Response to

Discussion Paper on the Growth Enterprise Market

Hong Kong Stockbrokers Association

30 April 2006

Summary

1. The GEM Board is a success by most measures. On its own, it would rank among the 50 top exchanges in the world, and in 2005 it had raised more funds than the Shenzhen Exchange. If the "promoted" companies are included, the GEM Board would have a greater "success" rate and better reputation.

2. We believe that the GEM Board should be retained. However, we are of the view that "failed" companies should be systematically removed in order to maintain the quality of the market, and counter negative publicity that had accumulated.

3. We do not believe that better quality companies should be "encouraged" to transfer or "promoted" to the Main Board. Such a policy would only re-enforce the misconception that companies that remain on the GEM Board are somehow "unsuccessful" or "second rate". However, as long as the GEM Board is managed by the HKEx and the Listing Division and Committees for both boards are effectively merged, it would be difficult to reverse the view that the GEM Board companies are "second rate".

4. The GEM Board should be positioned as a place where SME's can raise funds and maintain their listing status without any pressure to transfer to the Main Board or the stigma of staying on a a "second rate" board.

5. In view of the past scandals on both the Main Board and the GEM Board where sponsors are alleged to have been less than diligent. Hong Kong is not yet ready for an "AIM" type regime where the vetting and regulation of compliance is delegated to the sponsors.

Need for a growth company board

1. There are sensible arguments for the existence of a growth company board. Many of these reasons are common across markets. For example, there is a need for SME's to raise funds in all markets. However, for each market the final compelling reasons may be somewhat different. In some markets, the reason may be the need to simplify and tone-down excessive regulations while in other markets there may be a tradition of providing a second board for high-risk resource exploration based companies.

2. In Hong Kong, we believe that there is need for SME's from Hong Kong and the Mainland to raise funds for further development and expansion. At present, except for technology themed companies listed during the dotcom boom in 2000, there does not appear to be any industry specialisation such as can be found on the second boards of other markets. However, we are aware that the GEM Board is a preferred listing venue for privately owned Mainland companies making use of the so-called "456 exemption" as an alternative to listing on the Main Board. We believe that this should be allowed to continue without hindrance.

3. Companies listed on GEM Board may not move onto the Main Board for many reasons not related to size and quality. The NASDAQ in the US is an example of a second board which grew to challenge the main board. Some companies may see the GEM Board as a stepping stone but we believe that this should not taken for granted that it is a necessary step.

Market quality

1. At the same time, we are concerned that there appears to be a bias towards "promoting" companies to the Main Board. This takes away the "success stories" and leaves the impression that those that remain do not measure up in quality. Thus, although we would agree that the process of migrating stocks from the GEM Board to the Main Board be simplified and streamlined as far as possible and artificial barriers be eliminated, we wish to point out that it would have to be put in place concurrently with a "de-listing" process.

2. Companies listed on the GEM Board may or may not be higher risk. They may be profitable SME's which do not meet the profitability requirements of the Main Board but are otherwise well-managed companies with successful business models that are well proven. We urge that failed companies be removed from the GEM Board as speedily as practicable to ensures that the GEM Board is not viewed as a repository of failed companies.

3. For this purpose, we would suggest a system where companies that do not meet certain performance targets be highlighted for special attention, and later de-listed if the targets are not met after a fixed number of years. An example of this is the "special treatment" handling on the Shenzhen Exchange for companies that do not make a profit for 3 years in a row (or some other parameters to be determined) which are put on a watch list and a warning posted against the stock. If it still does not meet such parameters the fourth year, it is placed on a restricted trading list and finally de-listed a year after another year if it fails to meet such parameters.

<u>*Corporate governance and disclosure*</u>

1. We believe that with a "de-listing" regime in place, the current requirements for corporate governance and disclosure are more than adequate. In fact, we have concerns that the compliance costs for GEM Board companies are dis-proportionately more expensive than that for the Main Board.

2. There is a saying that "integrity cannot be legislated". More regulations do not of themselves mean better behaviour. The enforcement of the existing regulation will send a strong message that mis-behaviour and inadequate disclosure will not be tolerated.

<u>*Regulatory approach*</u>

1. The GEM Board is suffering from a severe case of schizophrenia. It cannot decide on whether it wants to be a second board for SME's, or an alternative market for untried companies and business models.

2. As a result of the dotcom boom and subsequent bust, and the penny stock incident, the HKEx and the SFC have tightened up the listing of smaller companies. In the view of the market, we have gone from a "disclosure-based" vetting in form to a "merit-based" vetting in substance.

3. The Listing Divisions of the GEM Board and the Main Board have been merged to reduce costs, and there is substantial overlap between the 2 Listing Committees. The end result is that the same people basically decide on the listing merits of applicants to both boards. We are concerned that there may be a bias in favouring the "big" companies as "low-risk" and therefore less likely to"blow-up". The end result is that it is becoming more difficult for smaller companies to list whether on the Main Board or on the GEM Board.

4. The regulatory approach must be suited to the market. If it is decided that GEM Board should be an alternative market then a "lighter" touch may be required as no amount of regulations or vetting will predict the ultimate success of the applicant.

Fund raising

1. We do not have a view on whether it should be mandatory for GEM Board listings to include a public offering. If the GEM Board is to be a market place for professional investors than a public offering should not be required or even allowed. However, if the GEM Board is for SME's than the public should be allowed to participate in a public offering albeit with sufficient disclosures and warnings.

Sponsors

1. The SFC has recently published a consultation conclusion on sponsors and compliance advisors. We believe that this should be extended to include any specific requirements from sponsors of GEM Board listings such as due diligence, etc.

2. In view of the scandals in the past few years where the sponsors have been shown to have been less than diligent, we would have major concerns with a "AIM" type regime which places the burden of regulatory vetting on the sponsors.

Promotion and education

1. The GEM Board is suffering from negative publicity and the perception that only "second rate" companies remain. We believe that a separate structure may be required to be put in place to promote GEM Board as a legitimate market in its own right.

2. By way of comparison in 2005, the GEM Board market capitalisation exceeded that of the Colombo exchange, the turnover was higher than that of the Lima Exchange (ranked 43rd in the world) and raised more funds than the Shenzhen Exchange (ranked 34th). If the companies "promoted" to the Main board were included in the figures, the market capitalisation would have been 32% higher and the turnover 24% greater.