CONSULTATION PAPER
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

Review Process to Date

1. This Consultation Paper puts forward Hong Kong Exchanges and Clearing Limited (HKEx)'s proposals for the further development of its Growth Enterprise Market (GEM).

2. HKEx commenced its review of GEM in 2005, beginning with informal interviews with market practitioners. Because the feedback obtained in these interviews was very diverse, HKEx decided to issue a Discussion Paper setting out options for the further development of GEM.

3. The Discussion Paper issued in January 2006 set out three structural options for GEM:

   (a) **GEM as a second board**, under which GEM would largely retain its existing structure and would be positioned as a stepping stone to the Main Board.

   (b) **GEM and the Main Board to merge as a single board**, either as an undifferentiated market or as a two-tier market of which the lower tier would form the market for growth companies.

   (c) **New alternative market**. Under this option existing GEM companies would be grandfathered into the Main Board and a new alternative market for growth companies would be opened under an enhanced regime along the lines of London's Alternative Investment Market (AIM).

4. The exposure period for the Discussion Paper ended on 30 April 2006. In response to market request, HKEx extended the exposure period a further month to 31 May 2006. By then 16 submissions had been received.

5. The submissions to the Discussion Paper, insofar as they expressed a view on the structural options, on the whole favoured option (c), the AIM model. The merger of GEM and the Main Board (option (b)) did not attract support. Option (a), GEM as a second board, received little comment. The submissions were released on the HKEx website in July 2006.

6. Since then, HKEx has continued to explore the implications of the various models in consultation with the Securities and Futures Commission (SFC).

AIM Model Not Considered Suitable for Hong Kong

7. HKEx in consultation with the SFC has seriously considered the practicality of adopting option (c), the AIM model, in Hong Kong.

8. The AIM model appears attractive. AIM is by many measures the world's most successful growth company market, with 462 new admissions raising £9.9 billion (HK$153 billion) of equity capital in 2006. Other jurisdictions in Europe and elsewhere in the world are setting up growth company markets along the lines of AIM. The AIM model received strong, although not universal, support from market practitioners making submissions to the Discussion Paper. Adoption of the AIM model would address existing market concerns about the uncertainty and cost of the listing process in Hong Kong.

9. However, HKEx and the SFC are of the view that it is too early to adopt the AIM model in Hong Kong. The Hong Kong market generally has a different structure from the London market, with a larger retail component that necessitates a more active role on the part of the regulators. The role of the sponsor (or 'nomad') in London is pivotal to the integrity of AIM, but in Hong Kong a revised regulatory regime for sponsors came into force in January 2007 and more time is needed to see its full effect. The statutory regulation of issuers in Hong Kong is less strong than in many overseas markets. This is being addressed by the 'statutory backing' initiative which will apply to both Main Board and GEM Listing Rules, but the initiative is not yet in place and time will be needed to gain experience of its effectiveness in practice.

10. Considerable efforts have been made by the regulators and the market community as a whole in recent years to improve Hong Kong issuer corporate governance. These achievements might be put at risk by premature adoption of the light-touch AIM regulatory model which relies on market and market intermediary self-discipline.

11. Having carefully considered all factors and the longer term interests of the market, HKEx and the SFC believe that Hong Kong is not yet ready for the AIM model.

Proposals for Further Development of GEM as Second Board

12. Option (b), the merger of GEM with the Main Board, did not attract much support. Submissions, and market comment generally, expressed concern at the potential dilution of quality on the Main Board if all GEM issuers were grandfathered into it. Accordingly, HKEx does not propose to consider option (b) further.

13. HKEx proposes to proceed with option (a), positioning GEM as a second board. HKEx recognises that at present many GEM issuers already regard GEM as a stepping stone to the Main Board. This option did not arouse concern in the submissions or market comment, and would have the least impact on existing issuers.

14. In developing GEM as a second board, HKEx would, in the main, codify existing practice on GEM. The aim would be to streamline procedures so as to make listing more attractive to smaller issuers. The opportunity would be taken to integrate the rules and regulations of GEM and the Main Board as much as possible, with the aim in the longer run of developing a single consolidated rule book covering both markets.

15. In order to streamline GEM admission procedure, and so help reduce the cost of listing, which is disproportionately high for smaller issuers, the power to approve listings would be delegated from the Listing Committee to the Listing Division. The Listing Committee would retain monitoring, appeal and policy responsibilities.

16. The other main proposed features of GEM as a second board are the following:

    - New quantitative admission requirements would be introduced for GEM.
    - Continuing obligations for GEM and the Main Board, very similar today, would be brought further into line. The only major differences between the two boards would be in respect of admission requirements and admission procedures.
    - Existing GEM issuers would remain in place, ie they would continue to be listed on GEM.
    - The process of transfer of listing from GEM to the Main Board would be streamlined.
    - The trading mechanism on GEM would remain unchanged, ie the mechanism would continue to be the same as on the Main Board.

17. Given that the approach to regulation on GEM would remain the same as on the Main Board, it is difficult for the ongoing cost of listing on GEM to be reduced. Nonetheless, HKEx believes that the greater transparency of the rules and the streamlining of procedures would result in greater certainty and some cost-savings for issuers.

Consultation Process and Next Steps

18. HKEx invites comments from interested parties on these proposals. The proposals are at concept level, but the Consultation Paper is intended to provide sufficient detail to enable the reader to understand how GEM is intended to operate in future. Following confirmation of the concepts HKEx will develop proposed rule changes and expose these rules in turn to the market for consultation.

19. Comments on the proposals in this Consultation Paper should be submitted on or before 31 October 2007. HKEx will consider the comments received and take them into account in planning GEM's further development.

CHAPTER 1 INTRODUCTION

Background and Purpose of the Paper

20. This Consultation Paper which concerns the listing of companies on the Stock Exchange of Hong Kong (SEHK)'s Growth Enterprise Market (GEM) has been prepared by the Listing Division under the guidance of the Listing Committee and takes into account the comments of the Board of HKEx and the SFC.

21. The purpose of this paper is to put forward for comment HKEx's specific proposals for the further development of GEM.

Progress of GEM Review to Date

22. In mid-2005, HKEx commenced a review of GEM. By some measures GEM has been quite successful since its launch in November 1999, listing some 220 companies which raised over HK$40 billion of equity capital. However, after sharing in the global technology boom at the time of GEM's launch, many stocks subsequently declined in price. Some GEM companies experienced losses and/or long periods of suspension and the shares of these companies are often illiquid. There has been a loss of confidence in GEM.

23. In the course of its review, HKEx not only looked at the experience of overseas growth company markets but analysed the performance and characteristics of GEM in detail. Informal interviews were also conducted with market practitioners. These discussions revealed highly diverse views within the market community on the future of GEM.

24. Because of these diverse views, HKEx did not believe it appropriate to formulate specific proposals for the further development of GEM at that stage. Accordingly, in January 2006, HKEx issued a Discussion Paper which set out comments from these informal interviews to elicit further views from a broader range of market users and interested parties.

25. The Discussion Paper highlighted three possible structural options for GEM based on interviewees' comments and overseas growth company board experience.

26. These three options can be summarised as follows:-

    (a) **GEM as a second board** – Under this option, common in overseas markets, GEM would largely maintain its existing structure and would be positioned as a stepping stone to the Main Board. The regulatory approach would be primarily the same as on the Main Board. HKEx would aim to encourage GEM companies to grow and transfer to the Main Board. Accordingly, the process of transferring to the Main Board would be streamlined as far as possible for qualified candidates.

    (b) **GEM and the Main Board to merge into a single board** – Here GEM would be merged into the Main Board to form a single board. The merged single board could be an undifferentiated market (with or without a concessionary channel for the admission of growth companies) or would have two tiers of which the growth market would form the lower tier subject to separate admission criteria. Existing GEM companies would be grandfathered into this board.

    (c) **New alternative market** – Under this option, GEM would be merged into the Main Board. Existing GEM companies would be grandfathered into the Main Board. A separate new alternative market for growth companies would be opened under an enhanced regime. The new market would be distinguished from the Main Board and would provide a listing venue where issuers were expected to stay for the long term. It could have a more flexible vetting regime but stricter sponsor regulation, and might be restricted to professional investors only.

27. By the end of the exposure period on 30 April 2006, 12 submissions to the Discussion Paper had been received. In response to market request, HKEx extended the exposure period a further month, to 31 May 2006. During that month a further four submissions were received, making 16 in total.

28. The responses to the Discussion Paper were released on the HKEx website in July 2006, together with a summary, and can be viewed at http://www.hkex.com.hk/consul/response/GEM-sub-sum.pdf.

29. Market responses to the Discussion Paper were supportive of retaining a second board in Hong Kong. Of the eleven responses that commented on the structural options for GEM, seven supported option (c), establishing a new alternative market along the lines of London's AIM. Two responses supported option (a) the second board model, and no responses supported option (b), the merger of GEM into the Main Board. See Table 1 below.

Table 1. Submissions' preference among the structural options

Discussion Paper option	**No. of submissions supporting**
(a) GEM as a Second Board	2
(b) GEM and Main Board to merge as a, (i) Universal Single Board (ii) Tiered Single Board	 - -
(c) New Alternative Market launched (existing GEM to be closed)	7*
(d) Others - OTC trading via independent automatic trading system (ATS) - Alternative board for companies not meeting Main Board requirements	 1 1
Total no. of submissions with view on preferred option	**11**

* One further submission was supportive of the AIM model as a long-term goal for Hong Kong.

30. In the ensuing months, HKEx studied these responses, conducted further research on the Hong Kong market and overseas markets, obtained legal advice on the implications of the various models, and consulted the SFC. The feasibility of each of the models was studied in detail.

31. Finally, notwithstanding market support for option (c), the new alternative market along the lines of AIM, HKEx in consultation with the SFC concluded that the Hong Kong market is not yet ready for the AIM model. The reasons for this decision are set out in Chapter 2.

32. Option (b), merger of GEM with the Main Board, did not receive support in the submissions. In the submissions and in public and media comment, concerns were expressed about the possible dilution under option (b) of the quality of the Main Board, and of its image and standing among investors. In view of these adverse comments, HKEx does not propose to explore option (b) further.

33. One other option was proposed in the submissions: to establish an over-the-counter (OTC) trading platform via independent alternative trading systems. As such platform would by definition not be operated by HKEx, HKEx does not propose to explore this model further. Any party interested in pursuing this model is advised to approach the SFC directly.

34. HKEx is of the view that option (a), repositioning GEM as a second board, is the best way forward. Accordingly, this option is explored further in this paper and specific proposals are made for the further development of GEM along these lines.

How to Respond to this Consultation Paper

35. HKEx invites market users and interested parties to submit written comments on matters discussed in this Consultation Paper no later than **31 October 2007**. Responses to the paper should if possible address the questions raised in Chapter 5, although other comments are also welcome.

36. HKEx's policy in handling personal data is set out in the Appendix.

37. Written comments may be sent:

By mail to: Corporate Communications Department
Re: Consultation Paper on GEM
Hong Kong Exchanges and Clearing Limited
12th Floor, One International Finance Centre
1 Harbour View Street, Central
Hong Kong

By fax to: (852) 2524-0149

By email to: GEMconsultationpaper@hkex.com.hk

38. HKEx's submission enquiry number is (852) 2840-3844.

CHAPTER 2 SUITABILITY OF NEW ALTERNATIVE MARKET FOR HONG KONG

The New Alternative Market Model Exemplified by AIM

39. Under option (c), GEM would be merged into the Main Board. Existing GEM companies would be grandfathered into the Main Board. A new alternative market would be launched with a different and distinct positioning.

40. The Alternative Investment Market (AIM), operated by the London Stock Exchange (LSE), is perhaps the most compelling alternative market of this nature.

41. AIM is currently regarded by many as the world's most successful growth company market. As at the end of 2006, AIM quoted 1,634 companies with a market capitalisation of £90.7 billion (HK$1,398 billion). Up to the end of 2006, a total of 2,664 companies had been admitted to AIM, raising total equity capital of £39.6 billion. The overall equity turnover ratio[1] of AIM in 2006 was 78%, substantially lower than the London Main Market's 160%, but similar to the Hong Kong Main Board's 62% and significantly higher than GEM's 54%. In 2006, 462 new companies were admitted to AIM, raising £9.9 billion (HK$153 billion). Of these, 124 were foreign companies, bringing the total number of foreign companies quoted on AIM to 306 or 19% of the total.

42. AIM also attracts companies from the London Main Market. In 2006, 31 companies migrated from the Main Market to AIM, and 3 companies moved the other way.

43. Nonetheless despite these achievements, commentators queried some aspects of AIM's development. The performance of AIM lagged that of the London Main Market in 2006. The sectors that predominate on AIM, such as natural resources and gambling, are volatile. There have also been concerns about particular companies that have experienced difficulties.

44. Perhaps partly to address such concerns, in February 2007 the LSE announced new rules governing nominated advisers (nomads). The new rules strengthen the LSE's regulation of nomads, setting out the requirements for due diligence, and introducing a process of annual review by the LSE of nomads' continuing eligibility. AIM disciplinary procedures were also tightened. AIM companies are required to maintain their own websites. Nonetheless, these reforms are regarded as codifying existing best practice rather than introducing any fundamental change to the market.

45. The main distinctive features of AIM are the following. In Hong Kong and most stock markets around the world the applicant issuer has to prepare a prospectus and submit it to the regulators for registration or approval. However, on AIM, it is not always necessary to involve the regulator. Subject to certain parameters (see paragraph 46 below) it is up to the issuer and its nomad to prepare an admission document, for which contents are specified, and to invite investors to subscribe for the shares. The process of admission to AIM and of capital raising is consequently much cheaper and quicker than in the case of a normal stock exchange listing.

[1] Turnover ratio is the annualised average monthly turnover ratio (monthly turnover value divided by month-end market capitalisation) for the year.

46. In accordance with the European Union (EU) Prospectus Directive, AIM is an exchange-regulated market rather than an EU-regulated market. Hence, issues of securities amounting to less than €2.5 million (HK$25.3 million) or to fewer than 100 people do not require a prospectus or vetting by the statutory authority (the UK Listing Authority, UKLA, within the Financial Services Authority, FSA). The latter criterion is dominant, and brokers' private clients do not count towards the 100 persons. Consequently, some AIM flotations, even for large amounts, do not require a prospectus. Nonetheless, in practice AIM issuers may choose to prepare a prospectus and submit it to the UKLA for registration in order to facilitate a broader capital-raising process.

47. In terms of post-admission compliance, AIM again has a light-touch regulatory regime. While on most exchanges significant or related party transactions are subject to comprehensive corporate governance requirements, on AIM – except in the case of reverse takeovers – there are no requirements for shareholder- or exchange approval. The issuer is only required to consult its nomad. This again saves time and cost and is particularly beneficial for companies seeking to grow through acquisition.

48. On AIM, the primary regulatory reliance is therefore placed upon the nomad. Each issuer is required to retain a nomad as long as it is quoted on AIM.

49. What holds the nomads to a standard of performance? The answer appears to relate to the culture of the City of London where traditionally a financial practitioner's word was his bond. Reputation is important, and the nomads – of whom there are some 85 including global investment banks and major accounting firms as well as small firms – have an incentive to bring good quality companies to the market. Supervision of nomads by the LSE, and scrutiny by institutional investors[2], also help maintain market integrity.

50. The potential price of the high degree of freedom enjoyed by issuers on AIM is investor protection. Under the AIM model, investors are presumed to a great extent to be able to take care of themselves. The regulators facilitate investor self-protection by mandating disclosure and by monitoring the performance of the nomads, who are held responsible for the issuer's conduct. However, a large proportion of the responsibility falls on the investor himself. Overall, the AIM model may be regarded as having a large self-regulatory element.

Suitability of AIM Model for Hong Kong

51. Is Hong Kong ready for the AIM model? Could Hong Kong adopt a self-regulatory model in which the regulators step back and leave the issuer and sponsor to negotiate freely with investors?

52. It is apparent that there are some important differences between the market environments in London and Hong Kong.

[2] A survey found that as of 23 August 2006, institutions controlled no less than 56.7 per cent of AIM shares (*Institutional Investors in AIM 2006*, Growth Company Investor).

53. One apparent success factor for AIM is the ***institutional investor base*** in London. As discussed above, institutional investors predominate on AIM. They are knowledgeable about investment and about the sectors and industries in which they invest. Given their professional and financial resources, institutional investors can be regarded as to a great extent capable of taking care of themselves. However, in Hong Kong, it is understood that fewer institutional investors are dedicated to smaller companies. Although no statistics are available, it is understood that GEM shares are normally subscribed and traded to a greater extent by retail investors.

54. A related factor underpinning AIM's investor following is the extensive base of UK ***tax concessions***. For individual investors, the tax concessions comprise certain capital gains tax reliefs, the Enterprise Investment Scheme, certain inheritance tax relief, and relief for losses; tax advantages are also provided to Venture Capital Trusts. The UK Government's policy objective in granting these tax concessions is to foster the UK small and medium enterprise (SME) sector.

55. In Hong Kong, there are no tax concessions for investment in GEM companies. It is considered unlikely that such concessions would be forthcoming from the Hong Kong Government.

56. Another critical success factor for AIM is the ***role of the nomads***. The Hong Kong regulatory regime for sponsors is currently in transition. To address concerns about the conduct of certain sponsors, a revised sponsor regime was introduced in Hong Kong effective January 2007 under the auspices of the SFC. Eligibility standards have been raised, and annual licence renewal is subject to continuing adherence to those standards. As a consequence of the new regime, the number of firms capable of acting as sponsors has reduced from 267 to some 84 at January 2007. It is hoped that the revised regime will encourage higher standards among Hong Kong sponsors. However, time is needed to see the effectiveness of the new regime in practice.

57. With the introduction of the revised sponsor regime, the SFC as the licensing body has taken over exclusive responsibility for the regulation of sponsors. HKEx will no longer be involved in approving or regulating sponsors; HKEx's rules have been amended accordingly. This constitutes a divergence from the AIM model under which the LSE actively supervises the nomads. If HKEx no longer has regulatory authority over sponsors, it would be difficult for HKEx to oversee sponsors' work on the proposed new alternative market. The SFC will be overseeing the sponsors, but the essence of the AIM model is a light-touch non-statutory approach, with statutory regulation as a back up.

58. The ***statutory regime*** governing issuers in Hong Kong is also in transition. At present the main reliance is placed upon HKEx's non-statutory Listing Rules. In the UK, the FSA has extensive powers to investigate and punish market manipulation, including insider dealing. The UK Department of Trading and Industry (DTI) has powers to investigate errant company behaviour, but there is no equivalent corporate regulator in Hong Kong.

59. Initiatives are in progress to upgrade the Hong Kong statutory regime. In September 2006, the SFC proposed amendment of the Companies Ordinance to strengthen liability provisions for false or misleading disclosure. A 'statutory backing' initiative is in progress to embody core provisions of the Listing Rules into statute, whereupon they will be enforceable by the SFC on both the Main Board and GEM. But these initiatives have not yet been implemented.

60. The UK Financial Reporting Review Panel, in operation since 1991, monitors listed company financial reporting; the establishment of an equivalent body in Hong Kong has commenced but it is not yet fully operational.

61. It should also be recognised that ***supporting conditions*** for an alternative market are less strong in Hong Kong. For example, in Hong Kong it is often difficult to ascertain the identity of shareholders.

HKEx's View

62. HKEx's view, arrived at after consultation and discussion with the SFC, is that the Hong Kong market is not yet ready for an AIM-style model. Enhancements to the statutory framework for *ex post facto* enforcement are not yet in place. It would appear unwise for the regulators to give up their powers of *ex ante* screening (through the initial listing approval and transaction vetting process) at this stage. The new sponsor regime has only recently been introduced, and needs time to prove its effectiveness. Factors such as tax concessions that support the success of the AIM market are not present and are unlikely to be obtained in Hong Kong.

63. HKEx believes that the growth of the Hong Kong market in recent years, involving a re-rating by global investors, is in part due to the active regulatory screening of listing applications and post-listing transactions. It would be risky to dispense with what appears to have been a fundamental plank of the market's success.

64. It must also be recognised that the main source of issuer supply to the Hong Kong stock market, including GEM, is Mainland China. Mainland China exhibits a number of the characteristics of a developing market economy: its issuers are generally not yet experienced in international standards of corporate governance and financial reporting. A light-touch regulatory regime may not be appropriate in such an environment.

65. HKEx also considered the possibility of a new alternative market restricted to professional investors, as indicated in the Discussion Paper. However, from discussion with practitioners there appears to be little or no demand for such a market. Retail participation is considered essential to the market's success. It should be borne in mind that the original plan for GEM was for retail investor access to be restricted by the imposition of a large board lot size; however, in response to public demand this restriction was withdrawn.

66. HKEx's and the SFC's conclusion, therefore, is that the Hong Kong market is not yet ready for the AIM model. This conclusion does not preclude the adoption of the AIM model in Hong Kong at a later date if regulatory and market conditions are appropriate.

CHAPTER 3 PROPOSALS TO REPOSITION GEM AS A SECOND BOARD

Background to the Proposals

67. On its establishment, GEM was intended to be an alternative market. It was supposed to operate under a modified disclosure-based, light-touch, buyers-beware regulatory regime. It also had a separate Listing Committee and a separate staffing structure. Certain investor protection measures, such as a large board lot size to preclude smaller retail investors, were also planned but in the event were not adopted.

68. It proved difficult to sustain a distinct regulatory approach on GEM, particularly in the face of problematic companies, declining share prices and public concern. The GEM Listing Rules were similar to those on the Main Board, but because of the different committee and staff involved, practice in interpretation began to evolve differently, which also provoked complaint.

69. In response to these factors, HKEx took the decision to unify the regulatory approaches on GEM and the Main Board as much as possible. In May 2003 the two Listing Committees were reformed with a common membership, and in January 2004 the GEM listing department was merged with that of the Main Board. Practice and interpretation were standardised as far as possible following the March 2004 Listing Rule amendments. However, there remain small but significant differences, some of which surface when GEM companies apply to transfer to the Main Board. For example, there are differences between Main Board and GEM on the required degree of independence of the listing applicant from its parent.

70. For more detail on the course of GEM's development, see Appendix I of the Discussion Paper.

The Need for GEM

71. The Discussion Paper raised the question of whether a growth company market is needed in Hong Kong. The response from submissions was positive. Of the 16 submissions, 14 confirmed that there was a need for a growth company market and only one responded negatively; one expressed no view.

72. There are currently almost 200 companies listed on GEM. If GEM were to be closed, the question would arise as to what would happen to these companies. A good number of them are performing well, although they may not yet meet Main Board admission requirements. Market sentiment is opposed to any wholesale grandfathering of GEM companies onto the Main Board, in order to maintain the standards of the latter. Therefore, even if no further applications for admission to GEM were received, GEM would have to continue in existence for the foreseeable future to provide a venue for its existing companies.

73. Based on internal analysis, there are over 30 existing GEM issuers which appear to comply with quantitative Main Board admission requirements, although some of these might not comply with qualitative requirements.

74. New listing applications for GEM have declined to relatively low level, there being just six admissions to GEM in 2006 and none during the first six months of 2007. This raises the question of the need for the market on an ongoing basis. However, it has to be borne in mind that Mainland-related companies that cannot meet relatively high thresholds (the so-called '4-5-6 rule'[3]) set by the Mainland authorities are not permitted to list on overseas main markets such as the Hong Kong Main Board, even though they may meet the admission requirements of that market. These companies are usually sizeable, with quite strong financial performance. For these companies, as well as other growth companies, there appears to be a continuing need for GEM.

3 Under the China Securities Regulatory Commission (CSRC)'s rule issued in July 1999, enterprises must have RMB400 million of net assets, raise US$50 million of funds, and have an after-tax profit of not less than RMB60 million before they can apply for listing on overseas main boards, including Hong Kong's.

The Current Proposals

75. Taking into account all factors, including the Discussion paper submissions and the difficulties inherent in option (b) or option (c) – as explained in paragraph 32 and Chapter 2 – HKEx's view is that the best way forward for GEM is to reposition it as a second board in accordance with option (a). HKEx is aware that many existing GEM issuers already regard GEM as a stepping stone to the Main Board. By the end of June 2007, 16 issuers had already transferred from GEM to the Main Board. Option (a) has the further merit of minimum impact on existing GEM issuers.

76. Under the second board model, GEM would be repositioned as a stepping stone to the Main Board. This would involve a change to the original design intention of GEM, although to a considerable extent, as indicated above, this change has already taken place in practice.

77. The main proposals for the repositioning of GEM are as follows.

    (1) New quantitative admission requirements would be introduced for GEM, largely in line with those of the Main Board but less stringent.

    (2) The power to approve new admissions to GEM would be delegated by the Listing Committee to the Listing Division. The Listing Committee would retain monitoring, appeal and policy responsibilities.

    (3) Continuing obligations for GEM and the Main Board would be brought further into line.

    (4) Existing GEM issuers would remain in place, ie they would continue to be listed on GEM.

    (5) The process of transfer from GEM to the Main Board would be streamlined.

    (6) The trading mechanism on GEM would remain unchanged, ie the same as for the Main Board.

    (7) In the longer term, a single rule book would be developed for GEM and the Main Board, the only significant divergences being in respect of the markets' admission requirements.

    These proposals are described in more detail in the following sections.

78. Given that the approach to regulation on GEM would remain the same as on the Main Board, it is difficult for the cost of listing on GEM to be reduced. Nonetheless, HKEx hopes that the greater transparency and streamlining of the rules and procedures would result in some cost-savings for issuers.

(1) Proposed enhanced admission requirements for GEM

79. At present, the substantive requirements for admission to GEM are rather minor. There are no requirements for financial performance. Twenty-four months of active business pursuits is required and (in effect[4]) HK$46 million of market capitalisation, but these are not indicators of future business viability. One of the major concerns about GEM is that it admitted a number of companies that did not have a viable business model and which after listing declined to a low level of activity or dormancy.

[4] GEM Listing Rule 11.23(2)(a) requires a minimum public float of HK$30 million at the time of listing. Rule 11.22 requires that the initial management shareholders and significant shareholders must, between them, hold at least 35% of the issued share capital of the issuer at the time of listing. Rule 11.23(5), Note 2, excludes initial management shareholders and significant shareholders from the public float at the time of listing. Therefore, the maximum public holding allowed is 65%. Dividing HK$30 million by 65% yields HK$46 million.

80. There is an existing GEM requirement for the new applicant to demonstrate that it has "a business of both substance and potential"[5]. However, with no financial parameters to define what is meant by these terms, the requirement becomes rather judgemental. The interpretation of "business of substance and potential" in relation to particular circumstances has become one of the major points of discussion between HKEx's Listing function and the applicant. In some cases, such discussion may have contributed significantly to the time and cost of a GEM listing. It is an area that needs to be clarified.

81. Accordingly, HKEx proposes to introduce a requirement for GEM applicants to have an adjusted cash flow from operating profits before changes in working capital and taxes paid[6] of HK$20 million in aggregate for the preceding two financial years. Cash flow is preferred to profit because profit can be affected by significant valuation measurement adjustments and increased by one-off items, whereas operating activities that are generating a reasonable level of cash flow are more likely to be sustainable. The minimum market capitalisation requirement would also be raised from an effective HK$46 million to HK$100 million.

82. From HKEx's internal analysis of the published financial information of GEM listing applicants, it appears that five out of the six successful applicants in 2006 would probably have met the proposed cash flow requirement if it had been in place at the time. This indicates that the proposed requirement is not unduly onerous.

83. If the above admission requirements are introduced, GEM applicant companies would have to be of a certain scale of operation. Accordingly, existing GEM requirements which relate more to the circumstances of very new companies would not to be needed. Following this, HKEx proposes,

- to drop existing GEM requirements imposing lockups on management shareholders and significant (5%) shareholders[7];
- to drop the requirement for the initial management and significant shareholders to hold 35% in aggregate[8]; and
- to allow employee shareholders to be included within the required minimum of 100 shareholders. The term "public" shareholders would be deemed to include employee shareholders but exclude connected persons, as per the Main Board formulation[9].

84. Nonetheless, GEM applicants would generally still be at the development stage of the business life cycle. Their business plan would be an important yardstick against which their subsequent progress can be measured. The existing GEM rules require applicants to state their business objectives and how they will be achieved after listing, and also to report on such achievement subsequently. However, performance in this area can be improved. Accordingly, HKEx proposes to expressly require that in the issuer's first two annual reports after listing it report on the achievement of its plan objectives.

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[5] GEM Listing Rules 11.12(3)(d) Note 3.

[6] The proposal can be illustrated by reference to the figure 3,740 on page 15 of Hong Kong Accounting Standard 7 (December 2004 version).

[7] GEM Listing Rules 13.15 and 13.16.

[8] GEM Listing Rules 11.22.

[9] Main Board Listing Rules 8.24.

85. As discussed above, from January 2007, HKEx no longer has responsibility for the regulatory supervision of sponsors, all duties in this regard being passed to the SFC. HKEx no longer maintains a list of sponsors approved for work on GEM. According, the current GEM requirement to appoint an SFC-licensed sponsor will remain unchanged.

86. Other proposed admission requirements are as follows:-

- the latest two financial years should be under substantially the same management;
- the issuer would be free to decide the offering mechanism used (including 100% placing); underwriting would not be compulsory;
- ownership continuity will follow Main Board practice.

87. HKEx's proposed enhancements to the GEM admission requirements are set out in Table 2 below.

Table 2. Proposed enhanced admission requirements for GEM

Existing Main Board	Existing GEM	Proposed GEM	Comments
Financial requirements			
1. Profit (test1) • HK\$50m in last 3 years (HK\$20m in most recent year); and • MC ≥ HK\$200m Or 2. MC/revenue (test 2) • MC ≥ HK\$4b; and • Revenue ≥ HK\$500m in recent year Or 3. MC/revenue/cash flow (test 3) • MC ≥ HK\$2b; and • Revenue ≥ HK\$500m; and • Cash flow ≥ HK\$100m for 3 years	• No requirements	• Positive operating cash flow ≥ HK\$20m in aggregate for the latest 2 financial years	• Operating cash flow is a better indicator of business viability
Operating history			
• 3 financial years under same management • Test 2: shorter record accepted	• 24 months active business pursuits (may be reduced to 12 months)	• Latest 2 financial years under same management	–

Table 2. Proposed enhanced admission requirements for GEM (cont'd)

Existing Main Board	Existing GEM	Proposed GEM	Comments
Market capitalisation (MC)			
• MC ≥ HK$200m	• MC effectively ≥ HK$46m; or • MC ≥ HK$500m for companies with only 12 months business pursuits	• MC ≥ HK$100m	–
Minimum public float			
• At least HK$50m • 25%, or 15%-25% if MC > HK$10b	• Minimum HK$30m • MC ≤ HK$4b: 25% • MC > HK$4b: higher of HK$1b and 20%	• At least HK$30m • 25%, or 15%-25% if MC > HK$10b (ie as for Main Board)	–
Holding by management and major shareholders			
• Ownership continuity and control for most recent financial year	• ≥ 35% in aggregate	• (As for Main Board)	–
Lock-up period			
• Controlling shareholders can't sell shares for 6 months (for 12 months must disclose pledge/charge) • For next 6 months, controlling shareholders can sell shares but should retain control	• 12 months for initial management shareholders, 6 months if ≤1% • 6 months for 5% shareholders	• (As for Main Board)	• No need to refer to management or significant shareholders since admission requirements now preclude start-ups
Spread of shareholders			
• 300 holders for test 1 or 3 • 1,000 holders for test 2 • ≤ 50% owned by 3 largest public holders	• Minimum 100 non-employee shareholders (300 if 12 months business pursuits, with the largest 5 and 25 holding ≤ 35% and 50% respectively of securities in public hands)	• Minimum 100 public shareholders • ≤ 50% owned by 3 largest public holders	–

Table 2. Proposed enhanced admission requirements for GEM (cont'd)			
Existing Main Board	**Existing GEM**	**Proposed GEM**	**Comments**
Underwriting and offering mechanism			
• Public tranche fully underwritten • Restrictions on allocation within public tranche and clawback mechanism between the placing tranche and the public tranche when over-subscription • May not list by placing only	• Underwriting not compulsory • Free to decide the offering mechanism provided full disclosure • Offer price ≥ HK$1 for companies with only 12 months business pursuits	• Free to decide the offering mechanism provided full disclosure • 100% placing allowed, underwriting not compulsory	• Public offers are not economic for smaller companies • No need to refer to offer price
Sponsor			
• Must appoint a sponsor	• (As for Main Board)	• (As for Main Board)	–
Focused line of business			
• No requirement	• Must pursue a focused line of business	• (As for Main Board)	–
Business plan			
• Statement concerning prospects for current financial year only	• Must state business objectives and how to achieve after listing	• Must state business objectives and how to achieve after listing • Must report on achievement of objectives in first 2 annual reports after listing	• Business plans are an important means to evaluate a growing company • Reporting on plan achievement needs to be strengthened

(2) Process of admission to GEM

88. At present, applications for listing of companies on the Main Board and GEM are reviewed by the Listing Division and approved by the Listing Committee. In respect of certain categories of security, such as debt securities and derivative warrants, the Listing Committee has delegated the power of listing approval to the Head of Listing. Post-listing transactions are also approved by the Listing Division on its own. In the areas where the Listing Division executives have been delegated the power of approval, the experience has been satisfactory from a regulatory point of view, and administratively the process has been relatively efficient.

89. HKEx is aware of market concerns as to the duration and predictability of the listing process for GEM companies. For smaller companies, these concerns translate into high costs relative to the small amounts of capital raised. From a regulatory point of view, the listing of a smaller company on GEM involves fewer investors and a smaller aggregate financial exposure than the listing of a larger company on the Main Board. HKEx's reputational exposure is correspondingly less. At the same time, HKEx is conscious that Listing Committee involvement represents a heavy commitment of scarce regulatory resources – resources which are needed for many other regulatory tasks within the market.

90. Accordingly, HKEx proposes that new listing applications on GEM be approved by the Listing Division on its own, without the involvement of the Listing Committee. The issuer would have the right of appeal to the Listing Committee against the Listing Division's decision. The Listing Committee would establish arrangements to monitor the work of the Listing Division on new listing applications, and would retain the power to determine policy and to direct the Listing Division's administrative practices.

(3) Proposed continuing obligations for GEM

91. In general, existing GEM continuing obligations would be brought into line with those of the Main Board. There would be no difference in the extent of Exchange pre-vetting of announcements and circulars between GEM and the Main Board. The issue of pre-vetting will be the subject of a separate policy initiative.

92. Alignment of the two boards' requirements would entail relaxation of certain existing GEM requirements. Relaxation is justified because GEM applicants would be required by the admission standards to be of a certain minimum business size. At present GEM rules prohibit fundamental change in business activity until two years after listing (unless SEHK waiver and shareholders' prior approval are obtained), whereas for Main Board the prohibition lasts for only one year. The GEM requirement would be reduced by one year to match the Main Board.

93. Bringing existing GEM requirements into line with those of the Main Board would result in a more stringent regime for GEM in the area of minimum public float. At present for historical reasons GEM has a complex set of concessions from the baseline requirement of 25%. It is proposed to bring the GEM regime into line with that of the Main Board. Existing GEM companies would be given a three-year period to comply with the new regime.

94. In three areas, pending further consideration, it is proposed that the requirements of the two boards will diverge for the time being.

- ***Periodic financial reporting.*** At present, GEM requires quarterly reporting, to relatively tighter deadlines than the Main Board. The issue of financial reporting on both boards will be subject to separate policy review.
- ***Compliance Officer.*** At present, on GEM one executive director must be compliance officer, while there is no requirement for a compliance officer on the Main Board. HKEx considers that given the earlier stage of development of the typical GEM company, it is desirable to retain the compliance officer requirement on GEM. Since the compliance officer is an executive director, this should not be onerous for the issuer.
- ***Compliance adviser.*** At present GEM rules require a compliance adviser to be retained until dispatch of the annual report for the second full financial year after listing, whereas the Main Board requires the compliance adviser to be retained only until after dispatch of the annual report for the first full financial year. It is proposed to retain the GEM requirement of two years since these are early-stage companies which would benefit from the compliance adviser's input.

95. Other continuing obligations for GEM would remain as at present:

- Disclosure of price-sensitive information;
- Corporate governance requirements;
- Sufficiency of operations or tangible or intangible assets.

96. See Table 3 below for HKEx's proposed enhancements to GEM's continuing listing obligations.

Table 3. Proposed enhanced continuing obligations for GEM

Existing Main Board	Existing GEM	Proposed GEM	Comments
Financial reporting requirements			
• Annual results (within 4 months), half-yearly results (within 3 months) • Disclose in newspapers (to be abolished) and HKEx website	• Annual results (within 3 months), half-yearly and quarterly results (within 45 days) • Disclose via GEM website	• (As for existing GEM)	• May be subject to separate review later
Other major information disclosure			
• Disclose price-sensitive information, connected transactions and notifiable transactions • Respond to unusual price movements or trading volume		• (Unchanged)	–
Other corporate governance requirements			
• 3 independent non-executive directors; at least 1 has financial expertise • An audit committee at least 3 non-executive directors, 1 with financial expertise • Full-time qualified accountant • Company secretary • Pre-emptive rights • Compliance with corporate governance code provisions, reasons for non-compliance • Compliance with the model code on directors' dealings		• (Unchanged)	• GEM companies should aspire to Main Board governance standards
• (No compliance officer)	• One ED must be compliance officer	• (As for existing GEM)	• This will not add additional burden as the GEM compliance officer is an executive director

Table 3. Proposed enhanced continuing obligations for GEM (cont'd)			
Existing Main Board	**Existing GEM**	**Proposed GEM**	**Comments**
Minimum public float			
• 25% of total issued share capital, or 15%-25% of total issued share capital for MC > HK$10b	• MC ≤ HK$4b: 25% • MC > HK$4b: higher of HK$1b and 20% For companies listed before 1/10/2001: • MC ≤ HK$1b: 20% • MC > HK$1b and ≤ HK$1.333b: HK$200m • MC > HK$1.333b: 15%	• (As for Main Board)	• Some existing GEM companies might have to raise their public float, and would be given a three-year "grace period" in which to do so
Sponsor/adviser			
• Appoint a compliance adviser till dispatch of annual report in respect of first year after listing	• Appoint compliance adviser till dispatch of annual report in respect of second year after listing	• (As for existing GEM)	• Existing extended compliance adviser role on GEM seen as beneficial
Business activity			
• No fundamental change in principal business activities within 1 year after listing, unless with SEHK waiver and independent shareholders' prior approval • Comply with spin-off requirement of separate listing of assets/businesses of the existing group	• No fundamental change in principal business activity for 2 years after listing, unless with SEHK waiver and independent shareholders' prior approval	• (As for Main Board)	• No need to unduly restrict changes in activities since GEM companies will in future be more established
Sufficiency of operations			
• Sufficient operations or tangible assets, intangible assets	• Sufficient operations	• (As for Main Board)	–
Vetting announcements			
• Pre-vetting of certain types of announcements is required under the Listing Rules		• (Unchanged)	• Both Main Board and GEM to move to post-vetting of more announcement types

(4) Existing GEM issuers

97. The proposed changes in the continuing obligations for GEM issuers are relatively minor. HKEx proposes that at the time of coming into effect of the proposed revised GEM rules, issuers already listed on GEM at that date would be required to comply with the new rules with immediate effect, except that in the case of the public float requirement they would be given a “grace period” of three years to comply.

(5) Proposed streamlined process of transfer to Main Board

98. At present, in keeping with GEM’s original design rationale as an alternative market, ie a long term listing venue, there is no special process for GEM companies to transfer to the Main Board. GEM companies wishing to transfer to the Main Board have to go through the full normal application process, like other Main Board applicants. However, if GEM is repositioned as a second board, the existing approach will no longer be appropriate. A more streamlined process of transfer is required to reflect the fact that GEM issuers are known to HKEx and have been in compliance with a regime that is very similar to that of the Main Board.

99. Accordingly, it is proposed that GEM companies may apply to the Main Board if they meet the Main Board quantitative requirements, have been listed on GEM for two years, and have a ‘good behaviour’ record, ie no material rule breaches for the past two years. No sponsor would be required, and HKEx’s review would be based as far as possible upon the issuer’s existing recent public disclosures.

100. At present, GEM issuers are required to go through a formal process of delisting from GEM in order to transfer to the Main Board. This requirement would be removed and replaced by a simple notification arrangement.

101. In the past, difficulties have arisen for GEM Main Board applicants because of small but significant differences between the GEM and Main Board regimes, in particular the required extent of independence of the listed company from its parent. The aim will be to eliminate these differences by bringing the GEM and Main Board rules and practices into line.

102. The process of HKEx scrutiny would be reduced. At a minimum, a check has to be performed that publicly-disclosed information meets the Main Board admission requirements; that there has been no rule material breach in the past two years; etc. In respect of admission requirements for which no existing public disclosures are available, such as number of shareholders, HKEx could either seek to rely upon the directors’ assurances or require confirmation by a licensed financial adviser.

103. The merit of requiring a financial adviser to confirm compliance with requirements for which publicly-disclosed information is not available is that it would provide HKEx with greater confidence and so tend to reduce the questions HKEx would need to ask and the time taken. On the other hand, in order to confirm the shareholding spread the financial adviser would in turn have to rely on the work of the directors – who would normally conduct an investigation of shareholdings under section 329 of the Securities and Futures Ordinance; accordingly the appointment of the financial adviser might add little value. HKEx invites views on whether or not a financial adviser should be appointed to confirm items which are not already the subject of public disclosures.

104. It is intended that the process should be as streamlined as possible. The application would take the form of an announcement by the issuer of its transfer to the Main Board, such announcement to be supported by documentation vetted by the Listing Division and approved by the Listing Committee. The announcement should be accompanied by the application form, the initial listing fee, and Form B (the director's declaration), other required forms, and if applicable (see paragraph 103 above) confirmation by a financial adviser of the issuer's compliance with relevant admission requirements.

105. In recognition of the lower level of work that would be required for reviewing the application for transfer, as compared with a normal Main Board listing application, HKEx proposes to reduce the Main Board initial listing fee for applicants from GEM by 50%.

106. Successful applicants from GEM to the Main Board would be exempt from the following restrictions applying to new Main Board applicants.

- the ban on new share issues within 6 months of listing[10]
- the ban on fundamental changes in principal business activities within 1 year of listing[11]
- the ban on the controlling shareholder selling its shares within 6 months of listing (and requirement to disclose any pledges or charges within 12 months of listing)[12]
- the ban on changes in control during the subsequent 6 months[13]

(6) No change to GEM trading mechanism

107. Seven of the submissions to the Discussion Paper recommended the introduction of market makers on GEM. However, HKEx believes that changes to the trading mechanism would not fundamentally improve the liquidity of the stocks. Changes to the trading mechanism could provide more scope for market abuse, which would not be in the interests of investors. HKEx therefore proposes no change to the existing trading mechanism on GEM, which is the same as that of the Main Board.

(7) Unification of Main Board and GEM Listing Rules

108. In considering the proposed unification of GEM and Main Board rules and practice, it is apparent that in some areas GEM may have a better formulation than the Main Board, in others the reverse, and in some areas both formulations could be improved. In some areas of the rules unification may be a relatively simple matter, in other areas more complex. The "statutory backing" initiative, which is currently in progress, adds a further complication. It is therefore unlikely that full unification of the two rule books can be achieved at one stroke.

109. HKEx proposes a gradual approach to rules unification. HKEx intends to amend the GEM Listing Rules first so as to incorporate the new requirements and the alignments with the existing Main Board Listing Rules. Any necessary changes to the Main Board rules so as to achieve full unification will be addressed as soon as practicable. Proposed rules amendments will be subject to public consultation.

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10 Main Board Listing Rules 10.08.

11 Main Board Listing Rules 14.89.

12 Main Board Listing Rules 10.07(1)(a).

13 Main Board Listing Rules 10.07(1)(b).

HKEx's Regulatory Approach and Staffing for GEM

110. As explained in paragraph 69 above, HKEx has introduced common membership of the GEM and Main Board Listing Committees, and has merged the former GEM and Main Board Listing departments, with the aim of standardising the regulatory approach to GEM and the Main Board. HKEx proposes to continue this uniform regulatory approach to the two boards as far as possible. However, in recognition of the procedural changes that will flow from the Listing Division approving GEM listing applications on its own, it will be necessary to revise the decision-making procedures for handling GEM applications.

Cost of Listing on GEM

111. The submissions and other comments received by HKEx express concern at the cost of listing and maintaining a listing on GEM. HKEx was requested to examine ways to reduce the cost.

112. Having considered the matter carefully, HKEx is of the view that under the existing regulatory model, it is difficult to reduce costs significantly. If the regulatory model were changed and the AIM model were adopted, costs could indeed be reduced. However, such cost reduction would come at the expense of investor protection. As explained in Chapter 2, HKEx believes that this would not be the right decision for Hong Kong at present.

113. Accordingly, given the retention of the existing regulatory model, scope for cost-reduction on GEM is limited. Under the existing model there are certain core processes associated with public listing, concerning compliance and the regulatory vetting process. These processes are irreducible, and result in a core cost component which is likewise irreducible. This irreducible minimum of cost bears relatively more heavily on the smaller companies listed on GEM than on larger Main Board companies.

114. HKEx believes that the greater transparency and explicitness of the proposed new regime for GEM should lead to some reduction in the cost and duration of the listing process. For example, as discussed in paragraphs 80 and 81 above, the introduction of an explicit requirement for cash flow should reduce the need for discussion about whether a business is of "substance and potential". The standardisation and eventual unification of the Main Board and GEM Listing Rules should also help reduce costs.

115. Since there will be no significant reduction in HKEx's work in approving listing applications or ongoing compliance and monitoring, HKEx has no scope to reduce its fees in these areas. However, as discussed in paragraph 105 above, because in general HKEx will have to perform less work in approving applications for transfer from GEM to the Main Board, HKEx proposes to halve the Main Board initial listing fee for applicants from GEM. The process of transfer for qualified applicants should also be simpler and cheaper under the proposals.

Other Issues

116. HKEx has received requests for more and better information to be made available on GEM companies, to facilitate investors. While HKEx has no specific proposals to make in respect of GEM, it will take up these requests in its forthcoming review of the GEM and HKEx websites and the Investment Service Centre. This review should ultimately result in improved information on not only GEM companies but Main Board companies as well.

117. HKEx is also aware of requests to make the GEM listing process more transparent. While HKEx has no specific proposals to make in respect of GEM, it will take up these requests in its review of the potential to disclose more information prior to the release of the prospectus. Any changes made as a result of this review will apply to GEM as well as the Main Board.

CHAPTER 4 POSSIBLE IMPLICATIONS OF GEM PROPOSALS FOR MAIN BOARD

118. The proposals set out in this paper concern GEM itself, and therefore should not in the first place impact the Main Board. However, the proposals may possibly have some indirect impact on the Main Board, as described further below.

119. It is proposed to introduce a streamlined process for transfer of qualified GEM companies to the Main Board. This may result in more GEM companies transferring to the Main Board. However, since these will be qualified companies, ie companies that meet the Main Board admission requirements, there should be no adverse impact on Main Board issuers.

120. HKEx's intention is to bring the GEM and Main Board rules into line with one another as much as possible, with the exception of the markets' respective admission requirements. Ultimately, these should be a single rule book with separate parameters or sections applying to GEM. This entails changing GEM rules so as to align with those of the Main Board, changing Main Board rules to align with GEM, or changing both markets' rules. In the latter cases, changes to the Main Board rules would be required.

121. In the following areas, HKEx believes that existing GEM concepts, or new concepts proposed for the revamped GEM, may be worthy of consideration for the Main Board as well.

(a) It is proposed in Chapter 3 to make ***operating cash flow*** the core requirement for admission to GEM, rather than the profit as on the Main Board. HKEx believes that cash flow is a better indicator of business sustainability in smaller companies than profit. For Main Board companies, their greater size and more-established nature make the issue of less significance. Cash flow is already incorporated in Main Board test 3 (Market Capitalisation, Revenue and Cash Flow, see Table 2). HKEx would like to consider whether operating cash flow should become more of a core requirement for the Main Board, as well as for GEM.

(b) GEM already requires applicants to state their ***business objectives***[14]. Additionally, it is proposed to require GEM companies to report on the achievement of these business objectives in their first two annual reports after listing. However, current Main Board Listing Rules require applicants to make a statement concerning prospects for the current financial year only[15]. For larger Main Board applicants, with mature businesses, the present requirement would appear sufficient. However, for more recently-established Main Board companies, there would normally be a business plan for development and growth; for these enterprises it may be desirable to require the fuller formulation proposed for GEM.

122. HKEx would conduct specific consultation on these issues before introducing any change to the Main Board Listing Rules. Such consultation is not a function of the present paper, which is focused on GEM, and will be conducted separately at the appropriate time. Nonetheless, preliminary views on these suggested changes to the Main Board Listing Rules are invited now.

[14] GEM Listing Rules 11.15.

[15] Main Board Listing Rules Appendix 1A34(1)(b).

CHAPTER 5 KEY CONSULTATION QUESTIONS

123. HKEx welcomes responses to the questions below. These questions are framed in the context of option (a), repositioning GEM as a second board. Where possible, please provide justification such as supporting arguments or information with your responses.

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

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

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

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

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

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

(f) A minimum of 100 public shareholders?

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

(h) Retaining the requirement for a sponsor?

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

(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)?

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

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?

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

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

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?

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?

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

(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?

(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?

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

Q7. Do you agree that the Main Board and GEM Listing Rules should eventually be 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?

APPENDIX PERSONAL INFORMATION COLLECTION AND PRIVACY POLICY STATEMENT

Provision of Personal Data

1. Your supply of Personal Data to HKEx is on a voluntary basis. "Personal Data" in these statements has the same meaning as "personal data" in the Personal Data (Privacy) Ordinance, Cap 486.

Personal Information Collection Statement

2. This Personal Information Collection Statement is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. It sets out the purposes for which your Personal Data will be used after collection, what you are agreeing to in respect of HKEx's use, transfer and retention of your Personal Data, and your rights to request access to and correction of your Personal Data.

Purpose of Collection

3. HKEx may use your Personal Data provided in connection with this consultation paper for purposes relating to this exercise and for one or more of the following purposes:

   - for performing or discharging HKEx's functions and those of its subsidiaries under the relevant laws, rules and regulations;
   - for research and statistical purposes;
   - for any other lawful purposes.

Transfer of Personal Data

4. Your Personal Data may be disclosed or transferred by HKEx to its subsidiaries and/or regulator(s) for any of the above stated purposes.

5. Your Personal Data may also be disclosed or transferred to members of the public in Hong Kong and elsewhere as part of the public discussion of this paper, including but not limited to disclosing your name to the public together with the whole or part of your comments by posting them on the HKEx website, publishing them in documents or by other means. If you do not wish your name to be disclosed to members of the public, please state so when responding to this paper.

Access to or Correction of Data

6. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the Personal Data (Privacy) Ordinance. HKEx has the right to charge a reasonable fee for processing any data access request. Any such request for access to and/or correction of your Personal Data should be addressed to the Personal Data Privacy Officer of HKEx in writing by either of the following means:

   By mail to: Personal Data Privacy Officer
   Hong Kong Exchanges and Clearing Limited
   12th Floor, One International Finance Centre
   1 Harbour View Street
   Central
   Hong Kong

   By email to: pdpo@hkex.com.hk

Retention of Personal Data

7. Your Personal Data will be retained for such period as may be necessary for the carrying out of the above-stated purposes.

Privacy Policy Statement

8. HKEx is firmly committed to preserving your privacy in relation to Personal Data supplied to HKEx on a voluntary basis. Personal Data may include names, addresses, e-mail addresses, login names, etc, which may be used for the stated purposes when your Personal Data is collected. The Personal Data will not be used for any other purposes without your consent unless such use is permitted or required by law.

9. HKEx has security measures in place to protect against the loss, misuse and alteration of Personal Data supplied to HKEx. HKEx will strive to maintain Personal Data as accurately as reasonably possible and Personal Data will be retained for such period as may be necessary for the stated purposes and for the proper discharge of the functions of HKEx and those of its subsidiaries.