of a more independent, AIM-type market in the future.

As regards the Institute's proposed features for the GEM, please refer to the Institute's submission dated 27 April 2006 in response to the proposed way forward for the GEM.