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March 20, 2003

Listing Division
Hong Kong Exchanges and Clearing Limited
11th Floor, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

Dear Sirs:

Re: CONSULTATION PAPER: Continuing Listing Criteria and Related Issues

The Asia Pacific Advocacy Committee (APAC) of the Association for Investment Management and Research (AIMR) [1] is pleased to comment on the Consultation Paper of the Hong Kong Exchanges and Clearing Limited, *Continuing Listing Criteria and Related Issues*. The APAC is a standing committee of AIMR charged with reviewing and responding to major new regulatory, legislative, and other developments that may affect investors, the investment profession, and the efficiency and integrity of the Asia Pacific region financial markets.

General Comments

The APAC supports the objective of this Consultation to assess

> *…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…listing status.* [p. 2-3]

[1] With headquarters in Charlottesville, VA, and regional offices in Hong Kong and London, the Association for Investment Management and Research® is a non-profit professional organization of 61,000 financial analysts, portfolio managers, and other investment professionals in 113 countries of which 48,800 are holders of the Chartered Financial Analyst® (CFA®) designation. AIMR's membership also includes 121 affiliated societies and chapters in 40 countries. AIMR is internationally renowned for its rigorous CFA curriculum and examination program, which had more than 100,000 candidates from 143 nations enrolled for the June 2002 exam.

We also agree with the Consultation's conclusion

> *…The quality of a listing market is crucial for investor confidence…We believe that the quality of the listing market is dependent on the interaction of the various key components of the market, namely, issuers, investors, intermediaries, infrastructures (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.* [p. 7]

A fundamental principle of AIMR's *Code of Ethics* and *Standards of Professional Conduct* is that the needs of investors and investment clients for fair dealing and full and fair disclosure of all material information must supersede other interests. Consequently, we would urge the Exchange when weighing the interests of the various market participants, and determining how best to resolve conflicts of interests, to consider first what principles and practices will best serve investors' interests and, therefore, promote strong investor confidence.

SPECIFIC COMMENTS

PART B: MINIMUM STANDARDS FOR MAINTAINING LISTING

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?

X *Yes (please answer Q2)*
_ *No*

Please state reason(s) for your view.

Basic, minimum standards are essential for a market to achieve its primary objectives, the rational allocation of capital among firms, and the raising of sufficient amounts of new investment capital to ensure reasonable economic growth. Moreover, such standards are fundamental for building and maintaining investor trust and confidence, crucial attributes for any stable, efficient, and effective market.

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?

X *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)*

If standards are to be effective, that is, capable of being understood and applied by market participants, as well as enforced by market regulators, then they must be as clearly defined, transparent, and objective as possible.

For investors to make well-informed investment decisions, they must have complete, clear, timely, and understandable information about a company's current operations, including the risk exposures, rewards, and the implications of these for the company's future prospects. In addition, investors must be able to understand market regulations, including minimum continuing listing standards, how they are to be applied in practice, and their implications for the company's future.

PART C: MINIMUM CONTINUING LISTING STANDARDS

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

X *Yes (please answer Q4)*
_ *No*

While agreeing in principle that continuing listing standards should be as simple and minimal as possible, we also believe strongly that the standards must require consideration of **all** of the major economic indicators of a company's financial performance and condition, rather than focusing on a single indicator.

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

FINANCIAL STANDARDS

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?

X *Profit*—If multiple years' of losses have been incurred along with small or negative shareholders' equity
X *Market capitalization*—If liquidity has deteriorated significantly
X *Shareholders' equity*—Should be considered in conjunction with profitability
X *Others. Please specify:*

1. Corporate governance—Companies with relatively greater oversight by independent directors, full transparency, a demonstrated strong commitment to ethics, and active shareholder involvement are more likely to best serve the interests of investors.
2. Liquidity or cash measures—Traditional measures of financial performance and condition, based upon historical cost/accrual accounting, must be supplemented by measures of liquidity, preferably those using cash flow data. Obligations cannot be paid with accrual accounting "profits". On the contrary, the company's ability to generate cash flows from operations is the single, most critical measure of the company's health and long-term viability.

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*
X *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 see our responses to Question 5.

Please state reason(s) for your view.

The APAC does not believe that any single indicator taken alone is sufficiently reliable or informative to be used as a "trigger" for remedial action. Instead, we believe that the company's overall financial condition and profitability, its liquidity and cash flow generating potential, information about its future prospects as reflected in its market capitalization, and the trends in these measures, must be jointly assessed.

However, if a company has experienced several years of mounting losses accompanied by precipitous declines in shareholders' equity, or is suffering sharply declining trends in liquidity, we would agree that these conditions should trigger remedial action.

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*
X *Others. Please specify:*

Please state reason(s) for your view.

Although we understand the desire to develop simple "rules of thumb" requiring little if any subjective judgment, and that are easily applied and easily enforced, we believe that it is not feasible to do so and not in the best interests of any market participants. Companies in different industries display widely varying patterns of profitability. For example, many so-called "deep cyclical" companies are hypersensitive to upturns and downturns in the economy and can be expected in the normal course of operations to suffer at least several years of losses, followed by years of higher-than-average profitability. Others, for example, certain health care service companies, whose operations and profitability are at best weakly correlated with the economy, will generate relatively stable and predictable earnings.

Consequently, we believe that profitability must be evaluated in terms of the economic characteristics and secular and cyclical trends of the company's industry, and the company's financial condition, including its liquidity and cash flow generating ability.

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?

X *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.

We believe that the indicators should be applied prospectively from the effective date of the amendments. Although the statistics suggest that the numbers of companies that would fail to meet the requirements may be quite small, other possibly marginal companies will need some minimal amount of time to adjust their operations, including shutting down or divestiture of unprofitable operations. We believe that an orderly transition to the new standards will benefit all market participants.

NOTE: THE APAC WILL ADDRESS QUESTIONS 9, 10, AND 12-14 JOINTLY, BELOW:

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?

See below.

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*
X *No. The appropriate duration should be* ***at least 1 reporting period****.*

Please state reason(s) for your view*.*

See below.

ABSOLUTE MINIMUM MARKET CAPITALISATION

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?

_ *Yes (please answer Q14)*
x *No (please answer Q13)*

Please state reason(s) for your view.

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

X *Yes. Please specify what the indicator should be and the threshold you consider reasonable.*
_ *No.*

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.

We agree that some minimum market capitalization should be established for continued listing on the Exchange. Market capitalization is a direct reflection of investors' views of the health and growth prospects of companies. Companies that are unable to meet the most minimal standards may variously:

- Be suffering deteriorating profitability and/or financial condition.
- Display little prospect for future growth.
- Be closely-held, or for other reasons are thinly traded.

Companies may not provide the best opportunities for investors who provide capital and bear risk in order to earn reasonable returns. At the same time, such companies increase the regulatory burden and cost that must be borne by all market participants. Consequently, the setting of reasonable minimum capitalization standards would provide the best cost/benefit outcomes to the markets.

Companies that are small merely because they are in an emerging or early growth stage may be registered on the GEM, so these standards would not apply to them.

We can concur with the benchmark minimum capitalization of HK$50 million, which represents a 75% decline from the initial listing requirements. We believe that most investors, knowing the standards, would rightly be concerned if a company no longer met those standards and would be on notice that should the company continue to decline, its continued listing would be in jeopardy. We also believe that the proposed HK$30 million "absolute minimum" threshold would serve as a useful trigger for remedial action. While providing a practical minimum starting point for initial implementation of the Continued Listing Standards, this amount is exceedingly small relative to the average listing on the Hong Kong Exchange and should be raised gradually over time.

We consider the 30-consecutive-day criterion for determining average market capitalization to be far too short to be practicable. In response to external political or other events, markets can suffer very steep temporary declines, sweeping even the highest quality securities along in the downdraft. If indeed the decline in the security's market capitalization is a response to deteriorating financial performance and/or condition, a better measure may be obtained by averaging the capitalization over one reporting period. This would also enable the regulators to better evaluate the price trend.

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.

We agree with the HK$50 million benchmark proposed by the Consultation. The 75% decline from the initial listing standards represents a severe deterioration of its condition at initial listing condition and warrants regulatory attention.

INSOLVENCY

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?

X *Yes*
_ *No*

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 *Yes*
_ *No*

Please state reason(s) for your view.

We concur fully with the Exchange's position that

> *…There has been and there will be a reasonable expectation of financial viability and performance of the issuer. We there consider it essential that an issuer must be operating on a "going concern" basis.*

Investment decisions are forward-looking and their valuations are based upon their expectations of the companies' future prospects. That is, investors provide their capital to companies in return for expected future returns commensurate with the risk assumed. If a company is no longer a going concern, then by definition the probability that it will be able to provide future returns in exchange for capital is remote.

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?

X *Yes (please answer Q18)*
_ *No*

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?

X *Yes*
_ *No*

Please state reason(s) for your view.

When a company enters receivership or provisional liquidation, the presumption is that, although by definition it is suffering from severe financial distress and has a much higher than average probability of failure near term, such failure is by no means certain. Consequently, we can agree that such companies should be treated differently from those for whom continued survival is remote.

However, we believe that companies in this situation must be subject to the most stringent monitoring and oversight in receivership. Moreover, it is critical that investors receive continuous information about any matters that may be relevant to their future viability as going concerns or to their future prospects.

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?

X *Yes*
_ *No*

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?

X *Yes*
_ *No*

Please state reason(s) for your view.

Our concern is with the interests of the investor and the protections available in such circumstances.

To the extent that the principal subsidiaries conduct operations that are vertically, horizontally, or otherwise integrated with the issuer, for example as a supplier of primary inputs to the issuer, a customer for its products, a financing subsidiary, or a manufacturer of a critical complementary

product (e.g., software and services for a hardware manufacturer), then issuance of a winding up order should call into question the continued viability of the issuer.

In addition, if any principal subsidiary represents a significant portion of revenues, earnings, assets, or other resources of the issuer, then a winding up order should result immediately in an enquiry into the stand-alone viability of the remaining operations of the issuer.

We believe that the remedial action undertaken by the company should be accompanied by a regulatory review of the viability of the remaining operations, including an assessment of their sustainability as a going concern.

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 capitalization requirement and the spread of shareholders requirement which the issuer would be required to comply with on an ongoing basis)?

X *Yes*
_ *No*
_ *Other views. Please specify:*

Please state reason(s) for your view.

We agree that such circumstances would provide a clear signal that the business may not be viable and that it poses significant long-term risks.

DISCLAIMER OF AUDIT OPINION OR ADVERSE AUDIT OPINION

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 and 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?

X *Yes*
_ *No*
_ *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?

X *Yes (please answer Q24)*
_ *No*

Q24. How much time should be given for the remedial action to be taken?

Please state reason(s) for your view.

Complete, accurate, understandable, consistent, and comparable information is essential to the efficient and effective operation of financial markets. Without such information, capital cannot be allocated rationally to businesses, and investors' trust and confidence in the markets will be eroded, to the detriment of all market participants. The attestation of the financial reports by independent expert auditors is a critical safeguard that protects the interests of investors and sustains the functioning of markets.

The two broad categories of exceptions, (1) going concern, and (2) accounting problems, resulting in either a disclaimer or an adverse opinion, are fundamentally different in nature and lead to different conclusions about what remedial actions should be taken. Going concern exceptions indicate that the auditors believe a substantial probability exists that the business will not survive another year. Thus, the economic viability of the firm is in question.

An exception for accounting problems is entirely different. Typically, this exception results from management's unwillingness to conform to generally accepted accounting principles (GAAP), or, much more rarely, from a scope exception, for example, the auditors' inability to observe the taking of year-end inventory or to perform other mandatory tests.

Firms receiving going concern exceptions usually face receivership or liquidation within a relatively short time. That is, the financial condition of the business has declined to such a severe state that management has little or no control over the future of the company. Normally, this would be dealt with under the provisions discussed above in the Insolvency section.

Accounting problems, other than the rare scope exception, are well within the control of management. Management could have met the requirements but chooses to not do so. We would propose in this case that management should be given a relatively short period, no longer

than a month, to "cure" the problem by meeting the regulatory requirement to conform to GAAP, or face immediate delisting. There can be no reason to permit a company's refusal to conform to market regulations to continue. To do so would place the self-serving interests of issuers above the best interests of investors who supply the capital. Such a circumstance would seriously erode the trust and confidence of investors, and the credibility of the market itself.

Scope exceptions should be addressed by requiring auditors to inform the regulator immediately, that is, when they first discover, that a material scope exception is going to occur. The regulator and auditors can determine how best to resolve the problem as expeditiously as possible and how best to inform investors of the problem.

MINIMUM TRADING ACTIVITY LEVEL

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)*
X *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*.*

Although we agree that trading volume *per se* should not be an indicator for remedial action by the regulator, we recognize that under some circumstances, companies with low trading volume may be subject to price manipulation and other liquidity problems that work to the detriment of investors. Frequently, pricing data are out-of-date for such firms which can pose problems for efficient and orderly market-making in the security.

In addition, low trading volume may indicate that the security is fundamentally private equity. Such firms may not be responsive to economic changes. That is, the risk of the company is largely unsystematic or idiosyncratic.

Q26. What in your opinion should be the appropriate threshold for trading volume?

Please state reason(s) for your view.

We do not have a view on what would be an appropriate *absolute* threshold for trading volume for the Main Board. However, based upon our concerns above, we believe that investors are best served when the volume of trading activity is sufficient to provide:

- timely, up-to-date prices; and
- adequate liquidity for accommodation of investors' usual trades in the company.

Such a threshold is likely to be a function of trading activity of both the Main Board and of the particular security.

REDUCTION IN OPERATING ASSETS AND/OR LEVEL OF OPERATIONS

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 capitalization 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)?

X *Yes (please answer Q28)*
_ *No*

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*
X *No (please answer Q29)*

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?

X *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?

X *Yes*
_ *No*

Please state reason(s) for your view.

We believe that the threshold for the decrease in net assets, total assets, operations, turnover, or after-tax profits should not be greater than **50%**. A decline of this magnitude represents a material shift not only in productive activities, but, critical for investors, a major change in the risk and reward characteristics of the company. When investors provide capital to a company, they do so based upon their knowledge of the company's operations, anticipated risks and rewards, and other factors.

If management should decide to undertake a major change in these characteristics, at a minimum, the management should be required to:

- inform investors of the plans to change the operations of the company, providing full disclosure of the range and effects of the plans on the operating performance and balance sheet of the company; and
- submit the plans to a vote of the independent shareholders.

The formal notification period should be lengthy to allow investors to consider the plans and, if they believe it necessary, take appropriate action with their investments in the company. We believe that the vote should be subject to a super-majority of the independent shareholders.

CASH COMPANIES

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?

X *Yes*
_ *No*

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?

X *Yes*
_ *No (please answer Q34)*

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?

X *Yes*
_ *No*

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?

X *Yes*
_ *No*

Please state reason(s) for your view.

The clear difficulty for investors is that it is impossible for investors to know what risks the company is going to incur and what the rewards distributions might be. Consequently, it is essential that management be required to:

- Disclose to shareholders their plans and intent for the investment or other disposition of the assets;
- Undertake remedial action within six months; and
- Continuously update shareholders as the plans are implemented.

The 90% threshold seems to us to be unnecessarily high, however. Few operating companies, other than those resulting from recent initial public offerings, would be likely to have such a high cash balance, and such companies are covered under other regulatory provisions.

We would concur with the requirement under the Corporate Governance provisions that managers contemplating such actions should be required to obtain the approval of at least 75% of the *independent* shareholders.

PROLONGED SUSPENSION

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?

X *Yes (please answer Q38)*
_ *No*

Q38. What period do you consider to be a reasonable benchmark?

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 *Yes (please answer Q40)*
_ *No*

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*
X *No*

Please state reason(s) for your view.

We believe that in circumstances where a listed company has been suspended for a prolonged period, as in all other circumstances in the financial markets, the criterion for judging appropriate action should be what regulatory or other intervention best serves the interests of investors.

Companies have an obligation to their providers of capital to make certain that all minimum regulatory requirements are met and maintained continuously. This includes full, timely, and transparent financial reporting and disclosure that conforms to generally accepted accounting principles.

Where deficiencies are so severe that suspension has occurred, and this continues for a prolonged period, for example, six months, the company's commitment to fair dealing with its shareholders must be called into serious question. Therefore, we believe that delisting in this case is appropriate and should not be further delayed.

Given the critical importance of timely and high quality financial information to informed decision-making, we believe strongly that no exception should be made for failure to provide required and appropriate financial disclosure.

PARAGRAPH 38 OF LISTING AGREEMENT

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)?

X *Yes*
_ *No*

We can foresee no circumstances that would provide persuasive argument that a company failing to meet the minimum listing requirements should be allowed to continue to be listed. We do not see the initial listing requirements as a single hurdle, the crossing of which admits a company into permanent status, regardless of its failure to comply with the regulations.

PERSISTENT BREACHES OF THE MAIN BOARD RULES

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?

X *Yes*
_ *No*

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

The APAC believes that clear, unequivocal statements that strict compliance is required, followed by prompt enforcement in all cases where either frequent or serious breaches have occurred likely will minimize such infractions in the future. Companies that have a pattern of breaches serve neither the market as a whole nor the participants well and should be removed from access to the market.

ILLEGAL OPERATION

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 make 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*
X *No*

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?

X *Yes*
_ *No*

Companies engaged in illegal activities of any sort should be subject to immediate remedial action with the expectation of imminent delisting if the illegal activities do not immediately cease with appropriate steps taken to prevent such activities from recurring. Any other course of action would undermine trust and confidence in the market and constitute a tacit approval of the activity.

EXCHANGE'S DISCRETION

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 reason(s) for your view.

We believe that provisions should not be adopted that provide loopholes or other opportunity for selectively circumventing strict enforcement of the listing requirements. It is inevitable that such a provision will be applied on a discretionary basis. Moreover, we observe that this provision contains no detailed guidance on its application, nor criteria or other constraints restricting its application.

Consequently, we believe it is inevitable that such a provision will be applied on a discretionary and inconsistent basis. The companies that commit the most egregious breaches would seem to be those that would most likely be considered for this provision. That is, companies for which corporate governance concerns are small would suffer the most extreme penalty, delisting, whereas those that represent the greatest risk to the investor would continue to be listed, being preserved from the severest penalties. Such a circumstance could effectively undermine the intent and effective implementation, application, and enforcement of the listing rules.

TRANSITIONAL PERIOD

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?

X *Yes (please answer Q49)*
_ *No*

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:

6 months maximum—complete, reliable information is critical to efficient and effective capital markets

Absolute Minimum Market Capitalisation:

12 months—unusual circumstances could occur that could cause the absolute minimum capitalization criterion to be violated, and it may require time for the conditions to reverse.

Insolvency:

No transition period.

Disclaimer of Audit Opinion or Adverse Audit Opinion:

No transition period. Rational market prices cannot be determined by market participants if insufficient, incomplete, or incorrect information is all that is available.

Reduction in Operating Assets and/or Level of Operations:

No transition period.

Cash Companies:

No transition period.

Prolonged Suspension:

No transition period.

Paragraph 38 of Listing Agreement:

No transition period.

Persistent Breaches of the Main Board Rules:

No transition period.

Illegal Operation:

No transition period.

Others. Please specify:

No transition period.

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?

X *Yes*
_ *No*

Please state reason(s) for your view.

We believe that companies will have received sufficient notice prior to final adoption of the standard. We concur with a twelve month period in the case of market capitalization. However, we believe that compliance with GAAP (generally accepted accounting principles) is so critical to informed investment decision-making that the period should be no longer than six months. We contemplate that a six month period should be sufficient to allow companies to bring their accounting and financial reporting systems into compliance with the listing standards.

We agree that the remaining deficiencies are sufficiently severe that no additional transition period should be permitted.

PART D: ALTERNATIVE TREATMENTS OF SECURITIES DELISTED FROM THE MAIN BOARD:

COMPULSORY PRIVATISATION OR BUY-BACK BY CONTROLLING SHAREHOLDERS
COMPULSORY WINDING-UP

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

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.

The Consultation states on p. 51:

> *…due to the lack of an organized 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…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.*

The important question in the case of a delisted company is which of the alternatives will best serve the interests of the investors. It is not clear to us that either a compulsory buy-back or a compulsory winding-up would best benefit the investors. To the contrary, these two methods of rapid *forced* liquidation of ownership interest would almost certainly work to the detriment of the shareholders. So, we believe issues of practicality and feasibility need not be considered.

Instead, we recommend that a system be established to permit delisted securities to continue to be traded.

ESTABLISHMENT OF AN ALTERNATIVE BOARD FOR THE LISTED MARKET

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?

X *Yes (please answer Q55)*
_ *No (please answer Q56)*

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)*

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?

X *Yes*
_ *No*

Please state reason(s) for your view.

We do not believe that securities delisted from the Main Board should be listed on the GEM. Such companies would have little in common with those trading on the GEM and should not be entered into the same trading systems.

We believe that a system such as the OTC Bulletin Board should be established for delisted companies. However, given the conditions that would lead to a delisting, a regulatory oversight regime should be established for such companies to ensure that investors' best interests are attended to. For example, we believe that regular financial reporting should be required, as with the Main Board listing.

MARKET FOR TRADING UNLISTED SECURITIES

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?

X *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*

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

X *Requirements for periodic (semi-annual) and ongoing reporting of price-sensitive events*
_ *Periodic (semi-annual) reporting only*
_ *Others. Please specify:*

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

_ *SFC*
_ *The Exchange*
_ *Others. Please specify:*

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

_ *The Exchange*
X *An independent marketplace provider regulated by the SFC*

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

X *Yes*
_ *No, it should use the automatching system*
_ *Others. Please specify:*

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

We believe that an exchange/system should be established, that the same information, reporting, and disclosure required by the Main Board should extend to this exchange/system, and that the reports should be filed with this same exchange/system. The exchange/system should be regulated by the SFC. We support the adoption of a market maker system. Liquidity must be provided to the system since the bid and offer could be far apart with such securities.

PART E: LOW-PRICED SECURITIES

Corporate governance related matters

Questions 63-74. We believe that these questions involve fundamental issues in corporate governance and can only be considered in that context. A corporate governance framework must be grounded in principles that consider the best interests of investors. For example, such matters should be made fully transparent through disclosure to shareholders, and should be subject to shareholder vote.

We do not believe these issues can or should be resolved in a superficial or mechanical way. Consequently, we would urge the Exchange first to undertake a thorough consideration of these corporate governance matters with a view to developing principles and a framework that can serve as a foundation for addressing the questions.

CLOSING REMARKS

The APAC appreciates the opportunity to comment upon this proposal. We commend the Hong Kong Exchanges and Clearing Limited's initiative in developing the *Consultation on Continuing Listing Criteria and Related Issues* and, in general, support the proposed continuing listing requirements. If the Exchange should have questions about the APAC's positions, or desire further information, please contact Rebecca McEnally, AIMR Vice President, Advocacy (434.951.5319 or rebecca.mcenally@aimr.org) and we will be happy to respond.

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