# Corporate

News Release

HKEx News Release

15 November 2002

**HKEx today released its revised consultation paper on Continuing Listing Criteria and Related Issues**

Hong Kong Exchanges and Clearing Limited (HKEx) has published a Consultation Paper on Continuing Listing Criteria and Related Issues (the Consultation Paper).

## Summary

The Consultation Paper released today represents a sincere attempt by HKEx to solicit the views of market participants on the concept of continuing listing criteria and to expose a number of options for comment and to facilitate public debate.

The quality of the market is crucial for investor confidence and it is appropriate that on a periodic basis HKEx stimulates public debate on new ideas and concepts which may enhance the quality of Hong Kong ' s market, irrespective of how controversial these may be.

No decision has been made on implementation and HKEx remains open minded about how to proceed. Where appropriate and after analysis of the responses from the public, further consultation may be undertaken.

The lessons from the July incident have led to improvements in our pre-consultation processes. In principle we have followed the recommendations of the PIPSI report, the Report of the Panel of Inquiry on the Penny Stocks Incident. The process of communication with the public on the subject of continuing listing criteria and related issues will continue.

## Further details

In July this year, HKEx announced that it would publish a separate consultation paper to replace the withdrawn Part C of the Consultation Paper on Proposed Amendments to the Listing Rules relating to Initial Listing and Continuing Listing Eligibility and Cancellation of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).

As in the July Consultation Paper, this Consultation Paper seeks to review the Main Board Listing Rules generally applicable to issuers of equity securities (but not debt securities) applying for listing or already listed on the Main Board of the Exchange under Chapter 8 of the Main Board Listing Rules, as well as mineral companies and infrastructure companies.

The Consultation Paper seeks market views on three main areas:

- for the purpose of enhancing the quality of the market and investor confidence whether, in addition to the initial listing eligibility, the Main Board Listing Rules should contain any minimum standards for an issuer to comply with for maintaining its listing on the Exchange; and if so, what are the possible options for these minimum standards?
- alternative treatments of securities delisted from the Main Board; and
- various issues commonly associated with low-priced securities.

In the process of preparing the Consultation Paper, HKEx has held a number of meetings with representatives from different market sectors, including broker associations, listed companies and professional bodies, to seek their views on the relevant issues relating to the continuing listing criteria and low-priced securities.

**HKEx would like to stress that this is a consultation only and that the Consultation Paper discusses the general concepts relating to continuing listing standards and low-priced securities. The proposals and options set out in the Consultation Paper are intended to facilitate consideration and debate by the market. Some of the proposals in this Consultation Paper have been developed to a greater extent than other proposals. This should not, however, be taken to mean that HKEx has decided in favour of a particular approach or option. No final decision has yet been made and HKEx remains open-minded about how to proceed and what should be the best way forward. HKEx invites comments, and where appropriate, may conduct further consultation on the basis of the comments received from this consultation exercise.**

The statistics on the number of companies effected by the options proposed for consideration are historic and provided solely for the purpose of illustrating the potential impact of the options should they be adopted.

**Whether there should be any minimum standards for continuing listing?**

Quality of the market is crucial for investor confidence, and in Hong Kong's case, for maintaining Hong Kong's leading position as the Asian hub in the global financial markets. The quality of the market is dependent on the interaction of various key components including issuers and information on their performance. Investors may assess the investment potential of an issuer by reference to its achievement (quantitatively) in terms of financial performance, and (qualitatively) in terms of its standard of corporate governance.

HKEx, as the first tier regulator of issuers under the "three-tiered regulatory structure" is to provide a fair, orderly and transparent market for the trading of securities.

The Main Board Listing Rules comprise both minimum requirements which have to be met before securities may be listed and also continuing obligations which an issuer must comply with on an ongoing basis once it is listed. These rules are designed to regulate corporate processes and actions of issuers to ensure protection of shareholder rights and the proper disclosure of information to the public.

The Main Board Listing Rules currently contain delisting criteria. Under the current rules, an issuer must carry out a sufficient level of operations or have assets of sufficient value to warrant its continuing listing. Apart from this general descriptive requirement, the Main Board Listing Rules contain no quantitative continuing listing standards.

HKEx noted during the earlier pre-sounding meetings with representatives from different market sectors that there were mixed views on the overall issue of whether continuing standards would enhance confidence in the Hong Kong market and make the market more attractive to issuers and investors. To give proper weight to the arguments, HKEx would like the views of a wider audience on whether there should be any minimum standards for continuing listing. The responses to this fundamental question will frame how HKEx will proceed.

**What should be the minimum standards for continuing listing?**

If it is agreed that for the purpose of maintaining the quality of the market, there should be certain minimum standards for issuers to comply with to maintain listing on the Exchange, HKEx would like to seek market views on what should these minimum standards be.

To facilitate public debate, we have put forward a number of possible options for minimum continuing listing standards. These options are predicated on the belief that the performance of listed companies may be measured by reference to their achievement, both quantitatively and qualitatively.

**What does failing to meet minimum standards mean?**

The minimum standards only serve as a trigger point for an issuer to take appropriate remedial action upon the issuer not meeting such standards. **There would be no immediate delisting or suspension of trading of securities of the issuer when the requirement to take appropriate remedial action is triggered.** Instead, the market would be alerted to the fact that the issuer has not met the continuing listing standards, such as by way of special codes shown on the trading screen against the issuer's securities. Only in the event that issuers fail to submit or implement proposals satisfactory to the Exchange would such steps be taken to cancel the issuer's listing. The cancellation of listing would have to be approved by the Listing Committee and is subject to the rules of natural justice.

The consultation paper also invites comments on the transitional arrangements necessary to bring about an orderly introduction of any proposals that may result from this consultation.

**Possible options for minimum continuing listing standards**

When would the trigger for a company to take remedial action arise? An outline of various options on which we seek the public ’ s view are set out below. The standards may operate as a standalone test or interact with other standards in a multiple part test, such as the options proposed for financial standards.

1. Financial Standards

To forestall any mistaken impression, the options for financial standards do not include a simple test of three years continuing losses or any other individual financial standard. The options proposed are:

- Loss making for 3 consecutive years and with negative equity (1.5% of total issuers listed on the Main Board as at 31 August 2002); or
- Loss making for 3 consecutive years and the average market capitalisation being less than HK$50 million over 30 consecutive days (2.5% of total issuers listed on the Main Board as at 31 August 2002); or
- The average market capitalisation being less than HK$50 million over 30 consecutive trading days and shareholders' equity being less than HK$50 million (2.3% of total issuers listed on the Main Board as at 31 August 2002).

2. Absolute Minimum Market Capitalisation

- The average market capitalisation of the securities of an issuer listed and traded on the Exchange being less than a certain absolute amount (for example, HK$30 million) for 30 consecutive trading days, irrespective of the level of its shareholders' equity. (On the basis of issuers having the average market capitalisation below HK$30 million for 30 consecutive days, there are 3% of total issuers listed on the Main Board as at 31 August 2002). HKEx is seeking views on the mechanism for computing market capitalisation, whether the standard should be used alone or in conjunction with other standards and on what is the appropriate level for such a threshold.

3. Insolvency

- The issuer goes into receivership or provisional liquidation with little or no prospect of recovery; or
- The issuer's principal subsidiaries (that singly or in aggregate account for more than 75% of the issuer's total assets or turnover or after tax profits or production volume) have been served with a winding up order by the court, or go into receivership or provisional liquidation, and the issuer's remaining business would be 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 a continuing basis).

4. Disclaimer of Audit Opinion or Adverse Audit Opinion

- Where the most recent auditor's report of an issuer contains a disclaimer opinion or an adverse opinion (a total of 56 annual reports issued by issuers in respect of financial years ended 31 January 2000 to 28 February 2002 contained a disclaimer opinion. Among these, 16 issuers' annual reports contained disclaimer opinions which are for 2 consecutive financial years.)

5. Substantial Reduction in Operating Assets and/or Level of Operations

- Where an issuer's net assets, total assets, operations, turnover or after tax profits have been or are to be substantially reduced or depleted by 75% or more of those of the immediately preceding financial year, as a result of a proposed corporate action, so that its remaining business will be unable to meet all the initial listing eligibility criteria. For the corporate action to proceed, the issuer would have to follow the Main Board Listing Rules regarding privatisation and obtain the independent shareholders' approval.

6. Cash Companies

- If by completion of a proposed corporate action, an issuer would become a cash company by having 90% of its assets in cash or short dated securities or portfolio share investment or other marketable securities. For the corporate action to proceed, the issuer would have to follow the Main Board Listing Rules regarding privatisation and obtain the independent shareholders' approval.

7. Prolonged Suspension

- If an issuer's securities have been suspended from trading for a continuous period of 12 months (10 issuers failed to publish their financial results for 12 months or more after the relevant prescribed deadlines during the period from 1 January 2000 to 31 August 2002).

- Delay in publishing financial results would not in the first instance be treated as failure to meet the minimum standards, unless there is an indication that an issuer is likely to fail to meet other continuing standards and there is no justification for the prolonged delay.

8. Paragraph 38 of Listing Agreement

- Failure to comply with Paragraph 38 of Listing Agreement which is retained as a reserved general ongoing minimum standard for maintaining listing to supplement the proposed qualitative standard on substantial reduction in operating assets and/or level of operations.

9. Persistent Breaches of the Main Board Listing Rules

- The Exchange may, at its discretion, subject those issuers that have persistently failed to comply with the Main Board Listing Rules to the cancellation of listing procedures. The frequency and nature of the breaches would be taken into account.

10. Illegal Operation

- If in the opinion of the Exchange there exists or occurs any event, condition or circumstances that makes further dealings or listing of an issuer's securities contrary to the Exchange's general principles.

**Likely effect of options on the investing public**

**The options set out in Part C of the Consultation Paper serve only as a trigger to require an issuer to take appropriate remedial action when it fails to meet the possible minimum standards. The securities of the issuer would not be immediately**

**delisted or suspended from trading. Instead, the market would be alerted that the issuer has failed to meet the continuing listing standards.**

Cancellation of listing would only occur if an issuer fails to submit or implement proposals to rehabilitate itself within a proposed specified period. The duration of the period specified as relevant for the purposes of submitting a resumption proposal was the subject of proposals in Part E of the July Consultation Paper. We will consider and analyse the views expressed on these proposals before proceeding with any rule changes. Furthermore the cancellation of listing would have to be approved by the Listing Committee and is subject to the rules of natural justice.

Accordingly, for key stakeholders that would likely be affected by the options, namely, issuers, investors, securities intermediaries such as stockbrokers, dealers and margin financiers, and credit providers, they would be alerted in sufficient time, and therefore should be able to react, before the issuer is delisted. Subject to market views on the introduction of alternative trading arrangements for securities delisted from the Main Board, the investors may be able to trade the securities of a delisted issuer on an alternative trading platform.

**The statistics on the number of issuers that could be affected by the options have been set out in Part C of the Consultation Paper. The statistics are historic and provided solely for the purpose of illustrating the potential impact of the options should they be adopted.**

**Alternative treatments of securities delisted from the Main Board**

HKEx notes that significant concern has been expressed on whether there will be any exit mechanism for shareholders holding shares of issuers that have failed to meet the proposed options of continuing listing standards and are faced with possible cancellation of listing.

There have been suggestions for compulsory buy-back and compulsory winding-up as two alternative potential mechanisms. As these may involve legal and other practical difficulties in implementation and therefore may not provide pragmatic and enforceable solutions, HKEx welcomes further views and suggestions for alternative proposals.

HKEx invites contribution from all interested parties on the relevant aspects of establishing an alternative board for listed securities operated by HKEx or setting up an alternative trading venue for unlisted securities (including trading and disclosure standards, and arrangements for clearing and settlement). Depending on the alternative, a whole range of complex regulatory and operational issues may need to be resolved before it could be implemented. Subject to the views collected from this consultation exercise, HKEx may carry out a separate consultation on the preferred alternative.

**Low-priced securities**

HKEx would also like to seek market views on issues frequently associated with low-priced securities from the perspective of issuers' corporate governance practices and maintenance of a fair and orderly market.

Corporate Governance Related Matters

There have been market criticisms and investor complaints about practices of certain corporates that have resulted in a substantial dilution of their minority shareholders' interest or a drop in their share prices. Concerns over such corporate practices are often associated with low-priced securities in the market. Although we recognise that there is not always a direct relationship between a low share price and standards of governance. We discuss three areas of relevant practice in the consultation paper.

- *Dilution through placings under the general mandate*

  Under the current Main Board Listing Rules, an issuer's existing issued share capital can be increased by up to 20% through the issue of securities under a general mandate and there are no restrictions on the number of times a general mandate may be "refreshed" or on the price at which securities may be issued under a general mandate.

There are views that some controlling shareholders have abused the use of general mandates and placed shares at a substantial discount to the market price, resulting in a substantial drop in the share price of the issuer and a massive dilution of minority shareholders' interests.

The Consultation Paper on Proposed Amendments to the Listing Rules relating to Corporate Governance Issues (Corporate Governance Consultation Paper) published by HKEx in January this year introduced proposals to address these concerns. Earlier this month the Exchange Executive indicated its views on the way forward on these proposals. A final decision requires approval from the Listing Committee and the Securities and Futures Commission. The Exchange Executive ' s views on this proposal are that controlling shareholders must abstain from voting at general meetings approving " refreshments " of general mandates and that a maximum discount of 20% should apply unless exceptional circumstances justify a deeper discount.

- *Dilution through rights issues*

  Rights issues are made on a pro-rata basis. If for whatever reasons existing shareholders decide not to take up all their entitlements, their interests will be diluted after the rights issues.

  There are views that repeated rights issues by some issuers have resulted in unfair dilution of the interests of minority shareholders that do not exercise their rights.

  Under the current Main Board Listing Rules, independent shareholders' approval is required for any rights issue that increases the issued share capital or market capitalisation of the issuer by more than 50% in the previous 12 months.

  The Corporate Governance Consultation Paper introduced proposals to address these concerns. Responses to the consultation indicate broad support for the proposals.

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

  There are views that repeated share consolidation undertaken by an issuer may have a spiralling down effect on its share price, resulting in a diminished value of the shares held by shareholders. The situation may get worse if there is a combination of share consolidation and rights issue, which might put further pressure on the share price of the issuer. These commentators suggested that there should be new restrictions on the number of corporate actions, such as share consolidation and rights issue, that an issuer may undertake in a given period of time.

  HKEx believes that the share price of an issuer should reflect its fundamentals and underlying value. Share consolidation or sub-division should not, in theory, affect the aggregate share value of an issuer or shareholders' proportionate interest in it, unless there are other external factors that have a negative impact on the adjusted share price. Any significant change in share price is a result of market manipulation should be subject to market manipulation rules. Yet, given the widespread market concern, HKEx will seek market views on whether there should be any additional requirements or restrictions on an issuer undertaking rights issue, share consolidation and share sub-division, if its share price is low.

<u>Fair and Orderly Market Related Issues</u>

There are views that predominance of low-priced securities in the Hong Kong listing market may have an adverse perception on the quality of the market generally. We discuss in the Consultation Paper the effect of low priced securities on the maintenance of a fair and orderly market and seek market views on whether an issuer should be required to undertake any appropriate remedial action if its share price falls below a certain benchmark, and if so, what that benchmark and appropriate remedial action should be.

The Consultation Paper highlights the following:

- *Lack of transparency*

  Trading of securities at prices below one cent cannot be done on the Automatic Order Matching and Execution System. Instead, trading of such securities can only be executed on the Semi-automatic Matching system of the Exchange to which only Exchange Participants have access. No real-time bid or offer information is available to the market. The lack of transparency can make it difficult for investors to make informed investment decisions.

- *Exceptional volatility*

  Trading of low-priced securities tend to be volatile, as changes in price which are small in absolute terms become significant in percentage terms.

- *Misconception of investors*

  There are views that less sophisticated investors may, without verifying the fundamentals of the issuer, think that low-priced securities are cheap and worth buying as the minimum investments involved would be low. They may therefore take on risks that they have not fully understood or considered carefully.

- *Market perception*

  Contrary to the views that predominance of low-priced securities in the Hong Kong listing market may have an adverse perception on the quality of the market there are views that the local circumstances should be taken into account as there are a large percentage of retail investors and low-priced securities are a characteristic of the Hong Kong market. It is argued that so long as there is transparency of trading and investors understand the risks involved in investing in low-priced securities, there should not be any regulatory interference.

### General

HKEx has set out above only the outline of the issues and possible options on continuing listing standards and the related issues on alternative treatments of securities delisted from the Main Board and low-priced securities. Members of the public are requested to refer to the Consultation Paper for details of the proposals and options.

Some of the issues raised in the Consultation Paper are controversial and HKEx anticipates that there will be divergent views. HKEx reiterates that the Consultation Paper discusses the general concepts relating to continuing listing standards and low-priced securities, and the proposals and options are intended to facilitate consideration and debate by the market. HKEx welcomes views and suggestions of alternatives. As the issues involved are important to the future development of the Hong Kong listing market, HKEx urges members of the public to consider the discussion and the suggestions set out in the Consultation Paper in detail and submit their detailed responses, including explanations for their views.

It is the objective of HKEx to receive comments on the Consultation Paper from a wide spectrum of respondents. HKEx will provide a hotline service during the consultation period at 2840 3800 and 2840 3400 to respond to any queries that respondents may have relating to the Consultation Paper. In addition, HKEx will hold seminars for issuers, market practitioners and Exchange Participants to discuss the proposals and options set out in the Consultation Paper.

Copies of the Consultation Paper and questionnaire will be despatched to the issuers, market practitioners and Exchange Participants on 18 November. Copies are available at the office of the Exchange at 11/F, One International Finance Centre, 1 Harbour View Street, Central, Hong Kong. The Consultation Paper can also be viewed at or downloaded from the HKEx website: www.hkex.com.hk.

Interested parties are invited to submit to HKEx their comments on the Consultation Paper by completing and returning the questionnaire booklet. If the use of the questionnaire booklet alone is not adequate to fully communicate comments on the Consultation Paper, respondents are welcome to supplement their comments and views by attaching additional sheets to the questionnaire booklet. They may complete and submit the electronic questionnaire available at www.hkex.com.hk . They may also download a soft copy of the questionnaire from the HKEx website and thereafter submit the completed copy via email at cvw@hkex.com.hk. Responses should arrive no later than the close of business on 28 February 2003.