HONG KONG SOCIETY OF ACCOUNTANTS

SUBMISSION

ON

CONSULTATION PAPER

ON

CONTINUING LISTING CRITERIA

AND

RELATED ISSUES

[A total of 81 pages]

12 MARCH 2003

PART B OF THE CONSULTATION PAPER
MINIMUM STANDARDS
FOR MAINTAINING LISTING

Paragraph 39 of Part B of the Consultation Paper

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***

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?

- ✓ ***<u>Yes</u>***

PART C

MINIMUM CONTINUING LISTING STANDARDS

Paragraph 48 of Part C of the Consultation Paper

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***

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

Financial Standards and Minimum Market Capitalization provide some guidelines but these indicators should not be rigidly considered on its own. Flexibility should be provided to consider a combination of factors. Please also refer to our Submission dated 30 October 2002 on the HKEx Consultation Paper on "Proposed Amendments to the Listing Rules relating to Initial Listing and Continuing Listing Eligibility and Cancellation of Listing Procedures" (July Consultation Paper).

FINANCIAL STANDARDS

Paragraphs 58 and 59 of Part C of the Consultation Paper

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.

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, 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?

- ✓ ***Others***

We consider that to trigger remedial action to be taken by an issuer, there should be a deficiency in a combination of all the following 3 indicators:

(a) Profit;
(b) Market capitalization; and
(c) Shareholders' equity.

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?

X No

The combinations of indicators should be:

To trigger a remedial action, there should be a deficiency in a combination of all the following 3 indicators:

(a) Profit;
(b) Market capitalization; and
(c) Shareholders' equity.

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?

- ✓ ***3 years of consecutive losses***

It is possible that a single, significant catastrophic event could make an otherwise healthy company loss making for two consecutive years. Three years of losses is an established trend and should be the criterion (although it is possible to create a scenario in which a company which has lost money for three years running is not a suitable candidate for delisting).

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***

It is important that any change to the current Listing Rules be undertaken with appropriate notice to enable listed issuers to properly consider and take advice on the changes and implement the appropriate actions or strategies to get their "house in order".

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?

HK$25 million

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?

X ***No***.

The appropriate duration should be 60 actual consecutive trading days.

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?

<u>When it is in negative equity.</u>

ABSOLUTE MINIMUM MARKET CAPITALISATION

<u>Paragraphs 63 and 64 of Part C of the Consultation Paper</u>

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.

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?

X ***<u>No</u>***.

<u>Not on its own. It should be a combination of the 3 indicators set out in our comments in Q.5.</u>

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

- ✓ ***Yes***

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.

No. Not on its own. It should be a combination of the 3 indicators set out in our comments in Q.5.

INSOLVENCY

Paragraphs 71 and 72 of Part C of the Consultation Paper

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.

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***

Except that while it is important that an issuer operates as a going concern, consideration needs also be given to the length of time that the issuer has not operated as a going concern (with some tolerance for relatively short periods) and the prospects for the re-establishment of a going concern.

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?

X *No*.

1. **Subject to our comments on the Exchange's use and misunderstanding of insolvency terms below, we consider that it is inappropriate for the making of a winding up order in itself to trigger the commencement of the delisting procedures.**

   A growing theme worldwide has been to develop a "rescue culture" whereby businesses are saved for the benefit of the stakeholders including creditors, shareholders, employees, unions, customers, suppliers, government and anyone else with an interest in the business. It is frequently impossible to achieve such a rescue without the imposition of a moratorium on creditors' actions because otherwise those seeking the rescue will be held to ransom by those with short-term interests. Under Hong Kong law, moratoriums are only available through the appointment of an external, independent person, such as a Liquidator, Provisional Liquidator or Receiver. To deny a re-listing in these circumstances is to defy the current worldwide movement on the rescue of businesses in trouble.

   This "rescue culture" has received the strong support of the High Court of Hong Kong in recent years where the Courts have initiated, assisted and monitored the rescue of listed Hong Kong companies facing financial difficulties by, broadly, appointing insolvency administrators to those listed companies in order to initiate and facilitate a restructuring, provided those practitioners with the power necessary to facilitate the rescue and allowed and supported adjournments of many months in order for these rescues to be successfully concluded. It should be noted that all such rescues are the subject of detailed Court scrutiny and require the Court's specific approval.

2. **Our members are familiar of a number of instances where companies in considerable financial difficulties have struggled on in circumstances where a Liquidator, Provisional Liquidator or Receiver would normally have been appointed but has not for technical reasons, such as to avoid triggering the determination of contracts with third parties. The rescue process has taken much longer in these cases, proved much more painful and been a lot riskier than it would have been with a statutory moratorium. It cannot be correct to encourage this sort of rescue by preventing the easier and more certain route.**

Exacerbating this mis-direction will worsen the current state of the Hong Kong economy. With no immediate recovery in sight, all steps possible should be taken to encourage and facilitate liquidity and growth. Blocking the opportunity to salvage a business in difficulties will further harm the economy.

3. **We strongly disagree that an issuer which has been the subject of a winding-up order (normally described as having a winding-up order made against it) should be immediately delisted. In at least five cases in the last two years in which our members have been involved, substantial value has been generated for stakeholders by assistance given by the company in liquidation to the listing by way of introduction of another applicant who has injected funds so that the company can be returned to solvency, through a scheme of arrangement. While we appreciate that these are difficult and time-consuming transactions, substantial value was derived for all stakeholders notwithstanding a winding-up order. The Stock Exchange should not unilaterally deprive shareholders of the realizations available to them from the assets in which they have an interest.**

   We consider that it should not be for the Exchange to dictate to shareholders what they should or should not be entitled to or to ignore the shareholders interest in a distressed company. Regardless of the dilution that shareholders invariably suffer when a distressed entity is to be restructured, any decision in relation to a shareholder's interest belongs to that shareholder alone.

4. **An illustration of the inappropriateness of commencing delisting procedures on the making of a winding-up order can be found in the draft legislation for Provisional Supervision. Provisional Supervision is legislation designed to facilitate the rescue of companies in financial difficulties. As the Exchange is no doubt aware, the legislation has been pending for some years now, although there are signs that the legislation may be introduced within 2003.**

   Under the draft legislation, one of the persons who can instigate Provisional Supervision is the liquidator of a company. This aspect of the legislation is very unlikely to change. Thus it is easy to envisage a situation where a liquidator, appointed after the making of a winding-up order, identifies a company as a suitable candidate for rescue and seeks to achieve this through Provisional Supervision only to find that his efforts are blocked by the Exchange's automatic delising procedures. Leaving aside the very bad publicity that this would no doubt attract to the Exchange, there would inevitably be legal challenges to the validity of the Exchange's action and a significantly poorer position for all the stakeholders.

5. **The commencement of delisting procedures on the making of a winding-up order would also frequently be inappropriate where the winding-up order arose from a dispute between shareholders and the company was still solvent and trading profitably. It would appear that the Exchange has associated the making of a winding-up order exclusively with insolvency. Indeed this section of the Consultation Paper is headed "Insolvency". However a company may have a winding-up order made against it for other reasons. While insolvency is the most common, it is by no means the only basis for a winding-up order. Although the disputes of shareholders of listed companies should be resolved before a winding-up order is made, this need not always be the case. To delist an obviously salvageable company in these circumstances would considerably disadvantage the shareholders, and to no end.**

6. **We consider that the Exchange's attempts to be prescriptive will lead to the wrong result in certain cases. We consider that there should always be an opportunity for a company to present its case for not being delisted, whatever indicators are adopted to commence the delisting proceedings they should only be indicative.**

   We believe that the Exchange has an obligation to demonstrate that a company should be delisted. We urge the Exchange to consider, if there is no adverse effect to any party, whether the Exchange should put any barriers in the way of restructurings that do undoubtedly improve the position of most if not all of the stakeholders.

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***

1. **Refer to Question 16. We do not believe such an event should trigger the delisting procedures. We stress that companies facing economic difficulties should be given sufficient time to formulate a rescue plan. In this connection, we would reiterate that the one month to present a resumption proposal is too short.**

2. **Broadly, any action to be taken by the Exchange as a result of winding-up order should only be undertaken when there are no prospects of a successful re-organization that will be advantageous to the company stakeholders.**

3. **The Consultation Paper contains a definition of "provisional liquidation" with which we disagree and which is not consistent with the definitions used for that term around the world. It is true that a Provisional Liquidator can be appointed at any time after a winding-up petition has been issued but before a winding-up order has been made but it does not follow that the presentation of a winding-up petition will lead to the appointment of a Provisional Liquidator or the liquidation of the company. In the substantial majority of cases around the world, the mere issuing of a winding-up petition does not lead to the appointment of a Provisional Liquidator or, indeed, have any lasting effect on the conduct of the affairs of the company. Importantly, notwithstanding the issue of the winding-up petition, the company that is the subject of such a petition will remain in the hands of and subject to the control of its directors who will be charged with and are entitled to defend such a petition. We urge the Exchange to seek legal advice on this point.**

4. **We also strongly urge the Exchange to seek appropriate advice in relation to the role, powers and authority of a Receiver. We have assumed for the purposes of this Questionnaire that the Exchange is referring only to the appointment of an out of Court Receiver appointed over all, or substantially all, the assets of an issuer. We say that because it will usually be possible for a secured lender to appoint a Receiver over individual assets of the company and it would be unfair and unreasonable for such a severe penalty to flow from the appointment over an individual asset.**

   The Consultation Paper does not appear to consider a court appointed Receiver but this is a quite different role and a distinction should be made.

5. **The proposals contemplated by the Exchange in this section are unbalanced in that they are limited to only three possible insolvency appointments. The ramifications of what is likely to happen upon the appointment of creditors' voluntary liquidators or members' voluntary liquidators (both of which can occur without an order of the court) must also be considered.**

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***

1. **Refer to Questions 16 and 17.**

2. **Broadly, any action to be taken by the Exchange as a result of winding-up order should be undertaken when there are no prospects of a successful re-organization that will be advantageous to the company stakeholders. The appointment of a Receiver or of a Provisional Liquidator must not automatically trigger de-listing procedures because there are many instances in which this would be inappropriate.**

3. **We consider that the Exchange has an obligation to investors to allow sufficient scope for a rescue. Often it is the minority shareholders, who have nothing to do with the mis-management that is the reason for the Company's insolvency, who will suffer most from there being no rescue.**

4. **We would like to reiterate our objection raised in our 30 October 2002 submission on the July Consultation Paper to the requirements, outlined in Part E of that Consultation Paper, to submit a proposal within a strict one-month period to bring the issuer into long-term sustained compliance with the listing criteria, and to implement it within a period of six months from the date of acceptance of the proposal by the Exchange.**

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***

But such concern should not prevent any opportunities that exist to remedy the concern or rescue the subsidiary.

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***

(But only if it is affecting the profitability, market capitalization and shareholders' equity of the listed company and if by "remedial action" the Exchange is considering other measures than commencing delisting procedures.)

1. **It is inappropriate automatically to start de-listing procedures because of an event in a subsidiary. The subsidiary may be immaterial to the issuer's accounts. There are too many exceptions to allow this to be a basis.**

2. **We re-iterate that we do not believe that the delisting procedures or any other similar penalty should be applied only because a company or any of its subsidiaries have been served with a winding-up petition. Any process that considers the implication of a winding-up petition should not ignore the status of the company's business and assets and should also be mindful that it is open for a variety of stakeholders to satisfy the demand underpinning the petition or to seek to show it is without merit. It may also be possible for a Liquidator, in a relatively short time, to realize sufficient assets or undertake other transactions that are able to return the company to solvency. In these circumstances, the imposition of substantial penalties as a result of the winding-up petition or winding-up order would be unfair and unreasonable.**

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***

DISCLAIMER OF AUDIT OPINION OR ADVERSE AUDIT OPINION

Paragraphs 75 and 76 of Part C of the Consultation Paper

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.

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 that 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***

A disclaimer opinion or an adverse opinion would be likely to affect one’s investment decision.

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, subject to the following comment.***

Except that the nature of the disclaimer/adverse opinion as well as the reason for the opinion would need to be identified before considering whether there will be any appropriate remedial action. Therefore disclaimer/adverse opinions should be considered on a case-by-case basis. In some cases, there might not be any appropriate remedial action.

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

It depends on the nature of the disclaimer or adverse opinion and the remedial action necessary. In some cases, no appropriate remedial action may be available.

MINIMUM TRADING ACTIVITY LEVEL

Paragraph 81 of Part C of the Consultation Paper

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?*

- ✓ **We agree that trading volume is not an appropriate indicator.**

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

N/A

REDUCTION IN OPERATING ASSETS AND/OR LEVEL OF OPERATIONS

Paragraph 87 of Part C of the Consultation Paper

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 privatization 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 privatization 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)?

X ***No***.

There are other sections of the Main Board Listing Rules which cover this.

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?

X ***No***.

Please refer to our comments in Q.27.

Q29. What percentage decrease do you think is appropriate?

N/A.

Please refer to our comments in Q.27.

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?

N/A.

Please refer to our comments in Q.27.

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

N/A.

Please refer to our comments in Q.27.

CASH COMPANIES

Paragraph 91 of Part C of the Consultation Paper

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 privatization 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 privatization 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***

All Listing Rules should have objective criteria.

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***

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

N/A

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***

The business strategy of the issuer, as disclosed to investor at IPO time, will have fundamentally changed.

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

X No.

Privatization is much more serious than this type of corporate action, which should only require the consent of 75% of the Independent Shareholders.

PROLONGED SUSPENSION

Paragraph 94 of Part C of the Consultation Paper

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 canceling the listing of its securities. Do you think it necessary to specify what constitutes a prolonged period?

✓ ***Yes***

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

This depends very much on the reasons for the suspension and the nature of the remedial action required. Objective milestones will be necessary.

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?

X ***No***.

This should not be the sole test. For example, the suspension may be caused by litigation between shareholders, whilst the issuer continues to be profitable.

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***

PARAGRAPH 38 OF LISTING AGREEMENT

Paragraph 96 of Part C of the Consultation Paper

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)?

N/A.

Not clear. Please refer to our earlier comments.

PERSISTENT BREACHES OF THE MAIN BOARD RULES

Paragraph 98 of Part C of the Consultation Paper

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.

Once again, there should be objective criteria as to what kind of frequency and nature of breached will trigger cancellation procedures.

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

This is a big subject and is worthy of a separate consultation paper.

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?

X No.

Cancellation of listing damages the independent minority shareholders more than the directors.

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

N/A.

Please refer to our comments in Q.43.

ILLEGAL OPERATION

Paragraph 101 of Part C of the Consultation Paper

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?

X No.

Equating "illegality" with a breach of "Exchange general principles" is considered inappropriate. In addition, the suggestion that the Exchange's "opinion" be a criteria is not considered an acceptable regulatory concept. Objective criteria must be made available. However, if any action is to be taken, the independent minority shareholders' interest should be taken into account.

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***

But this is subject to a number of other factors. Please also refer to our comments in Q.45.

EXCHANGE'S DISCRETION

Paragraph 102 of Part C of the Consultation Paper

We recognize 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 reason(s) for your view.

All of the Exchange's actions should be subject to objective criteria.

TRANSITIONAL PERIOD

Paragraph 104 of Part C of the Consultation Paper

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 also refer to our comments in Q.8.

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

12 months (In the case of loss making, it should not be retrospective. The first year of loss should start when the rule is effective)

Absolute Minimum Market Capitalisation

12 months

Insolvency

12 months

Disclaimer of Audit Opinion or Adverse Audit Opinion

12 months

Reduction in Operating Assets and/or Level of Operations

12 months

Cash Companies

12 months

Prolonged Suspension

12 months

Paragraph 38 of Listing Agreement

12 months

Persistent Breaches of the Main Board Rules

12 months

Illegal Operation

12 months

Others.

1. **Any remedial timeframe should be sufficient to allow new or independent parties to assess the relevant circumstances and take appropriate action.**

2. **The restructuring of distressed companies often covers a number of areas that are outside the various parties' control and therefore require flexibility. This includes the timetables of the courts in various jurisdictions for court approved schemes of arrangement and the often unpredictable but usually lengthy timeframe required in order to meet regulatory obligations in the PRC, such as those associated with MOFTEC, COFTEC or SAIC registration. Often, particularly in relation to the PRC approval process, these steps must be carried out sequentially and there is little or no room for any parallel processing of the applications. It is unreasonable to penalize the stakeholders because an arbitrary deadline is not met owing to the failure of a court to process the case or a regulatory delay in the PRC. We believe a more practical and reasonable solution, if the Exchange is determined to shorten existing timing, is to review the progress of the resumption proposal after a twelve month period and then proceed to the delisting procedures only if the Exchange is not satisfied with the progress.**

3. **Where the company's financial position may result in the appointment of a Liquidator, Provisional Liquidator or Receiver, even a 12 month timeline will be difficult to meet. Any Liquidator, Provisional Liquidator or Receiver will be independent and will have little or no understanding of the company's affairs. It will however be incumbent on him to undertake at least the following work before being able to proceed with a restructuring exercise:**

    a) **collect and protect all books and records;**
    b) **identify and protect all assets and undertakings;**
    c) **understand and stabilize the company's business;**
    d) **assess the financial position of the company and the merits associated with a restructuring of the company; and**
    e) **brief and instruct the necessary advisers.**

    It is highly likely that many months will pass before a distressed company in this situation is able to contemplate a restructuring let alone pursue, negotiate and settle a proposal (while consulting and providing the necessary information to shareholders and creditors).

4. **The Liquidator, Provisional Liquidator or Receiver will need a period to conduct negotiations in order to obtain the best deal. These negotiations will typically involve a number of potential investors, the major creditors, shareholders and management. These are complex negotiations and it is critical that sufficient time is given to the Liquidator, Provisional Liquidator or Receiver to negotiate a proposal that has good prospects of success.**

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.***

PART D
ALTERNATIVE TREATMENTS OF
SECURITIES DELISTED FROM THE MAIN BOARD

COMPULSORY PRIVATISATION OR BUY-BACK BY CONTROLLING SHAREHOLDERS

COMPULSORY WINDING-UP

Paragraphs 108 to 111 of Part D of the Consultation Paper

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

This depends very much on the criteria within which these measures are used or imposed. A compulsory buy-back may not be fair to the controlling shareholder.

Compulsory windings-up are matters to be determined by the courts. The appropriateness of the company being wound up would entirely depend on the circumstances, eg the reason why it was delisted.

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

<u>Please refer to our comments in Q.51.</u>

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?

1. **The prospect of a financial restructuring or a rescue is, by far, a preferred alternative.**

2. **While restructuring proposals often involve a substantial dilution of existing shareholders' equity interests, shareholders are invariably better off with a much diluted shareholding in a restructured issuer than an undiluted shareholding in an insolvent company or a company which has been wound up. A small return of their investment will always to be preferred to a total loss.**

ESTABLISHMENT OF AN ALTERNATIVE BOARD FOR THE LISTED MARKET

Paragraphs 112 to 115 of Part D of the Consultation Paper

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.***

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 that they must meet the qualifying criteria, as with other GEM Companies.

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.***

Otherwise, minority shareholders will be completely disenfranchised.

MARKET FOR TRADING UNLISTED SECURITIES

Paragraphs 116 to 128 of Part D of the Consultation Paper

Q57. Do you think that there should be an organized 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).***

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.***

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

- ✓ ***Others.***

This should be subject to a separate Consultation Paper.

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

<u>Please refer to our comments in Q.59.</u>

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

✓ ***Others.***

This should be subject to a separate Consultation Paper.

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

No comment.

PART E
LOW-PRICED SECURITIES

Corporate governance related matters

Paragraphs 131 to 143 of Part E of the Consultation Paper

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

***X No*.**

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?

N/A

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?

N/A

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%?

X No.

Theoretically, share consolidation and sub-division should not affect the real values of shares. Therefore, it is irrelevant to prohibit any rights issue within a specified period after a share consolidation or sub-division. Whether to subscribe for their right entitlement should be an investment decision made by existing shareholders. We do not consider carrying out a rights issue after a consolidation or subdivision to be abusive.

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?

X No.

We do not believe that share consolidation and subdivision would affect the real values of shares. To require additional safeguard measures such as requiring independent shareholders' approval would incur unnecessary costs and time for the issuer in making operational corporate actions.

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?

No other comments.

Fair and orderly market related issues

Paragraphs 144 to 153 of Part E of the Consultation Paper

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?

X No.

The question indicates a misconception of what is a fair and orderly market. There may be high volatility but a market can still be fair and orderly. The considered approach is not appropriate.

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

- ✓ **No action required.**

This is a commercial matter best left to the board of directors and not the Exchange.

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.

N/A

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?

N/A.

Please refer to our comments in earlier questions.

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

The Exchange should speedily conclude both the July Consultation Paper and this Consultation Paper and come out with a position on the issue of low-priced securities.

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.

This is a big subject and should be subject to a separate consultation.