



7 February 2005

**FEEDBACK STATEMENT ON THE CONSULTATION ON
CONTINUING LISTING CRITERIA AND RELATED ISSUES
7 FEBRUARY 2005**

Managing the quality of the Hong Kong market

Introduction

1. Looking ahead the success of the Stock Exchange of Hong Kong (the Exchange), a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited (HKEx), lies predominantly in its ability to work with the Government, the Securities and Futures Commission and other stakeholders to uphold its roles as an international financial centre and a premier capital formation centre for Mainland enterprises. Improving and maintaining market quality is the most important prerequisite.
2. This is the reason why the Exchange is committed to taking an active role in enhancing corporate governance in the market. Higher corporate governance standards translate into better internal control and risk management practices, which result in higher investor confidence, a lower cost of capital for the listed issuers, increased order flows and hence increased liquidity for the market. This creates a virtuous cycle where more quality enterprises are attracted to list in Hong Kong and more investors around the world are attracted to invest in the Hong Kong securities market.
3. In November 2002, the Exchange published a Consultation Paper on Continuing Listing Criteria and Related Issues as part of its efforts to explore administrative measures to enhance its handling of listed issuers which might pose a risk to either: the Exchange's statutory duty to maintain, as far as reasonably practicable, an orderly, informed and fair market; or the reputation and attractiveness of Hong Kong's Main Board market.
4. The Consultation Paper discussed and sought market views 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.
5. The Consultation period ended on 28 February 2003. A total of 57 submissions were received in response to the proposals in the Consultation Paper. The submissions included a batch of 23 responses from one professional association which were essentially identical.

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6. Analyses of the responses to the July 2002 consultation on delisting procedures and the November 2002 consultation were presented to the Listing Committee at the Quarterly Policy Meeting in April 2004 with a view to establishing the direction of future policy in these areas.

The Listing Committee's decision on how to proceed

7. The Listing Committee noted the market's general opposition to the introduction of new listing standards and any significant changes to the delisting mechanism. The Committee also recognised that recent changes to the Rules Governing the listing of securities in Hong Kong (the Main Board Listing Rules) and Rules Governing the listing of securities on the Growth Enterprise Market (the GEM Listing Rules), and developments in the Listing Division's working practices should have a positive impact and begin to address some of the underlying problems identified in the consultation papers.
8. The Listing Committee decided that a major overhaul of the Listing Rules did not appear necessary and that the status quo should be maintained for the time being. The Listing Committee directed the Listing Division to target specific regulatory problems, such as the need for more robust handling of sub-standard proposals for the resumption of long-suspended companies, deficiencies in financial reporting systems and controls and the absence of established procedures for delisting GEM issuers. In each of these problem areas the Listing Division was invited, in consultation with the Listing Committee and the Securities and Futures Commission, to identify and formulate policies and new working practices.
9. The purpose of this Feedback Statement is to draw the July 2002 and November 2002 Consultation exercises to a conclusion by providing a summary of the responses and a commentary on developments over the last year. The Listing Division's commentary on developments also serves as a measure to improve the Exchange's transparency in the discharge of its responsibilities for listing regulation.

Background to the Consultation

10. In July 2002, the Exchange 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 2002 Consultation Paper).
11. The July 2002 Consultation Paper sought to examine and review the Main Board Listing Rules generally applicable to issuers of equity securities (but not debt securities) applying for listing or already listed on the Main Board of the Exchange under Chapter 8 of the Main Board Listing Rules and mineral and infrastructure companies. The areas covered include:
 - (a) initial listing eligibility criteria;
 - (b) continuing listing eligibility criteria;
 - (c) continuing obligations;
 - (d) cancellation of listing procedures; and
 - (e) disclosure requirements at the time of initial listing.

12. Following the release of the July 2002 Consultation Paper, there was public concern over some proposals relating to continuing listing eligibility criteria. In response to these concerns, the Exchange withdrew Part C of the July 2002 Consultation Paper on continuing listing eligibility criteria for separate consultation.
13. The July 2002 Consultation Paper obtained the general support from the market on most of the Consultation Proposals set out in (a), (c) and (e) above, and these proposals were then carried through into the Listing Rule amendments that generally became effective on 31 March 2004.
14. Following the withdrawal of Part C of the July 2002 Consultation Paper the Exchange engaged in an extended pre-sounding exercise with members of a number of organisations, professional associations and market practitioners to help it develop a revised consultation paper. This further exercise culminated in the publication of the November 2002 Consultation Paper.
15. In that consultation paper the Exchange sought to reflect as closely as possible the views expressed by the parties to the pre-sounding exercise. The objective of the Paper was to facilitate the transparency of the consultation exercise and to enable the respondents to be aware of the varied nature of the responses and factors to be taken into consideration.

Summary of Responses

16. Responses to the Consultation Paper varied in scope and depth, with some respondents focusing on broad principles and others on points of detail. The responses were diverse and there was an absence of a clear consensus on key proposals. Although some themes emerged from the responses.
17. It was clear that respondents did not favour using the price of shares as a criterion to delist the shares of a company. A number of respondents, expressing their views on regulatory philosophy, commented that disclosure should play a prominent role and that investors should take responsibility for their decisions. On the whole, the market supported the Exchange's efforts to raise the quality of the Hong Kong market with the view to increasing its attractiveness to investors and issuers.
18. The following paragraphs highlight the more significant comments and themes emerging from the submissions received.

Minimum Standards and Continuing Listing Standards

19. Respondents generally support the concept of minimum standards for maintaining listing status. Although there were diverse views on what those standards should be.

20. A majority agreed in principle that continuing listing standards should be as simple and minimal as possible and backed by a disclosure-based regime. The Exchange adopts a primarily disclosure-based regulatory regime. A disclosure-based approach can only be successful where the requisite conditions are in place. These conditions include obligations for listed issuers to maintain adequate procedures, systems and controls to enable them to comply with the Listing Rules, obligations for directors to understand their responsibilities under the Listing Rules and sufficient powers for the regulators to pursue and invoke effective sanctions for wrongdoing after the event. Such sanctions should discourage directors and other officers of listed companies from making decisions in bad faith and to the detriment of shareholders.
21. A number of respondents expressed a strong view that the application of the standards should take into consideration all of the major economic indicators of a company's financial performance and financial condition rather than focusing on a single indicator. The Exchange should consider special circumstances underlying non-compliance with any continuing listing standards, such as the position of listed issuers in financial difficulties.
22. There was a broad consensus that price of itself was not a measure of quality and that the Exchange should not introduce the price of shares as a criterion for delisting the shares of an issuer.
23. Some respondents opined that a set of continuing listing standards solely based on certain objective and quantitative measures or requirements might not be adequate in assessing whether or not an issuer was suitable to continue to list its securities on the Exchange. They envisaged that it would be beneficial for the listed issuers and the market to allow the Exchange to exercise a certain degree of discretion.
24. By contrast a view was expressed that once a company was granted a listing and the facility to trade on the exchange's platform, the facility should not be withdrawn except in the most limited of circumstances, such as on completion of the liquidation of a listed company or when 100 per cent of the issued share capital has been acquired following a takeover offer. This view is more restrictive than the scope of the current Listing Rules and the Exchange does not agree that the examples given should be the only circumstances in which listed issuers might be delisted.
25. Concerns were raised that the introduction of the proposed minimum financial or quantitative standards might present a temptation to issuers and their controllers to influence and mislead the market by creating positive news or rumours for the purpose of boosting share prices or by resorting to creative accounting.

26. Out of the list of proposed indicators to be used as triggers for remedial action to be taken by an issuer, most respondents agreed that such remedial actions should be taken in situations that involved a substantial reduction in operating assets and level of operations or when a listed issuer became a cash company (that is, 90 per cent of its assets are in cash or short-dated securities or portfolio share investments or other marketable securities). In both situations, respondents agreed that it would be necessary to seek independent shareholders' approval prior to the issuer undertaking such corporate action. The Listing Rule amendments promulgated in January 2004 introduced the concept of a "very substantial disposal" where any of the relevant new percentage ratios is 75 per cent or more. A very substantial disposal now requires prior approval by those shareholders without a material interest in the proposed transaction.

Alternative Treatments of Securities Delisted from the Main Board

27. Most respondents expressed concern that the two proposals which might result in a forced liquidation of ownership interests (compulsory privatisation or buy-back by controlling shareholders and compulsory winding-up) would only work to the detriment of the shareholders. It was noted that both proposals were unlikely to be enforceable given the tremendous practical and legal difficulties that were likely to be encountered.
28. The establishment of an alternative board for the listed market in circumstances where an issuer was delisted from the Main Board market as a result of non-compliance of the proposed continuing listing standards was welcomed by most respondents. Theoretically such a mechanism would provide a means to allow minority shareholders to trade out of their positions in the delisted securities.
29. In view of the Listing Committee's conclusions on the Consultation proposals the Exchange will not be undertaking any further research or feasibility assessments on proposals to establish an alternative board.

Low-priced Securities

30. The majority of respondents did not support the proposals relating to low-priced securities. Most respondents did not consider the prevalence of low-priced securities as having an adverse impact on the perception of the quality of the market from the perspective of the Exchange's duty to maintain, as far as reasonably practical, a fair, orderly and informed market. Respondents suggested that low-priced securities are a feature of every market, a result of market forces of supply and demand and do not bear any relationship to the fairness or good order of the market.
31. These respondents argue that the Exchange should not attempt to restrict share consolidation or sub-division and that such corporate action should be solely a matter for shareholders to decide. The Exchange does not agree that it should take no interest in attempting to manage the impact of low-priced securities on market order at the extremities of the trading price range. Whilst the Exchange recognises the cost implications and potential enforcement issues that arise from mandating consolidation or sub-division, on a cases specific basis the Listing Division will raise its concerns with issuers and may utilise the Exchange's power under Listing Rule 13.64 to compel an issuer to take steps to consolidate or sub-divide its shares.

Cancellation of Listing Procedures

32. Most respondents did not support the proposal to introduce new cancellation of listing procedures. These respondents disagreed with the Exchange's proposal to accelerate the administrative delisting process through the introduction of the proposed continuing listing criteria and a shorter timescale applied to the delisting process.
33. These respondents argued that regard should be made to the individual circumstances of each listed issuer. Listed issuers in financial difficulties, for example, should be given an opportunity for rehabilitation. This process is more complex and takes a much longer period of time than that proposed by the Exchange.
34. These respondents also emphasised their view on the importance of a listing status and a view that once granted, it should only be removed in exceptional circumstances. They also argued that more stringent listing requirements, better quality of regulation and firm and effective enforceable actions with good follow-through procedures would be the key factors behind an attractive listing market.
35. In the context of promulgating the new requirements for reverse takeovers and back door listings the Exchange made the following remarks about financially distressed listed issuers in the Consultation Conclusions paper published in January 2004:

"Very often, investors may propose to inject assets into a financially delinquent issuer, and in consideration for such injections, the issuer will issue a substantial number of new shares either in the existing issuer, or the NewCo, in favour of such investors. This enables the investors to gain control of the issuer, or the NewCo.

We note respondents' concerns that the requirement that the assets to be injected must meet the track record/financial standards requirements may not facilitate rescues of issuers in financial difficulties. However, we consider that the requirement is appropriate if we were to provide a level playing field for all potential entrants to the Exchange, particularly where potential entrants wish to use a shell to seek a listing. Certain market practitioners treat failed companies with listed status as though the listing itself is of value. If an issuer has failed as a corporate entity, its shell company (a listed company with insufficient assets or operations) should not be entitled to treat the listed status as an asset of value nor to retain its listed status unless an asset that meets the initial listing criteria is injected into it. The underlying principle of the requirement is to prevent circumvention of the initial listing criteria by an otherwise unqualified listing candidate to obtain a listing status by buying into a listed shell.

Likewise, we do not consider it appropriate to grant exemption under rescue situation, as very often, the only exemption that is sought is in respect of the track record/financial standards requirements, given that the assets to be injected are themselves not suitable for listing. If an exemption is granted, the initial listing criteria would be rendered virtually meaningless in these cases of deemed new listing applicants."

36. The experience of the Listing Division over the last eighteen months also suggests that the timing, presentation and substance of resumption proposals for long-suspended companies frequently fall short of the Exchange's expectations. In particular this experience suggests that compliance with Rule 13.24 of the Main Board Listing Rules (Rule 17.26 of the GEM Listing Rules), formerly paragraph 38 of the Listing Agreement is best achieved if the applicant can present a clear, plausible and coherent proposal which meets or is close to the quantitative standards required for a new listing applicant under Chapter 8 of the Main Board Listing Rules.

Update on Progress and Developments in the Exchange's Practices

37. The steps taken by the Listing Division to provide a more effective approach to handling problem companies of the sort targeted by the proposals in the July and November 2002 Consultation Papers cover three thematic areas: increased transparency about the circumstances of certain listed issuers; a focused approach to handling listed issuers with signs of serious compliance problems and a more robust approach to handling long-suspended listed issuers.

Increased transparency

38. In March 2004 the HKEx website was revamped to provide better information services to the public. At the same time the Listing Division designed and introduced a number of new periodic and ad hoc reports to assist the investing public.
39. With the introduction of the additional reports there are now seven reports on the Listed Companies section of the HKEx website highlighting particular features of an issuer's status. These reports are:
- Announcements Concerning High Concentration of Shareholdings
 - Status Report on Issuers' Delay in Releasing Results Announcements
 - Status Report on Delisting Proceedings and Suspensions
 - Prolonged Suspension Status Report
 - Auditors' Reports with "Qualified Opinions" and/or Explanatory Paragraphs
 - Summary of Announcements Concerning Changing Auditors of Listed Issuers
 - Summary of Announcements Concerning Changing Company Secretaries of Listed Issuers

Focused approach

40. The Listing Division has adopted targeted reviews and robust handling of companies with signals of serious compliance problems. These include companies which are late in releasing financial results, which accounts contain qualified audit opinions, or which auditors or audit committee members resign. As a consequence of this approach, listed issuers are frequently required to give more disclosure to the Exchange and also the market on the matters that were the subject of the qualified opinions, or reasons for the resignation of auditors or audit committee members.

41. In some cases, the Listing Division will enquire to see if there are more significant systemic problems in the area of internal control and financial reporting. In some extreme situations, the Listing Division may require the companies to appoint a professional firm to conduct a special review in order to address these concerns. Under the Listing Rule amendments introduced at the beginning of this year, the Exchange has an explicit power to direct a listed issuer to appoint a Compliance Adviser even though the prescribed period for such appointment under the Rules has elapsed.

Handling long-suspended companies

42. The Listing Division also followed up closely on long-suspended companies (i.e. companies in financial difficulties and suspended for more than three months). Long-suspended Main Board companies are dealt with in accordance with Practice Note 17 of the Main Board Listing Rules, which stipulates a three-stage delisting process before a company is delisted from the Exchange.
43. In the 13 months ended 31 January 2005, the Exchange has put 12 long-suspended Main Board companies into the third stage of the delisting procedures. During the same period, the Exchange has delisted 7 long-suspended Main Board companies in accordance with these delisting procedures. As of 31 January 2005, there were 32 long-suspended Main Board companies, 10 of which were in the third stage of delisting.
44. GEM Listing Rules do not have provisions equivalent to Practice Note 17 of the Main Board Listing Rules. Long-suspended GEM companies are dealt with in accordance with Chapter 9 of the GEM Listing Rules. On the basis of experience gained in dealing with the delisting of long-suspended GEM companies, the Listing Division will consider whether it is necessary to develop delisting procedures for GEM companies.
45. As of 31 January 2005, there were 19 long-suspended GEM companies. The Listing Division has commenced dealing with these companies and has given notice to 5 such companies for delisting pursuant to Chapter 9 of the GEM Listing Rules. In addition on 27 January 2005 the Exchange delisted Codebank Limited. Codebank Limited is the first company to be delisted by the Exchange from GEM.