CONSULTATION

ON

CONTINUING LISTING CRITERIA

AND

RELATED ISSUES

November 2002

Hong Kong Exchanges and Clearing Limited

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PART A
INTRODUCTION

BACKGROUND

1. The quality of a listing market is essential for investor confidence. In July this year, we published a Consultation Paper on Proposed Amendments to the Listing Rules relating to Initial Listing and Continuing Listing Eligibility and Cancellation of Listing Procedures (the "July Consultation Paper") to seek market views on our proposals that are aimed at enhancing the quality of the Hong Kong listing market and consequently its attractiveness to investors and issuers.

2. The July Consultation Paper sought to examine and review the eligibility criteria for initial and continuing listing as well as the delisting procedures applicable to issuers of equity securities (but not debt securities) applying for listing or already listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Exchange") under Chapter 8 of the Rules Governing the Listing of Securities on the Exchange ("Main Board Rules"), and mineral[1] and infrastructure[2] companies. It was hoped that through the consultation exercise comments could be received to enable us to formulate policies for future implementation.

3. Following the release of the July Consultation Paper, there was public concern over some proposals in the July Consultation Paper relating to continuing listing eligibility criteria. In response to these concerns, we withdrew Part C of the July Consultation Paper on continuing listing eligibility criteria for separate consultation.

4. This Consultation Paper could be read independently of the July Consultation Paper. Discussions in the July Consultation Paper are reproduced in this Consultation Paper to the extent that they are relevant and necessary for readers' ease of reference. However, in the light of the withdrawal of Part C of the July Consultation Paper, references to Part

[1] Companies referred to in Chapter 18 of the Main Board Rules.
[2] Companies referred to in Rule 8.05(2) of the Main Board Rules and the Exchange's Announcement dated 31 January 1996.

C in Part E of the July Consultation Paper should be ignored. Following analysis of the responses to Part E of the July Consultation Paper the Exchange may introduce new procedural requirements ahead of any revised continuing listing standards that may be introduced following this consultation exercise.

OBJECTIVE

5. This document seeks responses from all interested parties including listed companies, investors and the general public, on the various proposals and options set out in Parts B to E and to address specific questions we pose. Some proposals in this document have been developed to a greater extent than other proposals. This should not be taken to mean that we have decided in favour of a particular approach or option. The Exchange remains open-minded about how to proceed and welcomes the comments and analysis of respondents. In particular, comments on Part D will inform us of any further work and recommendations that may form part of any subsequent consultation document.

OVERVIEW

6. The quality of a listing market is crucial for investor confidence. Such quality is in turn dependent on the interaction of the various key elements of the market, being issuers, investors, intermediaries, infrastructure (both hard and soft) and information. In the July Consultation Paper, we discussed the initial listing eligibility criteria, disclosure requirements at the time of initial listing, continuing obligations and new cancellation of listing procedures. In this Consultation Paper, we will focus on issues relating to the continuing listing standards, alternative trading arrangements for securities delisted from the Main Board and issues commonly associated with low-priced securities. We will discuss and seek market views on the following matters.

Whether there is any need for minimum standards to maintain listing status

7. In Part B, we discuss questions as to whether, in addition to the initial listing eligibility, there should be a set of minimum standards to serve as

indicators of an issuer's achievement in financial performance and level of public following for the purpose of maintaining its listing status. If the responses to this consultation support the notion that such requirements should exist, then whether there is any need to introduce, in addition to the existing general descriptive requirement under Paragraph 38 of the Listing Agreement[3], a set of objective quantitative and qualitative standards.

What are the indicators and thresholds for triggering action to be taken by an issuer to meet the minimum standards for maintaining listing status

8. In Part C, we look at what might constitute appropriate indicators and thresholds to trigger a requirement for an issuer to take remedial action to bring itself back to long-term compliance with such minimum standards. The adoption of such measures is conditional upon the conclusion of the consultation in Part B on whether there is any need for minimum standards to maintain an issuer's listed status. It is also subject to our analysis of the responses to this consultation.

Alternative treatments of securities delisted from the Main Board

9. The question of continuing eligibility requirements is inevitably linked to the broader issue of the structure of securities markets in Hong Kong. In Part D, we look at and seek market views on various alternative treatments of securities delisted from the Main Board. Subject to market responses to this consultation exercise, further consultation on the subject may be required.

Low-priced securities

10. In Part E, we look at and seek market views on issues frequently associated with low-priced securities from the perspectives of issuers' corporate governance practices and maintenance of a fair and orderly market.

[3] See Paragraph 38 of the Listing Agreement which requires an issuer to maintain a certain sufficient level of operations or assets so as to remain listed on the Exchange. See also paragraphs 31 and 41 of this Consultation Paper for a more detailed discussion.

NEXT STEPS

11. This Consultation Paper discusses the rationale behind the relevant issues, on the basis of views collected from different sectors of the market.

12. Some market commentators have questioned whether this is the appropriate time for issuing a consultation paper of this nature, given the current economic climate. As the matters that are the subject of this consultation exercise may have a profound effect on the future development of the Hong Kong listing market, we need to look forward and consider in good time the relevant policies. In the light of the response to this consultation exercise, the actual timing for implementation of the individual proposals can be decided taking into account the likely market impact.

13. **The proposals and options set out in this Consultation Paper are intended to facilitate public debate on the relevant issues, and do not necessarily represent the final position of the Exchange. Members of the public are invited to consider the discussion and the suggestions set out in this Consultation Paper in detail and forward to us any comments that they may have. We will analyse responses and comments so received and thereafter issue a report on the consultation results.** Please complete and submit your comments by completing and returning the questionnaire booklet to:

    Listing Division
    Hong Kong Exchanges and Clearing Limited
    11th Floor, One International Finance Centre
    1 Harbour View Street
    Central
    Hong Kong
    Fax: (852) 2868 5028

    Alternatively, you may complete and submit the electronic questionnaire available at the website of Hong Kong Exchanges and Clearing Limited (HKEx): www.hkex.com.hk.

    You may also download a soft copy of the questionnaire from the website of HKEx and thereafter submit the completed copy via e-mail at cvw@hkex.com.hk.

14. The consultation period will close on 28 February 2003.

Provision of Personal Data

15. Personal Data[4] is collected on a voluntary basis.

16. Please note that HKEx will make the original of all submissions to this consultation exercise available for public inspection at the office of HKEx at 11th Floor, One International Finance Centre, 1 Harbour View Street, Central, Hong Kong for a period of 14 days from the date of publication of the consultation results. In this connection, please read the Personal Information Collection Statement below.

17. If you do not wish your name to be disclosed along with your submission, please state that you wish your name to be withheld when you make your submission, in which case HKEx will make available a copy of your submission for public inspection and any references to your name will be blanked out.

Personal Information Collection Statement

18. This Personal Information Collection Statement ("PICS") is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which the Personal Data of respondents will be used after collection, what these respondents are agreeing to in respect of HKEx's use of their Personal Data and their rights under the Personal Data (Privacy) Ordinance.

Purpose of Collection

19. HKEx may use the Personal Data of respondents collected by HKEx in connection with the Consultation Paper for one or more of the following purposes:

- for performing 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

[4] Personal data as defined in the Personal Data (Privacy) Ordinance, Cap 486.

Transfer of Personal Data

20. Personal Data collected may be disclosed by HKEx to members of the public in Hong Kong and elsewhere, as part of the public consultation on the Consultation Paper.

Access to or Correction of Data

21. 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. If you wish to request access to and/or correction of your Personal Data provided in your submission on the Consultation Paper, you may do so in writing addressed to:

    Personal Data Privacy Officer
    Hong Kong Exchanges and Clearing Limited
    11th Floor, One International Finance Centre
    1 Harbour View Street
    Central
    Hong Kong
    cvw@hkex.com.hk

    HKEx has the right to charge a reasonable fee for processing any data access request.

Privacy Policy Statement

22. HKEx is firmly committed to preserving the privacy of respondents in relation to Personal Data supplied to HKEx on a voluntary basis. Personal Data may include names, addresses, e-mail addresses, login names etc. HKEx uses the information 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.

23. HKEx has security measures in place to protect the loss, misuse and alteration of the Personal Data of respondents. HKEx will strive to maintain Personal Data as accurately as reasonably possible and Personal Data will be retained for such period as may be neccessary for the proper discharge of the function of HKEx and those of its subsidiaries.

PART B
MINIMUM STANDARDS
FOR MAINTAINING LISTING

24. The quality of a listing market is crucial for investor confidence, and in Hong Kong's case, for maintaining Hong Kong's leading position as the Asian hub in the global financial markets. We believe that the quality of the listing market is dependent on the interaction of various key components of the market, namely, issuers, investors, intermediaries, infrastructure (both hard and soft) and information. These components are inter-linked and reinforce one another, and together they contribute to the quality of the listing market.

25. As the market operator, HKEx aims at balancing and optimising the various objectives of the different market components by imposing minimum requirements and standards on issuers, building investor confidence and stimulating market activities.

26. As the first tier regulator of issuers under the "three-tiered regulatory structure", the principal function of the Exchange is to provide a fair, orderly, efficient and transparent market for the trading of securities. The Main Board Rules comprise both minimum requirements which have to be met before securities may be listed and also continuing obligations with which an issuer must comply on an ongoing basis once it is listed. These rules are designed to regulate corporate processes and actions of issuers to ensure the protection of shareholder rights and the proper disclosure of information to the public.

27. Investors may have different considerations in making investment decisions, and the performance of issuers may be among one of these considerations. There are views, perhaps mostly from the perspective of the investing public, that the overriding quality requirement of an issuer should be its ability to perform commercially, in terms of profit, so that its share price could also perform. There are other views, however, that

an issuer which is loss making or has low share price does not necessarily mean it is of low quality. To these commentators, what really affects the quality of an issuer is the standard of its corporate governance practices, particularly the honesty and integrity of its management.

28. Taking these points together, investors may assess the investment potential of a listed issuer by reference to its achievement:

    (a) quantitatively – in terms of financial performance, which may be objectively assessed, and the level of the public's interest in the issuer which may be gauged, from factors such as the shareholder spread, share price performance, assets and earnings of the issuer; and

    (b) qualitatively – for corporate matters including corporate governance related areas. These may be subjectively achievable by disclosure and ultimately, may have an effect on the financial performance, level of investors' acceptance and business prospects of the issuer.

29. Under the current Main Board Rules, listing is granted subject to the over-riding principle that the Exchange may at any time, for the protection of the investor or the maintenance of an orderly market, suspend or cancel the listing of any securities in such circumstances and on such conditions as it thinks fit[5]. The Exchange may, among others, cancel the listing of an issuer if it does not have a sufficient level of operations or assets to warrant the continuing listing of the issuer's securities[6]. In these instances, cancellation of listing commences with trading suspension where an issuer shows signs of insufficiency of operation or assets. Typically, these issuers are in liquidation or receivership.

[5] See Rule 6.01 of the Main Board Rules.
[6] See Rule 6.01(3) and Paragraph 2 of Practice Note 17 to the Main Board Rules as well as Paragraph 38 of the Listing Agreement.

30. As a condition of the listing of their securities, all issuers are required to sign a Listing Agreement with the Exchange by which they undertake to comply with the continuing obligations. These obligations generally relate to disclosure of information. They are designed to help to ensure that issuers keep the holders of their securities (and the public) fully informed of all factors which might affect their interests and treat the holders of their securities in a proper manner[7]. Failure to comply with the terms of the Listing Agreement may lead to the suspension or cancellation of the listing of the issuers' securities[8]. However, depending on the seriousness of the breaches, the Exchange may subject non-compliant issuers to disciplinary actions, with the cancellation of listing as the most severe sanction.

31. Currently under the Main Board Rules there are no quantitative continuing listing standards, apart from the general descriptive requirement under Paragraph 38 of the Listing Agreement. Paragraph 38 of the Listing Agreement provides that an issuer shall carry out, directly or indirectly, a sufficient level of operations or have tangible assets of sufficient value and/or intangible assets for which a sufficient potential value can be demonstrated to the Exchange to warrant the continued listing of the issuer's securities. However, the current rule as it now exists, is not objectively definitive as to when delisting would be triggered. Through the passage of time, some issuers may have persistently under-performed, financially or in terms of public following, and sometimes to levels below the initial entry standards. As the current rule contains only general descriptions that inevitably involve the Exchange exercising a certain degree of subjective discretion, there is room for contesting rulings made under this provision, particularly on the grounds that the exercise of the Exchange's discretion may not be transparent to the market. In such circumstances, greater transparency and certainty in the application of this rule is desirable.

[7] See Rule 13.01 of the Main Board Rules.
[8] See Rule 13.07 of the Main Board Rules.

32. Some commentators consider that a listing status is a privilege and not a matter of right. Therefore, issuers should meet certain minimum quantitative[9] and qualitative standards at the time of listing and while the issuer remains listed on the Exchange. This would maintain the quality of the Hong Kong listing market. They generally agree that the minimum standards should be based on clear, objective and transparent quantitative and qualitative criteria to determine whether issuers continue to achieve financial performance and investors' acceptance. However, there are different views on what should be the appropriate criteria to determine whether there is a strong indication of failure by issuers.

33. Other commentators consider that it is not necessary to set any minimum standards, as the market will automatically regulate itself. Under-performing issuers will face difficulties in raising funds or will have to pay a high premium to raise funds. To these commentators, under-performing issuers would eventually exit from the market through market forces, when they fail to be rescued and must be liquidated. There are also views that if an issuer is not able to raise funds in the market, there is no real benefit for it to maintain a listing. Accordingly, there is no real need for an exit mechanism in the Main Board Rules.

34. Some commentators are of the opinion that HKEx, as the only market operator in Hong Kong to provide facilities for issuers to raise capital, should not seek to restrict access to its services by imposing quality tests for continuing listing. To these commentators, quality should be a matter for the market and not the regulators. However, if HKEx is to head in the direction of maintaining a listing market for quality issuers only, there should be alternative trading facilities in place for issuers that are otherwise not able to meet such quality.

35. There are also views that the existing mechanism under the current rules to require issuers to have a sufficient level of operations and/or assets has been working well. Therefore, it is not even necessary to seek views and consult the market on these issues.

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[9] For example, the requirements for an adequate trading record under substantially the same management (Rule 8.05 of the Main Board Rules), a minimum public float (Rule 8.08(1) of the Main Board Rules), an adequate spread of holders (Rule 8.08(2) of the Main Board Rules) and an expected minimum market capitalisation (Rule 8.09 of the Main Board Rules).

36. Among the commentators that support the introduction of clear, objective and transparent minimum standards, it is generally acknowledged that these criteria can help to maintain the quality of the Hong Kong listing market and to enhance Hong Kong's position as an international financial centre. Others, however, are of the view that a stock market tends to be a very local affair. Given that the constituents of the Hong Kong listing market are mainly local and PRC issuers and retail investors, Hong Kong should be building up its listing market with its own characteristics, and should not just follow international models.

37. There are some views opposing clear, objective and transparent minimum standards for issuers to maintain on a continuing basis. To these commentators, transparent minimum standards may create difficulties for the so-called "third, fourth and fifth tier" issuers to raise funds, as their financiers would be more cautious about the potential breach of such minimum standards by the issuers. Similar comments also apply in the case of margin financiers that either accept the securities of these so-called "third, fourth and fifth tier" issuers as collateral or finance the trading of their securities. This is particularly the case where the controlling shareholders wish to pledge their shares to obtain personal financing or financing for these issuers.

38. The views in paragraph 37, however, are considered by other commentators as having demonstrated the importance of the need to have clearly defined and transparent criteria for maintaining a minimum standard to enable financial institutions and margin financiers to better manage their investment risks.

39. Given the above comments, we would like to seek market views on whether, in addition to the initial listing eligibility, the Main Board Rules should contain any objective ongoing minimum standards for an issuer to comply with for maintaining its listing on the Exchange.

Q1. Do you consider it necessary to have certain ongoing minimum standards for an issuer to comply with for the purpose of maintaining its listing on the Exchange?

☐ *Yes (please answer Q2)*

☐ *No*

Please state reason(s) for your view.

Please note that the discussions in Parts C and D are based on the premise that, for the purpose of maintaining the quality of the market, certain minimum objective and quantitative continuing listing standards are considered appropriate for issuers to comply with for the purpose of continuing listing on the Exchange. If your answer to Q1 is negative, you may wish to proceed directly to Part E.

Q2. If your answer to Q1 is positive, do you consider that the minimum standards under the Main Board Rules that an issuer has to meet should be as clearly defined, transparent and objective as possible?

☐ *Yes (please proceed to Part C)*

☐ *Yes, but the current provision under the Main Board Rules is sufficient to serve the purpose. There is no need for changes. (Please proceed to Part E)*

☐ *No (please explain your view and proceed to Part E)*

PART C
MINIMUM CONTINUING LISTING STANDARDS

40. As discussed in Part B, some commentators support the introduction of clear, objective and transparent minimum standards for issuers to maintain on a continuing basis. On the premise that for the purpose of maintaining the quality of the market certain minimum continuing listing standards are considered to be appropriate for issuers to comply with to maintain listing on the Exchange, we discuss in this Part C the options for the possible minimum standards that can be adopted. Your views are sought on these options.

41. Currently under the Main Board Rules there are no quantitative continuing listing standards, apart from the general descriptive requirement under Paragraph 38 of the Listing Agreement. Paragraph 38 of the Listing Agreement provides that an issuer shall carry out, directly or indirectly, a sufficient level of operations or have tangible assets of sufficient value and/or intangible assets for which a sufficient potential value can be demonstrated to the Exchange to warrant the continued listing of the issuer's securities. However, the current rule as it now exists, is not objectively definitive as to when delisting would be triggered. Given that the current rule contains only general descriptions which inevitably involve the Exchange exercising a certain degree of subjective discretion, there is room for contesting rulings made under this provision, particularly on the grounds that the exercise of the Exchange's discretion may not be transparent to the market.

42. Under our current practice, Paragraph 38 of the Listing Agreement is applied when issuers are typically in liquidation or receivership. Securities of the issuer are immediately suspended and hence, there is no advance warning or transparency on the status of the issuer. Investors are therefore not afforded any opportunity to exit before the securities are suspended. The suspension will remain until a white knight rescues the issuer, or until cancellation of the listing if there is no prospect of recovery. Any rescue proposal will often involve a material dilution of existing shareholders' interests. If no rescue proposal is implemented, the current rules provide for the issuer to be delisted after a minimum period of at least 18 months. There are views that the existing delisting mechanism under the current rules are not effective and drag on for too long for issuers showing clear signs of non-viability and non-recoverability to be delisted.

43. In developing the various options for the minimum standards discussed in this Part C, we have made reference to the delisting standards in other major markets. We set out in Appendix 1 a table comparing delisting standards in a number of markets[10]. As the most comprehensive set of delisting standards is found in the US market, we have generally drawn on these standards in developing the options set out in Part C for consideration. We note that Nasdaq rules in respect of the minimum trading price are currently being examined with a view to revising the criteria.

44. The options for the minimum standards discussed in this Part C serve only as a trigger point for an issuer to take appropriate remedial action when it fails to meet the set of minimum standards to maintain a listing. In this regard, we do not consider it appropriate for the Exchange to stipulate what remedial action should be taken by an issuer. We consider that it should be for the management and shareholders, where necessary, of an issuer to decide on a course of action best suited to the issuer and its own particular circumstances.

45. There would be no immediate delisting or suspension of trading of the securities of the issuer when the requirement to take appropriate remedial action is triggered. Instead, the market would be alerted by way of an announcement that the issuer has failed to meet the continuing listing standards. The issuer would then be required to submit, within a specified period[11], a proposal. The proposal, if implemented within a certain timeframe, should be able to restore the issuer to long-term, sustained compliance with the continuing listing standards. During this period, the securities of the issuer would continue trading. Only in the event that issuers fail to submit or implement proposals satisfactory to the Exchange would such steps be taken to cancel the listing of the issuers' securities. The cancellation of listing would have to be approved by the Listing Committee and is subject to the rules of natural justice. In addition, the market may also be alerted by way of special codes shown on the trading screen against the securities of the relevant issuer. In this way, the market would be given

[10] Information in Appendix 1 is mainly derived from the SFC's research paper "Quality of Market and the Case for More Effective Delisting Mechanism".

[11] The duration of the period specified as relevant for the purposes of submitting a resumption proposal was the subject of proposals in Part E of the July Consultation Paper. We will consider and analyse the views expressed on these proposals before proceeding with any rule changes.

prior notice of a potential failure by the issuer to meet the minimum standards to maintain a listing.

46. We recognise that when an issuer fails to meet the continuing listing standards without suspension of trading, this in itself may cause a (further) decline in the share price of an issuer, which in turn could make it harder for the issuer to bring itself back into compliance with the proposed continuing financial standards. This is an inherent risk of providing early warning to investors that an issuer may be delisted and it is difficult to avoid. On balance, we believe that by putting in place certain early warning signals provides a degree of transparency which generally outweighs the potential impact on the share price of an issuer.

47. We would reiterate that our proposals on the continuing listing standards discussed in this Part C are only options. They are aimed at facilitating public debate on the relevant issues. We will take into account the views of respondents to this Consultation Paper when formulating our policies and, if required, any rule changes in this regard.

48. We discuss below the possible continuing listing standards. There are comments that if continuing listing standards are to be put in place, they should be kept as simple and minimal as possible, so as to facilitate understanding and application.

Q3. Do you agree that the continuing listing standards should be as simple and minimal as possible?

☐ *Yes (please answer Q4)*

☐ *No*

Q4. What in your opinion should be the appropriate continuing listing standard(s)? Please state reason(s) for your view.

FINANCIAL STANDARDS

Issues

49. A number of indicators, such as profit, market capitalisation and shareholders' equity, may help to assess the extent of financial performance and level of investor acceptance of an issuer after listing. Whilst some commentators believe that each indicator on its own is sufficient to trigger remedial action to be taken by an issuer, others are of the view that there should be a combination of indicators.

Profit

50. There are views that profit should be the only indicator to measure the extent of financial performance of an issuer, given that an issuer will normally be expected to be able to make profit from its business activities. To these commentators, the listing status of an issuer should be cancelled if the issuer has been loss making over an extended period of time, say, three consecutive years. However, it has to be noted that there may be times when, for reasons beyond the control of issuers, such as a prolonged general decline in the overall economic climate, their ability to make profit may be impaired. Therefore, it would not be reasonable to expect issuers to be profitable or achieve annual growth in profit every year. There are also other views that profit is not an appropriate indicator since it only reflects the past performance of an issuer, and is therefore backward looking.

51. There are also views that the mere fact that an issuer has been loss making should not be taken, on its own, as sufficient ground for cancellation of listing. This is because an issuer, though having continuously recorded losses for a number of years, may still have sufficient assets and operations. Alternatively, an issuer may still appear to be attractive to the public as reflected by its market capitalisation, even if it may be loss making. Accordingly, as a test of whether there are strong indicators of failure of issuers, there are views that a prolonged period of loss making should be considered together with other indicators, such as market capitalisation and shareholders' equity. In this regard, given that a listing applicant is required to demonstrate compliance with a 3-financial-year track record requirement, we suggest that an analogous period of three consecutive years may provide a reasonable benchmark as to what constitutes a prolonged period.

Market Capitalisation

52. There are views that market capitalisation is the only readily available fair indication of the value of an issuer in the eyes of investors. There are views that it reflects the judgment of the general public over the prospects of both the issuer and its industry, and therefore should be the most reliable indicator. Others, however, are of the view that as market capitalisation is subject to market forces that are beyond the control of issuers, it is not an appropriate indicator. Instead, the level of an issuer's net assets serves as a better indicator.

53. The Main Board Rules currently do not have a minimum market capitalisation requirement for continuing listing, although there is a HK$100 million minimum market capitalisation requirement for initial listing. The current Main Board Rules generally require that the expected market capitalisation at the time of listing of the shares which is held by the public must be at least HK$50 million[12] and there is a minimum public float of 25%[13]. Given these requirements, we would normally expect a listing applicant to have a minimum market capitalisation of HK$200 million at the time of listing. Otherwise, for a listing applicant with an expected market capitalisation of HK$100 million to be listed on the Exchange, it will have to increase the public float to 50%. During each of the years ended 31 December 2000 and 2001 and the 7-month period ended 31 July 2002, approximately 92%, 93% and 88% of newly listed issuers (excluding those that were listed under Chapter 21 of the Main Board Rules and by way of introduction) were able to meet the market capitalisation of HK$200 million. It is against such a background that we proposed in paragraph 67 of the July Consultation Paper to increase the initial minimum expected market capitalisation to HK$200 million.

54. Market capitalisation fluctuates as share prices fluctuate. There are views that it may not, therefore, be reasonable to require issuers to maintain at all times the proposed prevailing minimum market capitalisation applicable at the time of initial listing for issuers that list under the minimum profit requirement. There are, however, views that issuers should be required to maintain the minimum market capitalisation as a prerequisite for their continuing listing on the Exchange.

[12] See Rule 8.09(1) of the Main Board Rules.
[13] See Rule 8.08 of the Main Board Rules.

55. Given the fluctuating nature of market capitalisation, we suggest that it would be appropriate to set the benchmark in relation to market capitalistion at HK$50 million. This represents a drop of approximately 75% of the minimum market capitalisation at the time of listing (if our proposal on the minimum market capitalisation requirement set out in paragraph 67 of the July Consultation Paper is adopted).

56. For the purpose of calculating the market capitalisation of an issuer in this Part C, and in order to prevent last minute manipulation of the share price before closing, reference should be made to the "average market capitalisation". The term "average market capitalisation" would mean the average of the daily volume weighted market capitalisation of securities listed and traded on the Exchange over a certain period. In this regard, we suggest that a period of 30 consecutive trading days should provide a reasonable benchmark for observing the moving trend of an issuer's market capitalisation. Where the securities of an issuer are also listed and traded on other regulated markets, the term "average market capitalisation" would mean the average of the global market capitalisation over a period of 30 consecutive trading days. Global market capitalisation in turn would mean the sum of the daily volume weighted market capitalisation of securities listed and traded on the Exchange and the market capitalisation of securities listed and traded on other regulated markets. For this purpose, reference would be made to the daily closing price of such securities of the issuer listed and traded on other regulated markets as announced by these markets. There are, however, views that the period of 30 consecutive days is too short to properly determine a trend in the market capitalisation of an issuer.

Shareholders' Equity

57. Market capitalisation can be regarded as an important means to measure an issuer's achievement and therefore the extent of investors' interest in and acceptance of the issuer. However, there are industries where the share price is at a discount to the book value of the issuer's assets. In such a case, the reference to the market capitalisation alone may not really reflect the true underlying value of the enterprise. In these instances, we suggest that the issuer's shareholders' equity should be taken into account. Analogous to the percentage drop in market capitalisation as discussed in paragraph 55, we suggest that the same benchmark of HK$50 million should also apply to shareholders' equity.

In this connection, the issuer's latest published audited financial information and any subsequent published financial information may be used for the purpose of ascertaining its shareholders' equity.

Views to be sought

58. We propose for consideration that each of the following minimum standards should trigger remedial action to be taken by an issuer:

    (a) loss making for three consecutive years and with negative equity; or

    (b) loss making for three consecutive years and the average market capitalisation being less than HK$50 million over 30 consecutive trading days; or

    (c) the average market capitalisation being less than HK$50 million over 30 consecutive trading days and shareholders' equity being less than HK$50 million.

59. As at 31 August 2002, there were 12, 20 and 18 issuers, representing approximately 1.5%, 2.5% and 2.3% respectively of the total issuers listed on the Main Board[14], that would have failed the minimum standard of paragraphs 58(a), 58(b) and 58(c) respectively. Of these issuers, 3 issuers would have failed only paragraphs 58(b) and (c), and 5 issuers would have failed paragraphs 58(a), (b) and (c).

    Q5. What do you consider are the appropriate indicator(s) for the assessment of an issuer's financial performance in its industry and level of investors' acceptance?

    ☐ *Profit*

    ☐ *Market capitalisation*

    ☐ *Shareholders' equity*

    ☐ *Others. Please specify.*

[14] As at 31 August 2002, there are a total of 794 issuers listed on the Main Board.

Q6. Do you consider that each of the indicators on its own is sufficient to trigger remedial action to be taken by an issuer to maintain its listing status?

☐ *Yes*

☐ *No. The combinations of indicators should be (please tick one of the following):*

☐ *Profit and Market capitalisation*

☐ *Profit and Shareholders' equity*

☐ *Market capitalisation and Shareholders' equity*

☐ *Other combinations. Please specify.*

Please state reason(s) for your view.

Profit

Q7. If you agree that profit is an appropriate indicator, whether alone or jointly with other indicators, what in your opinion would be a reasonable benchmark for a prolonged period of loss making?

☐ *2 years of consecutive losses*

☐ *3 years of consecutive losses*

☐ *Others. Please specify.*

Please state reason(s) for your view.

Q8. If you agree that profit is an appropriate indicator, whether alone or jointly with other indicators, when in your opinion should the prolonged period of loss making commence?

☐ *Forward looking from the effective date of any proposed rule amendment that may result from this consultation*

☐ *Backward looking from the effective date of any proposed rule amendment that may result from this consultation*

☐ *Others. Please specify.*

Please state reason(s) for your view.

Market Capitalisation

Q9. If you agree that market capitalisation is an appropriate indicator, whether alone or jointly with other indicators, what in your opinion would be the appropriate threshold for the minimum market capitalisation?

Q10. Do you consider that the period of 30 consecutive days is a reasonable benchmark for observing the moving trend of an issuer's market capitalisation?

☐ *Yes*

☐ *No. The appropriate duration should be ____ days.*

Please state reason(s) for your view.

Shareholders' Equity

Q11. If you agree that shareholders' equity is an appropriate indicator, whether alone or jointly with other indicators, what in your opinion would be the threshold for the minimum shareholders' equity?

Please state reason(s) for your view.

ABSOLUTE MINIMUM MARKET CAPITALISATION

Issues

60. There are comments that issuers with a small market capitalisation may be more prone to market manipulation, as only a relative small amount of capital may be sufficient to affect their share prices. Accordingly, it may not be conducive to a fair and orderly market where an issuer's market capitalisation in respect of securities listed and traded on the Exchange has been too small for a prolonged period.

61. Other commentators, however, are of the view that if the market capitalisation has become too small thereby giving rise to potential market manipulation, the issue should be addressed via market manipulation rules under the regulatory framework. This course of action is desirable as on the one hand, the specific ill could be remedied, and on the other hand, the ability to trade the issuer's securities could be preserved.

62. There are also views that as market capitalisation is subject to market forces, the issuer should not be penalised for something over which neither it nor its management has control. To these commentators, market capitalisation should be considered in conjunction with other indicators, such as the level of trading activity, to show whether an issuer can command sufficient investors' interest.

Views to be sought

63. We propose for consideration that an issuer should be required to take appropriate remedial action, if the average market captialisation of its securities listed and traded on the Exchange is less than a certain absolute amount, say, HK$30 million, for 30 consecutive trading days, irrespective of the level of its shareholders' equity.

64. As at 31 August 2002, 25 issuers, representing approximately 3% of the total issuers listed on the Main Board, had average market capitalisation below HK$30 million for 30 consecutive trading days. Of these 25 issuers, 2 issuers would also have failed paragraphs 58(a), (b) and (c), 1 issuer would also have failed paragraphs 58(b) and (c) and 11 issuers would also have failed either paragraph 58(b) or (c).

Q12. Do you consider that the absolute minimum market capitalisation on its own is an appropriate indicator to trigger remedial action to be taken by an issuer to maintain its listing status?

☐ *Yes (please answer Q14)*

☐ *No (please answer Q13)*

Please state reason(s) for your view.

Q13. Do you consider that the absolute minimum market capitalisation should be considered in conjunction with other indicators to demonstrate sufficient investors' interest?

☐ *Yes. Please specify what the indicator should be and the threshold you consider reasonable.*

☐ *No*

Please state reason(s) for your view.

Q14. If you think that the absolute minimum market capitalisation is on its own an appropriate indicator, what threshold would you consider reasonable? Please specify and state reason(s) for your view.

INSOLVENCY

Issues

65. It is implicit in a listing status that there has been and there will be a reasonable expectation of financial viability and performance of the issuer. We therefore consider it essential that an issuer must be operating on a "going concern" basis. In attaching importance to the "going concern" concept, we also pay due regard to the principle that issuers should not be delisted prematurely when there is a prospect that they could be saved. Accordingly, where an issuer has been served with a winding up order by the court (or equivalent action in the issuer's country of incorporation) and such an order (or action) becomes effective, it indicates that the issuer, being in or facing financial and operational difficulties, has reached a stage that is beyond rescue. In such circumstances, given that the "life" of the issuer to exist as a corporate entity will soon be terminated, we suggest that the issuer should be subject to immediate delisting.

66. Under the current Main Board Rules, receivership or liquidation is a ground for suspension[15]. During the period from 1 January 2000 to 31 August 2002, there were 14 issuers that were suspended because of receivership or liquidation. Where an issuer goes into receivership or provisional liquidation, it is also indicative of the issuer being in or facing financial and operational difficulties. However, unlike the case where the issuer is beyond recovery when the winding up order (or equivalent action in the issuer's country of incorporation) served on it becomes effective, we consider that the issuer which goes into receivership or provisional liquidation should be given an opportunity to

[15] See Paragraph 3 of Practice Note 11 to the Main Board Rules.

rehabilitate itself by taking remedial action within the specified periods[16] to bring itself back to long-term, sustained compliance with the minimum standards.

67. We consider that the situation in paragraph 66 is similar to the case where any of the issuer's subsidiaries, singly or together, accounting for more than 75% of the issuer's total assets or turnover or after tax profits or production volume ("Principal Subsidiaries"), have been served with a winding up order by the court, or go into receivership or provisional liquidation. In these instances, the issuer's operations may be seriously affected. Yet, given that strictly speaking it is the Principal Subsidiaries and not the issuer itself that are in financial or operational difficulties, the issuer should be given an opportunity to take remedial action to bring itself back to long-term, sustained compliance with the minimum standards.

68. We propose for consideration that an issuer should be required to take appropriate remedial action, if its Principal Subsidiaries have been served with a winding up order by the court, or go into receivership or provisional liquidation, and the remaining business of the issuer is unable to meet the initial listing eligibility criteria. In this connection, we recognise that it may be difficult for an issuer to ascertain its market capitalisation after exclusion of the Principal Subsidiaries, and that it may be time-consuming and costly for the issuer to carry out an investigation under the Securities (Disclosure of Interests) Ordinance to ascertain its spread of shareholders[17]. As such, we see it appropriate that the issuer should be relieved from complying with the market capitalisation requirement and the spread of shareholders requirement, when demonstrating that its remaining business will be able to satisfy the initial listing eligibility criteria. However, for discussion purposes only, we suggest that the issuer should still be required to comply with the market capitalisation requirement and the spread of shareholders requirement on a continuing basis.

69. Where the Principal Subsidiaries of an issuer have been served with a winding up order by the court, or go into receivership or provisional liquidation, and yet the issuer's remaining business is still able to meet

[16] See footnote 11 above.
[17] See Section 18 of the Securities (Disclosure of Interests) Ordinance.

all the initial listing eligibility criteria (other than the market capitalisation requirement and the spread of shareholders requirement which the issuer would be required to comply with on a continuing basis), we suggest that the issuer should not be considered as failing to meet the minimum standards.

70. There are views that an insolvent issuer should be given a chance to rehabilitate itself. Given that its listing status has value and if the issuer can wait to be rescued, both its minority shareholders and creditors can benefit by recouping part of their investments, no matter how small it is.

Views to be sought

71. We propose for consideration that where the court has served on an issuer a winding up order (or equivalent action in the issuer's country of incorporation) and that order (or action) becomes effective, the issuer would be subject to immediate cancellation of listing.

72. We also propose for consideration that each of the following events should trigger remedial action to be taken by an issuer if:

    (a) it goes into receivership or provisional liquidation; or

    (b) its Principal Subsidiaries have been served with a winding up order by the court (or equivalent action in the country of incorporation of the Principal Subsidiaries), or go into receivership or provisional liquidation, and the remaining business of the issuer is unable to meet all the initial listing eligibility criteria, except for the market capitalisation requirement and the spread of shareholders requirement which the issuer would have to comply with on a continuing basis.

    The term "provisional liquidation" refers to the period after the presentation of a winding up petition and before the making of a winding up order by the court (or equivalent period in the country of incorporation of the issuer or its Principal Subsidiaries).

Q15. Do you consider it important that an issuer must be operating on a going concern basis?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

Q16. Do you consider it appropriate to subject an issuer to immediate cancellation of listing where a winding up order by the court, which has been served on an issuer, becomes effective?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

Q17. When an issuer goes into receivership or provisional liquidation, do you think it appropriate to treat the issuer differently from the case where a winding up order by the court, which has been served on an issuer, becomes effective?

☐ *Yes (please answer Q18)*

☐ *No*

Please state reason(s) for your view.

Q18. Do you think it appropriate that where an issuer goes into receivership or provisional liquidation, the issuer should be given an opportunity to take remedial action to bring itself back to long-term compliance with the minimum standards?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

Q19. Would you be concerned about the viability of the business of an issuer if any of the issuer's Principal Subsidiaries have been served with a winding up order by the court, or go into receivership or provisional liquidation?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

Q20. Do you consider it appropriate to require an issuer to take remedial action if its Principal Subsidiaries have been served with a winding up order by the court, or go into receivership or provisional liquidation?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

Q21. Do you think it more justified to require an issuer to take remedial action if its Principal Subsidiaries have been served with a winding up order by the court, or go into receivership or provisional liquidation, and the remaining business of the issuer is unable to meet the initial listing eligibility criteria (other than the market capitalisation requirement and the spread of shareholders requirement which the issuer would be required to comply with on an ongoing basis)?

☐ *Yes*

☐ *No*

☐ *Other views. Please specify.*

Please state reason(s) for your view.

DISCLAIMER OF AUDIT OPINION OR ADVERSE AUDIT OPINION

Issues

73. As we attach importance to the issuer being able to operate on a "going concern" basis, we consider that it is likewise important that an issuer should be able to keep proper books and records. The market needs reliable and timely information. If the most recent auditor's report of the issuer contains a disclaimer opinion (where the auditor does not give an opinion as to whether the financial statements give a true and fair view) or an adverse opinion (where there are certain matters that are so significant that the auditor cannot agree that the financial statements give a true and fair view of the state of the issuer's affairs), such an opinion raises serious concerns about the issuer's ability to meet its disclosure obligations as a listed company. In these instances, we believe that for the protection of investors the issuer should be required to take remedial action.

74. There are, however, views that a disclaimer opinion or an adverse opinion is just an auditor's opinion, and not a statement of fact. As such, it should not be treated as one of the minimum standards that an issuer has to comply with for maintaining its listing status. There are comments that if it is treated as a minimum standard, auditors may hesitate in issuing such an opinion. To these commentators, the matter could be dealt with by way of disclosure.

Views to be sought

75. We propose for consideration that an issuer should be required to take remedial action if its most recent auditor's report contains a disclaimer opinion or an adverse opinion.

76. A total of 56 annual reports issued by issuers in respect of financial years ended between 31 January 2000 to 28 February 2002 contained a disclaimer opinion. Out of these 56 disclaimer opinions, 23 were given on fundamental uncertainty relating to going concern only, and 25 were given on fundamental uncertainty relating to going concern and other accounting matters. 16 issuers' annual reports contained disclaimer opinions which are for two consecutive financial years.

Q22. Would the fact that the most recent auditor's report of an issuer contains a disclaimer opinion or an adverse opinion affect one's investment decision?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

☐ *N/A (if you are not an investor)*

Q23. Do you consider it appropriate to require an issuer to take remedial action if its most recent auditor's report contains a disclaimer opinion or an adverse opinion?

☐ *Yes (please answer Q24)*

☐ *No*

Please state reason(s) for your view.

Q24. How much time should be given for the remedial action to be taken? Please state reason(s) for your view.

MINIMUM TRADING ACTIVITY LEVEL

Issues

77. The Main Board Rules currently do not require an issuer to have a minimum trading turnover for continuing listing.

78. There are issuers that have been dormant in terms of trading activity on the Exchange, with little to no turnover in their securities, for years. The absence or thin trading volume in these issuers may signify either a lack of investors' interest in their securities, or that the existing shareholders are holding their shares as a long-term investment.

79. It is recognised, however, that there are times when external factors not relating to the fundamentals of issuers, such as a general slow-down in the overall market activities, may inhibit the trading of their securities. There are also instances where issuers may have a large number of public investors as shareholders and yet they have only a very low trading turnover. It is possible that these investors are holding on to the issuers' securities as long-term investments.

80. To ensure that every issuer listed on the Exchange is able to attract sufficient public interest to warrant its listing status, there are views that it would be appropriate to set a minimum trading activity level as a continuing listing requirement. Yet, for reasons as discussed in paragraph 79, the lack of liquidity, on its own, may not be indicative of the performance of the issuer being sufficiently poor to warrant cancellation of listing of its securities. Therefore, we do not propose that trading volume should be considered as one of the continuing listing standards.

Views to be sought

81. We do not propose that an issuer should be required to take remedial action based on trading volume.

Q25. Do you agree that trading volume is not an appropriate indicator to trigger remedial action to be taken by an issuer to maintain its listing status?

☐ *Yes, trading volume is an appropriate indicator (please answer Q26)*

☐ *No, trading volume is not an appropriate indicator.*

☐ *No, trading volume should be considered in conjunction with other indicators. Please specify what are these other indicators.*

Please state reason(s) for your view.

Q26. What in your opinion should be the appropriate threshold for trading volume? Please state reason(s) for your view.

REDUCTION IN OPERATING ASSETS AND/OR LEVEL OF OPERATIONS

Issues

82. Under the current Main Board Rules, delisting will commence with trading suspension where an issuer shows signs of insufficiency of operations or assets, characterised by:

    (a) financial difficulties to an extent which seriously impair an issuer's ability to continue its business or which has led to the suspension of some or all of its operations; and/or

    (b) net liabilities as at the balance sheet date[18].

83. On the basis of the current position referred to in paragraph 82, we propose for consideration that if an issuer's net assets or total assets or operations or turnover or after tax profits have been or are to be substantially reduced or depleted as a result of a corporate action[19] resulting in its remaining business not being able to meet the initial listing eligibility criteria, the issuer should be required to take remedial action to bring itself back to long-term, sustained compliance with the minimum standards. In this connection, we suggest that a decrease in the issuer's net assets or total assets or operations or turnover or after tax profits by 75% or more of those of the immediately preceding financial year as a result of corporate action should be regarded as substantial. Given that the effect of a substantial reduction in an issuer's operating assets and/or level of operations is similar to that of a "very substantial disposal" as proposed in the Consultation Paper on Proposed Amendments to the Listing Rules relating to Corporate Governance Issues, January 2002[20] ("Corporate Governance Consultation Paper"), we suggest that the same threshold of 75% should be used.

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[18] See Paragraph 2.2 of Practice Note 17 to the Main Board Rules.

[19] For issues discussed under the paragraphs headed "Reduction in Operating Assets and/or Level of Operations" and "Cash Companies" in this Part C of the Consultation Paper, the term "corporate action" refers to any action outside the ordinary and usual course of business of an issuer.

[20] See section 16 of Part B of the Corporate Governance Consultation Paper.

84. Where an issuer proposes to undertake a corporate action that would have the effect of decreasing its net assets or total assets or operations or turnover or after tax profits by 75% or more of those of the immediately preceding financial year resulting in its remaining business being unable to meet all the initial listing criteria, it would in effect be selling off the majority, if not all, of its business. We perceive that if our proposal in paragraph 87(a) is adopted, a proposal to undertake any such corporate action should trigger the need for an issuer to take action. In these instances, for shareholders' protection, the shareholders of the issuer should be made aware of the circumstances and their approval should be sought on such corporate action. Accordingly, for the purpose of enabling the issuer's shareholders to vote on the resolution regarding whether to proceed with the corporate action, we propose for consideration that the issuer should follow the current Main Board Rules regarding privatisation[21].

85. On the same rationale as discussed in paragraph 68 of this Consultation Paper, it may be difficult for an issuer to ascertain its market capitalisation after the corporate action that has the effect of substantially reducing or depleting its net assets or total assets or operations or turnover or after tax profits. Likewise, it may also be time-consuming and costly for the issuer to carry out an SDI investigation to ascertain its spread of shareholders before proceeding to undertake such a corporate action. Accordingly, we consider it appropriate that the issuer should not be required to meet the market capitalisation requirement and the spread of shareholders when demonstrating that its remaining business after the corporate action will be able to satisfy the initial listing eligibility criteria. However, for discussion purposes only, we suggest that the issuer should still be required to comply with the market capitalisation requirement and the spread of shareholders requirement on a continuing basis.

86. Where the remaining business of an issuer, after a corporate action that has the effect of reducing the issuer's net assets or total assets or operations or turnover or after tax profits by 75% or more of those of the immediately preceding financial year, still meets all the initial

[21] See Rule 6.12 of the Main Board Rules.

listing eligibility criteria (other than the market capitalisation requirement and the spread of shareholders requirement which the issuer would be required to comply with on a continuing basis), we propose for consideration that the issuer should not be regarded as failing to meet the minimum standards. We also propose for consideration that the issuer's latest available published financial information after the corporate action, excluding cash, should be used for the purpose of determining whether its remaining business satisfies the initial listing eligibility criteria.

Views to be sought

87. We propose for consideration that:

(a) an issuer should be required to take appropriate action, if after a corporate action proposed to be undertaken by the issuer, there would be a decrease in its net assets or total assets or operations or turnover or after tax profits by 75% or more of those of the immediately preceding financial year, and its remaining business would be unable to meet all the initial listing eligibility criteria, except for the market capitalisation requirement and the spread of shareholders requirement which the issuer would be required to comply with on a continuing basis; and

(b) the approval of the shareholders of the issuer should be sought prior to the issuer undertaking any such corporate action. For the purpose of enabling the issuer's shareholders to vote on the resolution regarding whether to proceed with the corporate action, the issuer should follow the Main Board Rules regarding privatisation by:

(i) obtaining independent shareholder's approval, which under the current Main Board Rules is a majority in number representing three-fourths in value of the shareholders present and voting either in person or by proxy at a general meeting. However, if our proposal for shareholders' approval for

privatisation in the Corporate Governance Consultation Paper is adopted, an issuer will be required to obtain:

- the approval of at least 75% of the votes attaching to the shares held by independent shareholders cast either in person or by proxy in a general meeting of independent shareholders; and

- the number of votes cast against the resolution must not be more than 10% of the votes attaching to all the shares held by independent shareholders; and

(ii) offering to its shareholders and holders of any other class of listed securities, if applicable, other than the directors, chief executive and controlling shareholders, a reasonable cash alternative or other reasonable alternative.

Q27. Do you consider it appropriate to require an issuer to take remedial action where its net assets or total assets or operations or turnover or after tax profits have been or are to be substantially reduced or depleted as a result of a corporate action, and its remaining business will be unable to meet all the initial listing eligibility criteria (other than the market capitalisation requirement and the spread of shareholders requirement which the issuer would be required to comply with on a continuing basis)?

☐ *Yes (please answer Q28)*

☐ *No*

Please state reason(s) for your view.

Q28. Would you regard a decrease in net assets or total assets or operations or turnover or after tax profits by 75% or more of those of the immediately preceding financial year as a result of a corporate action as substantial?

☐ *Yes*

☐ *No (please answer Q29)*

Please state reason(s) for your view.

Q29. What percentage decrease do you think is appropriate?

Q30. Should there be any such corporate action, do you consider it necessary for shareholders' protection that the approval of the issuer's independent shareholders should be sought prior to the issuer undertaking such corporate action?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

Q31. For shareholders' protection, do you think the issuer should be required to follow the Main Board Rules regarding privatisation to obtain the approval of the independent shareholders in respect of any such corporate action?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

CASH COMPANIES

Issues

88. The Main Board Rules currently provide that an issuer or group (other than investment company) whose assets consist wholly or substantially of cash or short-dated securities and which thus ceases to trade, will not normally be regarded as suitable for listing. Consequently, any change in an issuer's position which produces this situation will normally result in a suspension of listing[22].

89. We consider that our current rule is sufficient to determine whether cash-rich companies without sufficient operations should maintain the listing status. However, we consider that there should be an objective criterion to determine what constitutes a cash company. In this connection, we propose for consideration to treat an issuer (except for investment companies, banks, insurance and other similar financial services companies) as a cash company if it proposes to undertake any corporate action that would result in 90% of its assets being cash or short dated securities or portfolio shares investment or other marketable securities. Whilst recognising that to an extent 90% is an arbitrary figure, our intention in proposing a high threshold is to ensure that the rule captures companies whose assets are substantially cash and cash equivalents and not those which have retained a high level of liquid assets for genuine business purposes.

90. If our proposal in paragraph 91(a) is adopted, the consequences of an issuer proposing any such corporate action should be to trigger a requirement for the issuer to notify shareholders of the proposal and obtain their prior approval. In this regard, we propose for consideration that the issuer should follow the Main Board Rules regarding privatisation.

[22] See Rule 14.35 of the Main Board Rules.

Views to be sought

91. We propose for consideration that:

(a) an issuer should be required to take appropriate remedial action if by completion of the proposed corporate action, it would become a cash company. An issuer (except for investment companies, banks, insurance and other similar financial services companies) having 90% of its assets in cash or short dated securities or portfolio shares investment or other marketable securities would for the purpose of this requirement be considered as a cash company; and

(b) the approval of the shareholders of the issuer should be sought prior to the issuer undertaking any such corporate action. For the purpose of enabling the issuer's shareholders to vote on the resolution regarding whether to proceed with the corporate action, the issuer should follow the Main Board Rules regarding privatisation by:

(i) obtaining independent shareholder's approval, which under the current Main Board Rules is a majority in number representing three-fourths in value of the shareholders present and voting either in person or by proxy at general meeting. However, if our proposal for shareholders' approval for privatisation in the Corporate Governance Consultation Paper is adopted, an issuer will be required to obtain:

- the approval of at least 75% of the votes attaching to the shares held by independent shareholders cast either in person or by proxy in a general meeting of independent shareholders; and

- the number of votes cast against the resolution must not be more than 10% of the votes attaching to all the shares held by independent shareholders; and

(ii) offering to its shareholders and holders of any other class of listed securities, if applicable, other than the directors, chief executive and controlling shareholders, a reasonable cash alternative or other reasonable alternative.

Q32. Do you think it necessary to introduce an objective criterion to determine what constitutes a cash company?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

Q33. Would you consider an issuer (except for investment companies, banks, insurance and other similar financial services companies) to be a cash company if it undertakes any corporate action that results in 90% of its assets being cash or short dated securities or portfolio shares investment or other marketable securities?

☐ *Yes*

☐ *No (please answer Q34)*

Please state reason(s) for your view.

Q34. What other factors and percentage decrease would you take into account? Please state reason(s) for your view.

Q35. Should there be any such corporate action, do you consider it necessary for shareholders' protection that the approval of the issuer's independent shareholders should be sought prior to the issuer undertaking such corporate action?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

Q36. For shareholders' protection, do you think the issuer should be required to follow the Main Board Rules regarding privatisation to obtain the approval of the independent shareholders in respect of any such corporate action?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

PROLONGED SUSPENSION

Issues

92. Under the current Main Board Rules, the continuation of a suspension for a prolonged period without the issuer taking adequate action to restore its listing may lead to the Exchange cancelling the listing[23]. There is, however, no specific indication as to what constitutes a "prolonged period". During the period from 1 January 2000 to 31 August 2002, there were 7 issuers that were suspended for a considerable period for reasons other than receivership or liquidation or failure to comply with the requirements of Paragraph 38 of the Listing Agreement. To maintain a fair and continuous market, and to ensure that a suspension period should be kept as short as reasonably possible, we propose for consideration to introduce an objective criterion to determine what constitutes a "prolonged period". In this connection, we propose for consideration that a period of 12 months would provide a reasonable benchmark. In arriving at such a benchmark, we have made reference to the approach adopted in the UK. The UK Listing Authority will normally cancel listing if a security has its listing suspended for more than 6 months[24] without the issuer taking adequate action to obtain a restoration of listing.

[23] See Rule 6.04 of the Main Board Rules. Indeed, Rule 1.19 of the UK Listing Rules provides similarly that the UK Listing Authority may cancel the listing of any securities if it is satisfied that there are special circumstances which preclude normal regular dealings in them.

[24] See paragraph 9.4.3 of the UKLA Guidance Manual.

93. As discussed in paragraphs 204 to 206 of Part D of the July Consultation Paper, we propose to introduce a continuing obligation to require issuers to publish timely financial results. It is our proposal to suspend the securities of those issuers that do not publish the requisite financial results on time. Accordingly, we suggest that issuers that have been suspended for more than 12 months because of delay in publishing financial results should not, prima facie, be treated as failing to meet the minimum standards on the ground of prolonged suspension. During the period from 1 January 2000 to 31 August 2002, there were 75 issuers that failed to publish the financial results within the deadline as required under the Main Board Rules. Of these 75 issuers that were late with their accounts, 10 issuers failed to publish their financial results for 12 months or more after the relevant prescribed deadlines. Of the 10 issuers, 3 issuers eventually published their financial results despite the lateness, the remaining 7 issuers were either undergoing restructuring or have been delisted and did not publish their financial results. However, where there is any indication that an issuer is likely to fail to meet other minimum standards and there are no acceptable or justifiable reasons for the issuer's prolonged delay in the publication of its results, we propose for consideration that the issuer should be required to take appropriate remedial action to bring itself back to long-term compliance with the minimum standards, failing which it may face cancellation of the listing of its securities.

Views to be sought

94. We propose for consideration that an issuer should be required to take appropriate remedial action, if for whatever reasons, its securities have been suspended from trading for a continuous period of 12 months. We do not propose to treat issuers that have been suspended for more than 12 months because of a delay in publishing their results as, prima facie, failing to meet the minimum standards. However, where there is any indication that an issuer is likely to fail to meet other minimum standards and there are no acceptable or justifiable reasons for the issuer's prolonged delay in the publication of its results, the Exchange may require the issuer to take appropriate remedial action to bring itself back to long-term compliance with the minimum standards, failing which the issuer may face cancellation of the listing of its securities.

Q37. Under the current Main Board Rules, the continuation of a suspension for a prolonged period without the issuer taking adequate action to restore its listing may lead to the Exchange cancelling the listing of its securities. Do you think it necessary to specify what constitutes a prolonged period?

☐ *Yes (please answer Q38)*

☐ *No*

Please state reason(s) for your view.

Q38. What period do you consider to be a reasonable benchmark? Please state reason(s) for your view.

Q39. Do you think it reasonable to treat an issuer whose securities have been suspended from trading for a prolonged period (other than a delay in publishing financial results) as failing to meet the minimum standards for maintaining a listing?

☐ *Yes (please answer Q40)*

☐ *No*

Please state reason(s) for your view.

Q40. Would your view differ where there is any indication that an issuer is likely to fail to meet other minimum standards for maintaining a listing, and there are no acceptable or justifiable reasons for the issuer's prolonged delay in the publication of its results?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

PARAGRAPH 38 OF LISTING AGREEMENT

Issues

95. It is currently a continuing obligation under Paragraph 38 of the Listing Agreement, that an issuer has to carry out a sufficient level of operations or have sufficient assets to warrant its continuing listing. We consider that the ability of an issuer to carry on a viable business is important for maintaining its listing status. It is against such a background that we propose for consideration in paragraph 87 where an issuer has its operating assets and/or level of operations substantially reduced resulting in its remaining assets not being able to meet the initial listing eligibiltiy criteria, the issuer should be required to take remedial action to bring itself back to long-term compliance with the minimum standards, failing which it will face the cancellation of its listing status. As such, the sufficiency of operations or assets is more an issue of continuing listing standards (failure to comply with which would give rise to a requirement for an issuer to take appropriate remedial action to maintain its listing status) than a continuing obligation (failure to comply with which would result in breaches of the Main Board Rules and give rise to disciplinary action).

Views to be sought

96. We propose for consideration to retain Paragraph 38 of the Listing Agreement as a reserved general ongoing minimum standard for maintaining listing to supplement the proposed quantitative criterion on reduction in operating assets and/or level of operations (paragraph 87). We propose for consideration that an issuer should be required to take appropriate remedial action if it fails to comply with Paragraph 38 of the Listing Agreement.

Q41. It is currently a continuing obligation, under Paragraph 38 of the Listing Agreement, that an issuer has to carry out a sufficient level of operations or have sufficient assets to warrant its continuing listing. Do you think the sufficiency of operations or assets is more an issue of continuing listing standards (failure to comply with which would give rise to a requirement for an issuer to take appropriate remedial action to maintain its listing status)

than a continuing obligation (failure to comply with which would result in breaches of the Main Board Rules and give rise to disciplinary action)?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

PERSISTENT BREACHES OF THE MAIN BOARD RULES

Issues

97. There are instances where issuers may have persistently committed breaches of the Main Board Rules and therefore be subject to disciplinary actions. Very often, these breaches could have been avoided if the issuer had exercised due care to ensure compliance with the relevant obligations. Our aim is to promote a high standard of awareness among issuers of the importance of strict compliance with the Main Board Rules. Therefore, we propose for consideration that the Exchange may in its discretion, having taken into account the frequency and nature of the breaches, subject those issuers that have persistently failed to comply with the Main Board Rules to the cancellation of listing procedures. Examples that the Exchange will take into account will be where the issuer has been given repeated sanctions of public censure or public statement involving criticism in accordance with the disciplinary procedures in the Main Board Rules.

Views to be sought

98. We propose for consideration that the Exchange may in its discretion, having taken into account the frequency and nature of the breaches, subject those issuers that have persistently failed to comply with the Main Board Rules to the cancellation of listing procedures.

Q42. How should awareness of the importance of strict compliance with the Main Board Rules be promoted among issuers? Please explain your view.

Q43. Do you think it appropriate to subject an issuer that has persistently breached the Main Board Rules to the cancellation of listing procedures, rather than to disciplinary procedures?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

Q44. In considering what constitutes persistent breaches, what factors should be taken into account? Frequency and nature of the breaches? Or any other factors?

ILLEGAL OPERATION

Issues

99. It is the broad principle under the Main Board Rules that listing is granted subject to the condition that the Exchange may, at any time, suspend or cancel the listing of any securities in such circumstances and on such conditions as it thinks fit, where it considers it necessary for the protection of investors or the maintenance of an orderly market[25].

100. In the specific case where an issuer changes its focused line(s) of business and commences operation of a focused line of activity that is illegal or contrary to the Exchange's general principles set out in the Main Board Rules[26], then for the protection of investors or the promotion of fair trading, we propose for consideration that the Exchange may in its discretion subject the issuer to the cancellation of listing procedures.

Views to be sought

101. We propose for consideration that an issuer should be required to take appropriate remedial action, if there exists or occurs any event, condition or circumstances that makes further dealings or listing of the issuer's securities, in the opinion of the Exchange, contrary to the Exchange's general principles.

Q45. Do you think it appropriate if an issuer that operates a focused line of activity which is illegal or contrary to the Exchange's general principles should remain listed on the Exchange?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

[25] See Rule 6.01 of the Main Board Rules.

[26] See Rule 2.03 of the Main Board Rules. The Exchange's general principles are, for example, that the issue and marketing of securities is conducted in a fair and orderly manner and that potential investors are given sufficient information to enable them to make a properly informed assessment of an issuer, investors and the public are kept fully informed by issuers, all holders of listed securities are treated fairly and equally, directors of an issuer act in the interests of its shareholders as a whole, and all new issues of equity securities by an issuer are first offered to the existing shareholders by way of rights issue unless they agree otherwise.

Q46. If an issuer operates such activities, do you think it appropriate for the protection of investors or the promotion of fair trading to require it to take appropriate remedial action?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

EXCHANGE'S DISCRETION

102. We recognise that the introduction of objective and transparent continuing listing standards may present opportunities for the controlling shareholders of an issuer to circumvent minority shareholders protection under the Main Board Rules and the Takeovers Code. Given that once an issuer is delisted, it would no longer be subject to the Main Board Rules or may not be subject to the Takeovers Code and the Share Repurchases Code, and delisting may lead to a lower degree of minority shareholders protection. To act as a deterrent against abuse of the delisting process, we propose that the Exchange should retain a discretionary power to deviate from the application of the cancellation of listing procedure.

Q47. What is your view on such discretion of the Exchange and how should it be exercised? Please state the reason(s) for your view.

TRANSITIONAL PERIOD

103. We suggest that if continuing listing standards are to be introduced as part of the Main Board Rules, such standards should become effective immediately when amendments of the Main Board Rules are made, given that some of these standards may be met by the issuer not taking the relevant actions. However, we are also mindful that the immediate enforcement of certain of the new standards upon them becoming effective may be too harsh on existing issuers and the grant of transitional periods may therefore be justifiable to enable issuers to take remedial action to comply with.

104. There are, indeed, views that it would be unfair to existing issuers given that these standards did not exist at the time when they got listed. To these commentators, if after consultation it is decided to introduce continuing listing standards, existing issuers should be given a longer transitional period to achieve compliance. Accordingly, we propose for consideration that:

(a) there should be a transitional period of 12 months for issuers to bring themselves to compliance with the following minimum standards:

(i) financial standards; and

(ii) absolute minimum market capitalisation;

(b) there should be no transitional period for the following:

(i) reduction in operating assets and/or level of operations;

(ii) cash companies;

(iii) prolonged suspension;

(iv) Paragraph 38 of the Listing Agreement;

(v) persistent breaches of the Main Board Rules;

(vi) illegal operation;

(vii) insolvency; and

(viii) disclaimer of audit opinion or adverse audit opinion; and

(c) all listing applicants that are approved after the amendment of the Main Board Rules should be subject to the new continuing listing eligibility criteria immediately upon listing of their securities on the Exchange. There should be no transitional period.

Q48. In respect of existing issuers, do you agree that there should be transitional periods for them to achieve compliance with the continuing listing standards, if adopted?

☐ *Yes (please answer Q49)*

☐ *No*

Please state reason(s) for your view.

Q49. In respect of each of the continuing listing standards that you consider issuers should be allowed time to comply with, how long do you consider the transitional periods should be? Please state reason(s) for your view.

Financial Standards

_____

Absolute Minimum Market Capitalisation

_____

Insolvency

_____

Disclaimer of Audit Opinion or Adverse Audit Opinion

_____

Reduction in Operating Assets and/or Level of Operations

_____

Cash Companies

_____

Prolonged Suspension

Paragraph 38 of Listing Agreement

Persistent Breaches of the Main Board Rules

Illegal Operation

Others. Please specify:

Q50. All listing applications that are approved after the amendment of the Main Board Rules should be subject to the new continuing listing eligibility criteria immediately upon listing. Do you consider this to be reasonable?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

PART D
ALTERNATIVE TREATMENTS OF SECURITIES DELISTED FROM THE MAIN BOARD

GENERAL

105. After its securities are delisted from the Main Board, an issuer would become an unlisted company, in which case the Main Board Rules would have no application. The rights of its individual shareholders would then be governed by the law of the place of its incorporation as well as its constitutional documents.

106. Although delisted from the Main Board, the issuer still remains a public company and its securities can still be traded over-the-counter by willing buyers and sellers. However, there are comments that due to the lack of an organised open market, existing shareholders of these delisted issuers will be the most adversely affected as they would encounter difficulty, such as insufficient transparency, in disposing of their securities. To these commentators, putting in place alternative arrangements for delisted securities is a prerequisite for introducing a delisting regime. It is essential that existing shareholders should be able to trade their securities after delisting, although they acknowledge that this venue for trading of delisted securities may not necessarily be liquid.

107. Two alternative potential mechanisms, compulsory buy-back and compulsory winding-up, have been suggested to enable minority shareholders to realise their investments. For the reasons mentioned below a number of commentators believe that neither of these proposals would provide a pragmatic and enforceable solution that could be applied consistently. Notwithstanding these views, we welcome further analysis and suggestions on these and other potential mechanisms.

COMPULSORY PRIVATISATION OR BUY-BACK BY CONTROLLING SHAREHOLDERS

108. An issuer, whether under the existing delisting procedures[27] or the proposed cancellation of listing procedures, are required to submit a

[27] See paragraph 3 of Practice Note 17 of the Main Board Rules.

resumption or rehabilitation proposal to ensure that it will be able to, under the existing rules, comply with Paragraph 38 of the Listing Agreement by having sufficient assets or operations to warrant a listing status, or under the proposed cancellation of listing procedures, restore itself to long-term, sustained compliance with the minimum continuing listing standards.

109. There are suggestions that where an issuer fails or refuses to submit a proposal or the proposal submitted is not approved by the Exchange, the controlling shareholders of the issuer should be compelled to privatise the issuer by making a general offer to buy back the shares held by the minority shareholders at a reasonable price.

110. Other commentators are, however, of the view that it is not just and equitable to treat controlling shareholders differently, particularly when the dire situation of the issuer facing possible delisting is caused by financial difficulties of the issuer or substantial losses arising from the issuer's ordinary course of business. To these commentators, there should not be any distinction between controlling and minority shareholders. Their rights and obligations on delisting of the issuer should be the same. Where the event of delisting is not brought about by the conduct of the controlling shareholders or the controlling shareholders are passive and not involved in the management of the issuer, there are further concerns about the fairness of this proposal. Further, leaving aside the practical legal difficulties that an issuer, a minority shareholder or the Exchange, in an enforcement capacity, may face under the relevant law of the jurisdiction in which the issuer is incorporated, on whether its controlling shareholders could be compelled to make a compulsory privatisation, there are a number of reasons why compelling controlling shareholders to privatise the issuer on delisting may not be practically feasible. We note examples of these difficulties below, although this is not an exhaustive list.

    (a) There may not be, by definition, any controlling shareholders holding 30% or more of the voting right at general meetings of an issuer[28].

[28] See the definition of "controlling shareholder" in Rule 1.01 of the Main Board Rules.

(b) Even if there are controlling shareholders, they may not necessarily have adequate financial resources for the general offer.

(c) In certain regulated industries consent from regulatory bodies will be required before a change in control or an acquisition of further shares by a controlling shareholder. In other situations, a waiver from competition restrictions may be required. There is no guarantee in these circumstances that the offeror would be able to obtain the necessary consents.

(d) Restrictions on the ability of the controlling shareholders, such as Mainland domestic entities, to buy shares on the Hong Kong market, except a company's repurchase of its own shares, pose a significant issue for this sector. Similarly, amendments to the constitutional documents of PRC issuers may not be approved by Mainland authorities.

COMPULSORY WINDING-UP

111. Some commentators suggest that if the controlling shareholders do not do anything to help the issuer from being delisted, the issuer should be compulsorily wound up after delisting, such that the existing shareholders would be able to share in the remaining assets, if any, of the issuer. Other commentators, however, consider that compulsory winding-up is not a feasible course of action as upon delisting, the Main Board Rules would no longer have application and the rights of the shareholders of a delisted issuer would then involve the law of the issuer's place of incorporation, and the issuer's constitutional documents. Similar to the case of compulsory privatisation, the suggestion to compulsorily wind up an issuer after delisting may be met with legal difficulties, in initiating and enforcing the process, under the relevant law of the jurisdiction in which the issuer is incorporated. Accordingly, such a solution may not be legally capable of implementation. Furthermore, typically, values reserved through insolvency proceedings are less than the carrying values of the assets in the issuer's books and depending on any discount to the net asset value may also be lower than market value. Where a company is not solvent, the process of liquidation is likely to be controlled by creditors rather than shareholders and their objectives may not be aligned with those of shareholders.

Q51. What is your view on the feasibility of compulsory buy-back and compulsory winding-up?

Please state reason(s) for your view.

Q52. What other practical and legal difficulties would you anticipate with compulsory buy-back or compulsory winding-up?

Q53. In view of the difficulties mentioned above with the proposals for compulsory buy-back and compulsory winding-up, do you have any suggestions on how to overcome these problems or any alternative suggestions?

Please state reason(s) for your view.

ESTABLISHMENT OF AN ALTERNATIVE BOARD FOR THE LISTED MARKET

112. There are suggestions that issuers removed from the Main Board should be allowed to retain its listing status and continue to trade on the platform of the Exchange's existing third generation of the Automatic Order Matching and Execution System (AMS/3). To differentiate these issuers that are no longer qualified for listing on the Main Board from the rest of the Main Board issuers, these issuers could be re-classified under a special category. Once these issuers are able to meet the initial listing criteria they should be allowed to return to the Main Board under simplified procedures.

113. There are comments that securities delisted from the Main Board could be transferred to the Growth Enterprise Market ("GEM") for trading. However, given that GEM was established to provide an avenue for capital formulation for emerging companies to facilitate their business development and/or expansion, it may not be appropriate if issuers that do not qualify for continuing listing on the Main Board are allowed to switch the trading of their securities on GEM immediately after having been delisted from the Main Board. Accordingly, we consider that if an issuer, subsequent to delisting from the Main Board, wishes to apply for listing on any market operated by the Exchange, it would have to satisfy

the relevant listing rules requirements of such market. In this connection, we suggest for track record purposes the commencement date should be from the date of its delisting from the Main Board.

114. The approach in paragraph 112 is to operate a listed market for issuers that can meet the initial listing eligibility criteria but fail to satisfy the minimum standards to maintain a continuing listing on the Main Board.

115. As the establishment of an alternative board or other alternative platforms involves policy consideration on a whole range of regulatory and operational matters that requires further study, we will collect as much market views as possible on the issues. Subject to the market views collected from this consultation exercise, we may issue a separate consultation paper on the establishment of an alternative board or other alternative platforms should it be considered appropriate.

Q54. Do you consider it appropriate that the Main Board and the GEM should continue to cater for companies with different objectives and features and that securities delisted from the Main Board should not be allowed to list immediately on the GEM?

☐ *Yes (please answer Q55)*

☐ *No (please answer Q56)*

Please state reason(s) for your view.

Q55. Should there be any conditions for issuers removed from the Main Board to meet before their securities can be listed on the GEM?

☐ *Yes. The conditions should be:*

_____

☐ *No (please answer Q56)*

Please state reason(s) for your view.

Q56. Do you consider it appropriate to set up an alternative board for the trading of listed securities of issuers that are removed from the Main Board?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

MARKET FOR TRADING UNLISTED SECURITIES

116. Instead of retaining the listing status of those issuers that are no longer qualified for continuing listing on the Main Board, there are suggestions that an alternative trading platform should be provided to enable the securities of these delisted Main Board issuers to continue to be quoted for trading.

117. There is currently no organised open market for unlisted equity securities in Hong Kong. There are, however, arrangements by which "automated trading services" (ATS)[29] may provide trading facilities for securities. Licensing, authorisation and registration are required for a person to carry on ATS activity[30] given that ATS constitutes one of the nine regulated activities (i.e. Type 7)[31] under the Securities and Futures Ordinance (SFO).

[29] "Automated trading services" refers to services provided by means of electronic facilities, not being facilities provided by a recognised exchange company or a recognised clearing house, whereby (i) offers to sell or purchase securities or futures contracts are regularly made or accepted in a way that forms or results in a binding transaction, (ii) persons are regularly introduced, or identified to other persons in order that they may negotiate or conclude, or with the reasonable expectation that they will negotiate or conclude sales or purchases of securities or futures contracts in a way that forms or results in a binding transaction; or (iii) transactions referred to in (i); resulting from the activities in (ii); or effected on, or subject to the rules of, a stock market or futures market, may be novated, cleared, settled or guaranteed. The term does not, however, include such services provided by a corporation operated by or on behalf of the Government. See the definition of "automated trading services" in Part 2 of Schedule 5 to the SFO.

[30] Part III, Division 7 and Part V of SFO. For details of the principles, procedures and standards in relation to licensing, authorisation and registration of persons by the SFC for providing ATS, please refer to the Guidelines for the Regulation of Automated Trading Services published by the SFC in February 2002.

[31] See Part 1 of Schedule 5 to the SFO."

Practices in other markets

The United States

118. In the United States, there are two alternative trading venues for unlisted securities – the OTC Bulletin Board[32], an electronic quotation service operated by the National Association of Securities Dealers on the Nasdaq market system but not regulated by or associated with Nasdaq, and the Pink Sheets, a quotation service provided by Pink Sheet LLC, an independent portal.

OTC Bulletin Board

119. Under the Securities Exchange Act of 1934[33], any company with more than 500 shareholders and more than US$10 million of assets is subject to periodic reporting requirements imposed by the U.S. Securities and Exchange Commission (SEC)[34]. Those unlisted companies, inclusive of companies delisted from Nasdaq, that are current in their reports with the SEC are eligible to trade on the OTC Bulletin Board (OTCBB).

120. The OTCBB is a regulated quotation service that displays real-time quotes, last-sale prices, and volume information in over-the-counter (OTC) equity securities. An OTC equity security is generally any equity that is not listed or traded on Nasdaq or a national securities exchange.

121. The OTCBB operates as a dealer system. As such, a company that wishes to be quoted on the OTCBB should contact a participating market maker (SEC-registered brokers/dealers) and request the market maker to register to quote the security. Companies that are quoted on the OTCBB are subject to periodic reporting of financial information to the SEC[35].

[32] In 2003, the OTC Bulletin Board will be phased out, and a new market, the Bulletin Board Exchange, will be launched.
[33] See Section 12(g) of the Securities Exchange Act of 1934.
[34] For example, an annual report on Form 10-K and quarterly report on Form 10-Q.
[35] See footnote 34.

Pink Sheets

122. Similar to the OTCBB, the Pink Sheets is not an exchange. It is a centralised quotation service that collects and publishes market maker quotes for OTC securities in real time. Only market makers can quote securities in the Pink Sheets. However, unlike on the OTCBB, companies are not required to be SEC reporting and current in their reporting requirements for a market marker to quote their securities in the Pink Sheets.

123. It should be noted that both the OTCBB and the Pink Sheets are operated on the basis of a market maker system.

Mainland China

124. In Mainland China, the Securities Association of China (SAC)[36] has established an "Agency Share Transfer System (代辦股份轉讓系統)" in June 2001 to provide a market place for the trading of those shares previously traded on the NETS and STAQS[37] as well as delisted stocks[38]. This platform makes use of the trading facilities of the Mainland stock exchanges.

Japan

125. In Japan, the Japan Securities Dealers Association, which operates the JASDAQ OTC market, has a Green Sheet Market for unlisted stocks. The Green Sheet Market includes a "Phoenix Section" for delisted stocks. Currently, there are 4 stocks traded on this section out of a total of 58 companies traded on the Green Sheet Market.

Possible models of alternative trading venues for Hong Kong

126. From the practices in other markets, it would appear difficult to establish a viable trading venue for delisted securities only. The OTCBB and the Pink Sheets in the United States appear to be more successful,

[36] SAC is a non-government body. It was founded in August 1991 and registered as a non-profit making and self-regulatory organisation of the Mainland securities industry.

[37] NETS is the abbreviation for "National Electronic Trading System" (全國電子交易系統); and STAQS is the abbreviation for "Securities Trading Automated Quotation System" (證券交易自動報價系統).

[38] Up to 16 August 2002, there are 9 companies traded on the "Agency Share Transfer System", with investors of about 95,000 and accumulated turnover of RMB2.1 billion.

as they are independent markets in their own right on which a number of securities other than those from delisting are quoted. It seems to be rather difficult to build up a public following for a market that comprises only delisted companies, that is, companies that are perceived to have "failed".

127. Accordingly, incidental to the issue on whether Hong Kong should establish an alternative board, or an alternative trading venue for trading unlisted securities or just securities delisted from the Main Board, other issues, such as the extent of which this should follow the "Agency Share Transfer System" model, or the OTCBB model, or the Pink Sheets model, all operated by parties other than the relevant stock exchanges, and what should be the trading and disclosure standards and arrangements for clearing and settlement, require further consideration.

128. This Consultation Paper invites contributions from all interested parties on the relevant aspects of setting up an alternative trading venue (including trading and disclosure standards, and arrangement for clearing and settlement). Subject to the views collected from this consultation exercise, we may carry out a separate consultation specifically on the introduction of an alternative trading venue in the future.

Q57. Do you think that there should be an organised open market or ATS for trading of all unlisted equity securities or just equity securities delisted from the Main Board?

☐ *Yes, for all unlisted equity securities (inclusive of equity securities delisted from the Main Board)*

☐ *Yes, but only for equity securities that are delisted from the Main Board*

☐ *No, it is not necessary to have an alternative trading venue*

Please state reason(s) for your view.

Q58. What should be the appropriate level of disclosure for companies traded on the alternative trading venue?

☐ *Requirements for periodic (semi-annual) and ongoing reporting of price-sensitive events*

☐ *Periodic (semi-annual) reporting only*

☐ *Others. Please specify.*

Please state reason(s) for your view.

Q59. To whom do you consider that the periodic reports of financial information should be filed?

☐ *SFC*

☐ *The Exchange*

☐ *Others. Please specify.*

Please state reason(s) for your view.

Q60. By whom do you think that the alternative trading venue in Hong Kong should be operated?

☐ *The Exchange*

☐ *An independent marketplace provider regulated by the SFC*

Please state reason(s) for your view.

Q61. Do you think that the mode of trading on the alternative trading venue in Hong Kong should adopt the market maker system?

☐ *Yes*

☐ *No, it should use the automatching system*

☐ *Others. Please specify.*

Please state reason(s) for your view.

Q62. How would you suggest clearing and settlement arrangement for any alternative trading venue be addressed?

Please state reason(s) for your view.

PART E
LOW-PRICED SECURITIES

GENERAL

129. As discussed in the previous sections, the quality of the market is dependent on the interaction of various key components including issuers and information on their performance and fair and orderly market related elements such as market transparency, volatility and efficiency in executing transactions. We consider that the standard of corporate governance is an important criterion for assessing the performance of issuers, and their attraction as an investment.

130. The discussions in this Part E focus on the issues relating to low-priced securities from the perspective of certain corporate governance practices of issuers and the maintenance of a fair and orderly market[39].

Corporate governance related matters

131. We note that there have been market comments and investors' complaints about certain corporate governance practices of some issuers relating to rights issues, share consolidation and sub-division which may have resulted in dilution of minority shareholders' interests or a drop in the share price. These market commentators tend to associate their concerns on such corporate governance practices with issuers whose shares are low-priced. However, it should be noted that such corporate governance practices may in fact be carried out by any issuer regardless of the level of their share price.

[39] The SFC's research paper "Quality of Market and the Case for More Effective Delisting Mechanism" also has a discussion on low-priced securities. According to this paper, Hong Kong has many small listed companies with small market capitalisation and low prices, i.e. the so-called penny stocks and micro caps, and market capitalisation and stock price are negatively correlated with financial performance of the listed companies. 72 out of the 95 companies with market capitalisation below HK$100 million were loss-makers, whereas only 2 out of the 71 companies with market capitalisation larger than HK$5 billion reported losses. Among the 107 companies with prices below HK$0.1, 86 or 80% were reporting losses, compared to 12% for the companies traded above HK$1.

Dilution through placings under the general mandate

132. There are complaints from investors that some controlling shareholders may have abused the use of general mandates and have placed shares at a substantial discount to the market price. This has resulted in low-priced securities of issuers that have undertaken these corporate activities. These activities are detrimental to minority shareholders' interests and have resulted in a massive dilution of their interests in some cases.

133. In relation to the possible abuse of the general mandate and placing of shares at a substantial discount, we have consulted the market on these issues in the Corporate Governance Consultation Paper. We have consulted the market on whether (a) the number of shares to be issued under the general mandate should be restricted, (b) refreshments of general mandates should be allowed, (c) independent shareholders' approval should be required for refreshments of general mandates, and (d) there should be restrictions on the issue of shares at a substantial discount. We are currently analysing the responses to the Corporate Governance Consultation Paper and we expect to publish the results shortly.

Dilution through rights issues

134. The existing Main Board Rules aim to strike a balance between facilitating issuers to raise funds and the protection of shareholders' interests. Therefore, the Main Board Rules require independent shareholders' approval for any rights issue, which when aggregated with other rights issues and open offers in the previous 12 months, would increase the issued share capital or market capitalisation of an issuer by more than 50%. Subject to this requirement of independent shareholders' approval, no other shareholders' approval is required as rights issues are made on a pre-emptive basis.

135. As rights issues are made on a pro-rata basis, if existing shareholders were to subscribe for all their rights entitlement, their interests will not be diluted after the rights issue. Existing shareholders' interests will be diluted when they decide, based on their own investment decision and criteria, not to take up all their rights entitlement. The Main Board

Rules ensure that detailed disclosure on the rights issue including the use of proceeds is made in the listing document so that shareholders can make an informed decision.

136. Some commentators consider that repeated rights issues have resulted in unfair dilution to minority shareholders that decide not to take up their rights entitlements. As discussed in paragraph 134, the existing Main Board Rules already contain certain safeguards for minority shareholders by requiring independent shareholders' approval in certain instances. In our Corporate Governance Consultation Paper, we have consulted the market on whether the independent shareholders' approval requirement for any rights issue which when aggregated with other rights issues and open offers in the previous 12 months, would increase the issued share capital or market capitalisation by more than 50%, should be retained as some commentators consider that, based on the "one share one vote" principle, all shareholders (except those that have a material interest in the transaction) should be allowed to vote. We are currently analysing the responses and we expect to publish the responses to that Consultation Paper shortly.

Combination of consolidation, sub-division of shares and rights issue

137. Under the laws of the places of incorporation of issuers listed on the Exchange, a consolidation and a sub-division of shares must be approved by shareholders at a general meeting as it involves an alteration to the share capital of the issuer.

138. There are a number of cases where the share price of an issuer is trading at a fairly low price, which may have been due to market forces or may have followed other corporate actions such as rights issues, share consolidation or sub-division. The issuer then undertakes a share consolidation and its share price after completion of the share consolidation drops further. The issuer then undertakes another share consolidation, which is followed by a further drop in the share price again. The repeated share consolidation appears to have a spiralling down effect on the share price, resulting in a diminished value of the shares held by shareholders. Some commentators consider that this is an abuse of otherwise legitimate corporate actions such as a share consolidation. Such abuse of corporate actions without independent shareholders' approval has been detrimental for minority shareholders.

The situation is made worse where there is a combination of share consolidation and rights issue, resulting in a further dampening effect on the share price. In this case, minority shareholders are unlikely to take up their rights entitlement resulting in a dilution in their interest.

139. We consider that the share price of an issuer should reflect the fundamentals and underlying value of the issuer. Consolidation and sub-division should not, in theory, affect the value of shares and shareholders' proportionate interest in the issuer. The share price should still reflect a similar underlying value of the issuer as before the consolidation or subdivision, provided there are no other external factors that will have a negative impact on the share price. If the drop in share price is a result of market manipulation, this should be subject to the applicable rules and regulations.

140. Some commentators consider that share consolidation may result in the shareholding of minority shareholders being reduced to a smaller number of shares, which may be an odd-lot. The value per share of odd-lots traded on the Exchange is generally lower than the value per share of a board lot. Minority shareholders are therefore unfairly disadvantaged. Other commentators are, however, of the view that the share price of an issuer should reflect the fundamentals and underlying value of the issuer. If an issuer has a low-priced share, say at HK$0.01, any further drop in the share price cannot be properly reflected in the trading system. In these instances, the share price of the issuer does not reflect its true underlying value. The price drop after consolidation might, therefore, be a fairer reflection of the underlying value. In some situations where shares are traded below HK$0.01, the market might be illiquid and non-transparent, hence investors might have difficulties to exit. If the issuer undertakes a share consolidation to bring its share price above HK$0.01 and trade on the AMS/3, the value per share will increase and this may provide opportunities for investors to exit.

141. Sub-division of shares also should not result in any change in the value of the issuer or the interest of shareholders in the issuer. It is also very common for issuers doing a share sub-division to proportionally increase the size of a trading board lot. One of the common reasons for a sub-division is to increase the liquidity of securities. This may not be a valid reason as shares are traded in board lots. To reduce the value per share and yet retain the same board lot value will not result in the

securities being cheaper. As there is no change in the board lot value after a sub-division, the liquidity of the shares should remain the same.

142. Some commentators suggest that the Exchange should limit the number of share sub-division or consolidation that an issuer can undertake in any one year. There are other comments that the Exchange should not allow an issuer to undertake share consolidation followed immediately by a rights issue. Other commentators consider that the Exchange should prohibit rights issues after or within a period of time of a share consolidation.

143. We note that there may be genuine reasons for issuers to undertake share consolidation, for example where the issuer is trading at a price that is below the nominal value. Generally, issuers that are listed on the Exchange are prohibited under the relevant regulations in their place of incorporation, from issuing shares for a consideration below their nominal value. Given this restriction, it is not possible for issuers whose share price is trading below the nominal value of the shares to raise capital. The situation may be exacerbated if the issuer is loss making and has retained losses. In this case, the issuer may firstly consolidate its shares. The effect of this is to increase the nominal value and price per share. The issuer may then undertake a capital reduction to reduce the nominal value of its share, so that it will be below the price per consolidated share. The reduced capital can then be utilised to eliminate the retained losses. After the exercise, the balance sheet of the issuer will be in a healthier position and the issuer will be able to raise capital, as the price per share will be above the nominal value.

Q63. Do you consider it necessary to restrict an issuer from undertaking any share consolidation and sub-division?

☐ *Yes (please answer Q64)*

☐ *No*

Please state reason(s) for your view.

Q64. If you consider that it is necessary to restrict issuers from undertaking share consolidation and sub-division, please state what should be these restrictions and under what circumstances?

The restrictions should be:

_____

The circumstances should be:

_____

Please state reason(s) for your view.

Q65. For share sub-divisions, do you consider that no sub-divisions of shares should be undertaken if the share price is below a minimum benchmark? Should the benchmark price make reference to a period of time?

☐ *Yes. The minimum benchmark should be HK$_____over a period of _____ days.*

☐ *No*

Please state reason(s) for your view.

Q66. Do you consider that it is necessary for the Exchange to intervene by prohibiting any rights issue within a specified period after a share consolidation or sub-division, given that (a) rights issue is made on a pre-emptive basis, (b) the Main Board Rules require full disclosure of the particulars of the rights issue including the use of proceeds and (c) independent shareholders' approval is required for rights issue that will increase the market capitalisation or issued share capital of the issuer by more than 50%?

☐ *Yes. Please state:*

(a) what you consider the Exchange should do to intervene?

_____

(b) what should the specified period be?

_____

☐ *No*

Please state reason(s) for your view.

Q67. Are there any other alternative safeguard measures in relation to share consolidation and sub-division you consider necessary to protect the interests of shareholders?

☐ *Yes. Please state what these measures should be:*

_____

☐ *No*

Please state reason(s) for your view.

Q68. Are there any other measures you consider is appropriate to improve issuers' corporate governance practices in the areas discussed in paragraphs 131 to 143?

☐ *Yes. Please state what you consider these measures should be:*

_____

☐ *No*

Please state reason(s) for your view.

Fair and orderly market related issues

144. The discussions in this section only relate to issuers with low-priced securities that could otherwise meet the continuing listing standards discussed in Part C. We discuss below the effect of low-priced securities on the maintenance of a fair and orderly market.

Lack of transparency

145. Under the Exchange's AMS/3, the minimum price at which orders can be input and matched is HK$0.01. AMS/3 provides real-time data on the bid-ask prices and the transaction volume and value of individual listed securities to Exchange Participants through its trading network and to the market generally through information vendors that receive similar real-time data via separate networks. This transparency helps to ensure orderly trading of the relevant securities.

146. Trading of securities at prices below HK$0.01 cannot be done on AMS/3. Orders for the trading of such securities are therefore input to and transacted on the Exchange's Semi-automatic Matching System ("SMS"). Only Exchange Participants can have access to the price and quantity information on the securities traded on SMS via their trading terminals. No real time bid/ask information on SMS is provided to the market.

147. Some commentators consider that the Exchange should change its trading system to cater for those shares that are very low-priced. However, such a change would affect not only the trading system of the Exchange but also the systems of others including Exchange Participants and information vendors.

Exceptional volatility

148. Trading of low-priced shares tends to be more volatile, whether they are traded on AMS/3 or SMS, as changes in price which are small in absolute terms would become significant in percentage terms. For example, a price change of HK$0.005 from HK$0.015 to HK$0.01 represents a percentage change of 33%. Also, the Exchange Rules provide that the minimum price movement for a share priced between HK$0.01 to HK$0.25 is HK$0.001, and for a share priced between

HK$0.50 to HK$2.00 is HK$0.01. Therefore, an increase of HK$0.001 (being the minimum price change) for a share priced at HK$0.01 is 10%, whereas an increase of HK$0.01 (being the minimum price change) for a share priced at HK$1.00 is 1%[40]. Therefore, there are views that shares that are priced at HK$0.01 should be consolidated, thereby reducing unnecessary volatility.

Misconception of investors

149. Low-priced securities may lead the less sophisticated investors to believe that they are "cheap" and "worth buying" in the sense of being good value for money without verifying the fundamentals of the individual issuer. Some commentators consider that this issue should be dealt with by investor education programmes.

Market Perception

150. Irrespective of whether issuers can meet the continuing listing standards, there are views that the predominance of low-priced securities on the Hong Kong listing market may have an adverse perception on the quality of the market generally. This adverse perception may in part be due to the problems associated with the trading of low-priced securities, such as exceptional volatility (paragraph 148) and absence of transparency (paragraphs 145 and 146). It is well known that international institutional investors, whether restricted by law or otherwise, would tend not to buy stocks that are priced below US$1. To these commentators, the exclusion of stocks listed on the Exchange from the investment portfolios of international investors because they are low-priced may not be desirable to the continued growth of the Hong Kong listing market as well as the developing image of Hong Kong as an international financial centre. The statistics set out in Appendix 2 show that the number of issuers on the Hong Kong listing market with low-priced securities has been increasing.

[40] See Second Schedule to the Rules of the Exchange.

151. Some commentators consider that issuers should be compelled to take immediate remedial action where their share prices fell below a certain threshold. Remedial action may include share consolidation and share buy-back. These issuers should also refrain from taking any corporate action that will result in a further decrease in their theoretical share price after the corporate action. These commentators consider that the Main Board Rules should expressly prescribe the figure of the benchmark share price. As such, the Exchange should clarify and amend the existing wording in the Listing Agreement that it reserves the right to require an issuer either to change the trading method or to proceed with a consolidation or splitting of its securities, where the market price of its securities approaches the extremities of HK$0.01 or HK$9,995. Failure to comply with any proposed minimum benchmark share price on a continuing basis should result in the Exchange taking disciplinary action against the issuer and its directors for breach of the Main Board Rules.

152. The dissenting views are that Hong Kong should concentrate on developing its own listing market by taking into account local characteristics and needs. The Hong Kong listing market typically comprises a large percentage of retail investors and low-priced securities is a feature of the Hong Kong listing market. Some commentators consider that investors have different risk profiles and trading objectives. Some investors hold securities for investment purposes and for a long term, while others hold them for speculative purposes and for a short term. To these commentators, the market should provide an avenue for investors to choose from a variety of investment products, according to their individual needs. Therefore, if issuers meet other continuing listing standards, investors need not consider whether or not they are investing in low-priced shares as long as the share price meets their investment risk and criteria.

153. Some commentators consider that there are no fair and orderly market issues regarding low-priced securities as long as there is transparency and investors are fully aware of the risks involved in investing in such securities. To this end, these commentators consider that the current trading system should be changed so as to promote transparency and the Exchange should undertake investor education programmes. Should there be any market manipulation, the regulatory problems should be addressed through market manipulation rules so that the wrongdoers would be prosecuted for breach of law.

Q69. Do you consider that the prevalence of low-priced securities creates an adverse impact on the perception of the quality of the market from the fair and orderly market perspective?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

Q70. What do you consider would be the most appropriate remedial action that an issuer should take if its share is low-priced?

☐ *Compulsory share consolidation if the share price reaches a predetermined benchmark*

☐ *Share buy-back by the issuer until the share price reaches a predetermined benchmark*

☐ *Others. Please state what this remedial action should be:*

_____

☐ *No action required*

Please state reason(s) for your view.

Q71. If you consider that issuers should be compelled to consolidate its shares if its share price reaches a predetermined benchmark, what do you consider this benchmark value should be? Should such benchmark value make reference to a period of time? Please state reason(s) for your view.

The benchmark should be HK$_____ over a period of _____ days.

Q72. Should an issuer fail to take any remedial action for its low-priced shares, what do you consider should be the most appropriate action to be taken by the Exchange, for example, taking no action, issuing a warning letter, taking disciplinary action, or considering cancellation of listing status?

☐ *No action is considered necessary.*

☐ *The most appropriate action should be:*

_____

Please state reasons for your view.

Q73. Do you have any other views on the issue of low-priced securities?

☐ *Yes. My views are_____.*

☐ *No*

Please state reason(s) for your view.

Q74. What other measures in relation to the maintenance of a fair and orderly market do you consider are appropriate to safeguard the interest of shareholders? Please state reason(s) for your view.

APPENDIX 1

Comparison of Delisting Standards in Other Markets

Quantitative criteria	Nasdaq (US)		NYSE (US)	London (UK)	SGX (Singapore)	ASX[1] (Australia)	Mainland China
	National Market	Small Cap Market					
1. Trading price	√[2]	√	√				
2. Market capitalisation	√*	√*	√*				
3. Shareholders' equity	√*	√*	√*				
4. Total assets	√*						
5. Revenue	√*						
6. Profit		√	√				√
7. Public float	√	√	√	√	+		
8. Number of shareholders	√	√	√				
9. Number of market makers		√	√				
Specific qualitative criteria							
1. Corporate governance	+	+	+	+[3]			
2. Bankruptcy / liquidation	+	+	+	+[3]			
3. Qualified opinion or "going concern" emphasis in accounts	+	+	+				
4. Failure to make periodic filings/reports	+	+	+	+[3]			
5. Failure to observe good accounting practice			+				
6. Unsatisfactory financial conditions			+	+[3]			
7. Inability to meet debt obligations/finance operations			+	+[3]			
8. Abnormally low selling price or volume of trading			+				
9. Reduction in operating assets and/or scope of operation			+				

* Alternative criteria in a single test; √ Criterion leading to definite delisting; + Criterion leading to potential delisting

[1] Under the ASX Listing Rules, an entity would only be delisted if (i) it is unable or unwilling to comply with, or breaks, a listing rule; (ii) it has no quoted securities; or (iii) appropriate for some other reason. There was previously a rule for automatic removal after a long suspension but such rule has been deleted in September 2001.

[2] Nasdaq rules in respect of the minimum trading price are currently being examined with a view to revising the criteria.

[3] The UK Listing Authority (the "UKLA") may cancel the listing of any securities if it is satisfied that there are special circumstances which preclude normal regular dealings in them. The UKLA will normally cancel listing if a security has its listing suspended for more than six months without the issuer taking adequate action to obtain a restoration or if there are insufficient shares held in public hands. In theory any suspension may lead to cancellation. Recent examples of when the UKLA would normally suspend listing include (i) where an issuer fails to publish financial information in accordance with the listing rules; (ii) where an issuer fails to meet the continuing obligations of listing; (iii) where an issuer is unable to accurately assess its financial position and inform the market accordingly; and (iv) if the issuer has appointed administrators or receivers, or is in winding up.

APPENDIX 2

The following table sets out the number and percentage of Main Board issuers with share price at or below HK$0.50, HK$0.30, HK$0.10 and at HK$0.01 as at 31 December 1997, 1998, 1999, 2000, 2001 and 31 August 2002

Number (and percentage) of Main Board issuers with share price	31/12/1997	% to total issuers	31/12/1998	% to total issuers	31/12/1999	% to total issuers	31/12/2000	% to total issuers	31/12/2001	% to total issuers	31/8/2002	% to total issuers
at or below HK$0.50	**140**	21	**302**	44	**306**	44	**355**	48	**371**	49	**408**	51
at or below HK$0.30	**65**	10	**209**	31	**210**	30	**252**	34	**271**	36	**320**	40
at or below HK$0.10	**28**	4	**65**	10	**91**	13	**91**	12	**118**	16	**157**	20
at HK$0.01	**0**	0	**0**	0	**0**	0	**5**	1	**10**	1	**16**	2
Total number of issuers	***658***	*100*	***680***	*100*	***701***	*100*	***736***	*100*	***756***	*100*	***794***	*100*