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NUS Law Working Paper 2024/011

NUS EW Barker Centre for Law & Business Working Paper 24/05

## **The Design of Market Admission Rules: Insights from 3 Asian Alternative Markets**

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**[Uploaded December 2024]**

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# **The Design of Market Admission Rules: Insights from 3 Asian Alternative Markets**

**Petrina Tan Tjin Yi**

## **Abstract**

The creation of viable alternative markets for SME fundraising and access to finance necessitates meeting the two core goals of capital market regulation: capital formation and investor protection. This paper investigates how these objectives are addressed through the regulatory design of market admission rules by stock exchanges in three Asian alternative markets: Hong Kong, Singapore, and Malaysia. It starts by analysing empirical IPO data from these markets, followed by an exploration of the core goals of regulatory design in the context of capital markets as well as alternative market-specific considerations which are operationalised by the stock exchange. The paper then compares the market admission rules and reform initiatives undertaken by these stock exchanges with a focus on capital formation and investor protection. Contrary to the perception of alternative market regulation as ‘light touch’ compared to the more prescriptive main market rules, the analysis reveals various counterbalancing mechanisms that ensure the quality of potential applicants. These findings provide a nuanced understanding of the balance between regulatory flexibility and investor protection in alternative markets.

*Had the stock exchange in America not created colossal fortunes, how would large-scale industry and a social movement have been possible in that land of farmers? – Fredrich Engels to Eduard Bernstein, 8 February 1883*<sup>1</sup>

## Introduction

The recognition of the importance of access to finance for SMEs has led to efforts by the stock exchange to set up alternative markets for SME fundraising as part of a state's broader developmental strategy. The viability of alternative markets is a function of its regulation to be in line with the fundamental goals of capital market regulation, namely capital formation and investor protection. As such, a key question which arises is how the stock exchange meets these goals through the regulatory design of market admission rules as an entry point for companies through initial public offerings (IPOs).

This paper seeks to answer this question by engaging in a comparative analysis of the regulatory design of the market admission rules of 3 Asian alternative markets by the stock exchanges in Hong Kong, Singapore, and Malaysia. These markets have been chosen because of their similar legal and regulatory structures which enable a functional analysis of the listing rules and the responses undertaken by the stock exchanges to the challenges encountered in regulating and developing these markets. The analysis here is framed from the perspective of capital formation and investor protection and how it is implemented by the stock exchange.

The first section of this paper sets out an analysis of the relevant data points on the performance of the Hong Kong, Singapore, and Malaysian alternative markets from 2015-2023 by way of setting the stage for the subsequent analysis. The second section then turns to capital formation and investor protection as central goals of capital market regulation and examines how they are operationalised by the stock exchange in designing alternative market admission rules. The third section of the paper discusses the form and function of the alternative market listing rules before engaging in a comparative analysis of the same to critically examine how the capital formation and investor protection objectives are met in practice and its implications. This section also briefly discusses the alternative market reform initiatives carried out by the Hong Kong and Malaysian stock exchanges. The paper concludes with a summary and brief concluding thoughts.

## I. IPO Performance and Investor Interest in the GEM, Catalist and ACE Markets from 2015-2023

This section sets out and appraises the performance of the GEM, Catalist and ACE IPOs from 2015-2023 to illustrate the relative attractiveness of the alternative market for fundraising purposes. The IPO stage in which securities are first offered to

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This working paper is a revised version of a conference paper which was previously presented at the 21<sup>st</sup> ASLI Conference in Chulalongkorn University, Thailand on 29 May 2024. The author is grateful for financial and research support from the EW Barker Centre for Law & Business, National University of Singapore as well as helpful comments from Hans Tjio and participants of the ASLI conference panel on a previous draft of this paper. All errors and omissions are the author's own.

<sup>1</sup> Gareth Hutchens 'Even Karl Marx used his stimulus payment to bet against professional traders' (ABC News, 31 January 2021) <<https://www.abc.net.au/news/2021-01-31/karl-marx-also-liked-to-bet-against-the-stock-market/13106214>> accessed 16 April 2024

the public is essential as it represents the debut of a company in the public equity markets.<sup>2</sup> Over time, the call to create a robust IPO market grew stronger as it became evidence of the creation and flourishing of new businesses with regard to the maturity of companies: entrepreneurs eager to trade ample public capital for the responsibility to shoulder regulatory burdens and be accountable to shareholders; and the fact that new companies gave institutional and retail investors an opportunity to participate broadly in high-growth stocks.<sup>3</sup> The IPO market thus became a proxy for determining whether a country's economy was healthy and dynamic and the comparison in the number of IPOs has been used to signify the relative competitiveness of financial centres such as New York, Tokyo, London, and Hong Kong.<sup>4</sup>

On the domestic front, research has suggested that IPOs financed growth and stimulate innovation, productivity, and job creation.<sup>5</sup> They are also essential as an exit route for existing shareholders, facilitating acquisitions, and allowing access to additional equity as well as a signal of commitment to governance standards. However, there have also been controversies relating to IPOs, whether in terms of the IPO price-setting by investment banks which were criticised as either too low or too high<sup>6</sup> or numerous IPOs which failed to launch post-listing to the disappointment of public shareholders.<sup>7</sup> Given the risks inherent in the IPOs of emerging companies, such outcomes are unsurprising and more so when one considers the tendency of tech stocks to be subject to bubbles and manias, from the sonics-and-tronics frenzy of the '60s to the dotcom bubble of the late '90s<sup>8</sup> which continues to persist in today's age of decentralisation and AI. Notwithstanding these formidable external forces, the stock exchange remains tasked to ensure market fairness and investor protection in the face of these pressures while under the oversight of the statutory securities regulator. It follows that trust between issuers, intermediaries, and investors is important when floating an IPO and at subsequent stages.<sup>9</sup>

At the stage of admission to the alternative market, an important overarching paradigm is that of growth through the listing of new issuers as they represent a fresh source of revenue for the stock exchange and a gateway into subsequent trading fees. This is measurable using the number of new IPOs as well as the average market capitalization on a year-to-year basis to demonstrate changes in the size of the market. Although the overall number of listed companies has been cited as an example to illustrate market growth<sup>10</sup>, this is a marker which is subject to constant fluctuations due

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<sup>2</sup> Marshall Lux and Jack Peard, 'Hunting High and Low: The Decline of the Small IPO and What to Do About It', April 2018, M-RCBG Associate Working Paper Series No. 86, <[https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/working.papers/86\\_final.pdf](https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/working.papers/86_final.pdf)>, accessed 30 November 2022, 4

<sup>3</sup> n 2 above, 5

<sup>4</sup> Committee on Capital Markets Regulation, "The Competitive Position of U.S. Public Equity Markets" Dec. 4, 2007. However, note the importance of banks and other form of financing in construing the competitiveness of these financial centres, particularly where the economy in question is bank-centred e.g. Japan

<sup>5</sup> Martin Kenney, Donald Patton and Jay Ritter, 'Post-IPO Employment and Revenue Growth for U.S. IPO's, June 1996-2010', [2012] Kauffman Foundation Report

<sup>6</sup> Kevin Rock, 'Why new issues are underpriced', (1986) 15(1&2) *Journal of Financial Economics*, 187

<sup>7</sup> See for e.g. Elizabeth Demers and Philip Joos 'IPO Failure Risk', *Journal of Accounting Research*, [2007] 45(2) 333-371; Natasha Ketabchi, 'Looking at Failed IPOs in the Age of the Unicorn' <https://www.toptal.com/finance/corporate-finance-consultants/failed-ipos> accessed 29 November 2022

<sup>8</sup> n 2 above, 6

<sup>9</sup> David Chambers and Elroy Dimson, 'IPO Underpricing over the Very Long Run', (2009) 64(3) *The Journal of Finance* 1407, 1438

<sup>10</sup> *ibid*

to transfers, merger and acquisition activities, and delistings which are factors affecting market growth and lie beyond the remit of this paper.

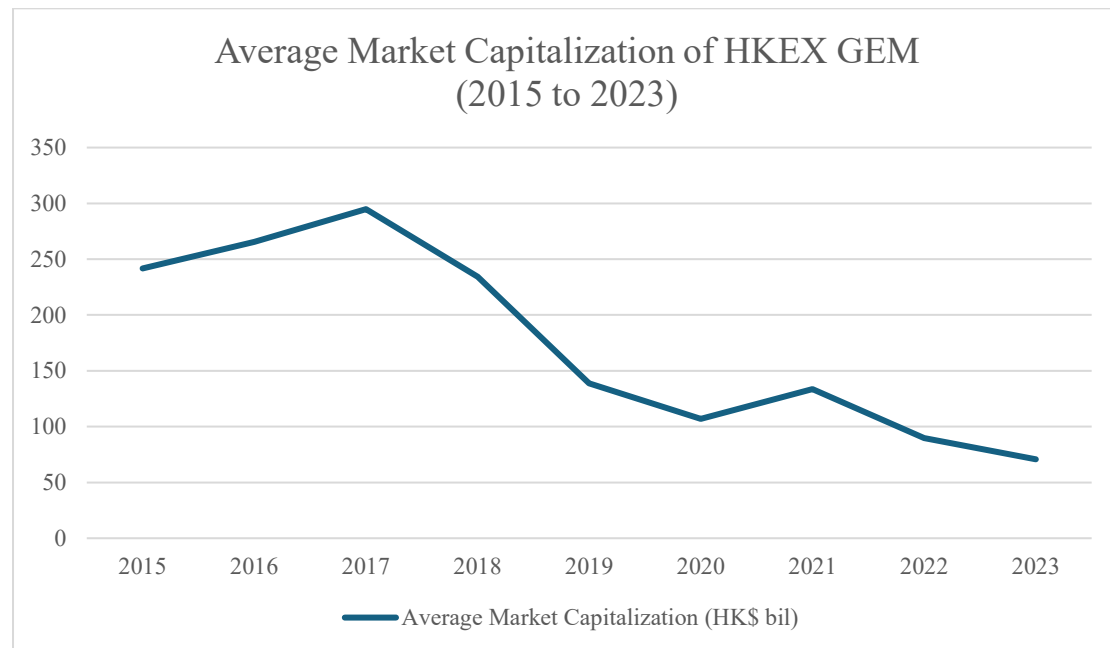


Figure 1: Average Market Capitalization of HKEX GEM from 2015 to 2023<sup>11</sup>

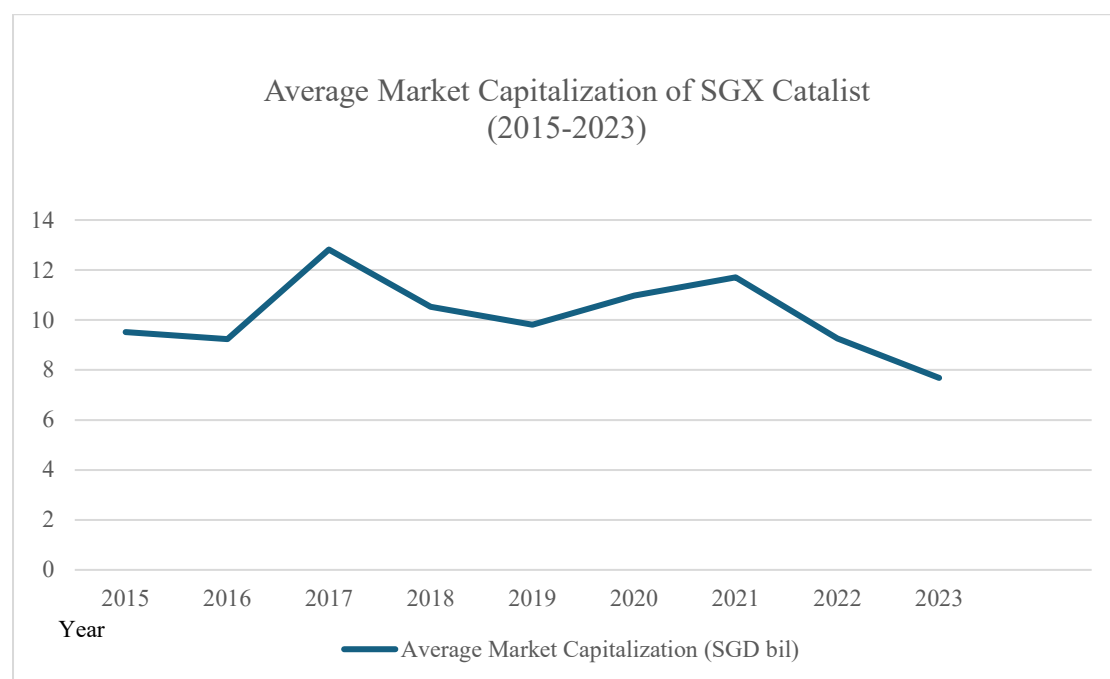


Figure 2: Average Market Capitalization of SGX Catalist from 2015 to 2023<sup>12</sup>

<sup>11</sup> CEIC Data

<sup>12</sup> Monetary Authority of Singapore, 'Table III.7 SGX-ST: Price Index, Number of Listed Companies, Turnover and Capitalisation' < <https://eservices.mas.gov.sg/statistics/msb-xml/Report.aspx?tableSetID=III&tableID=III.7> > accessed 15 March 2024

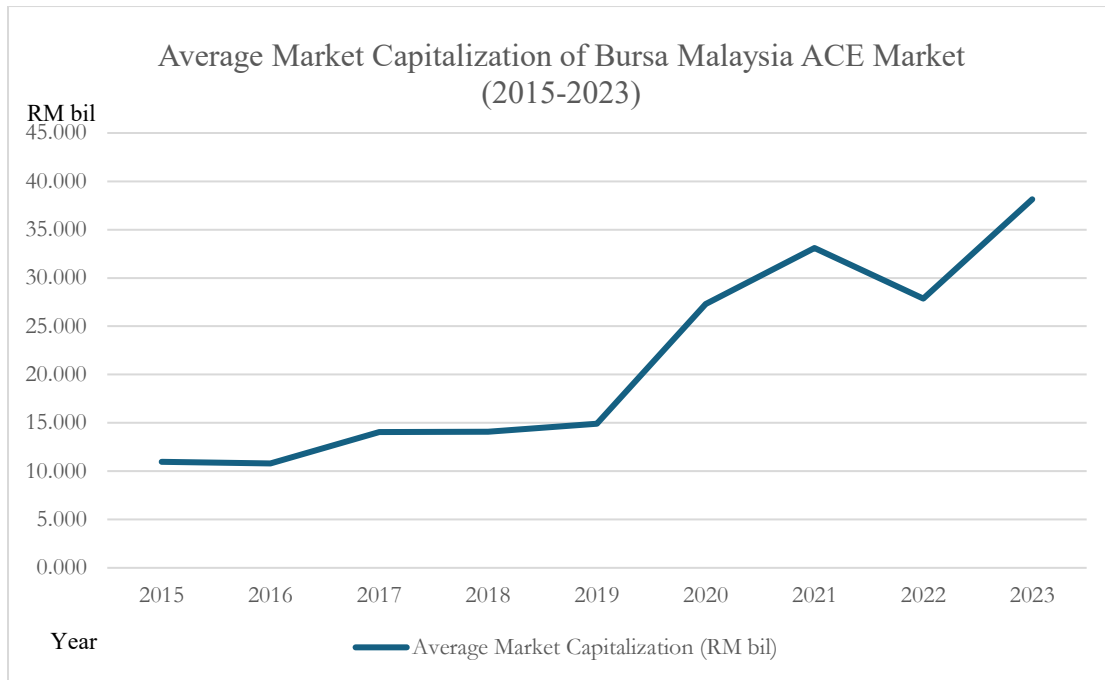


Figure 3: Average Market Capitalization of Bursa Malaysia ACE Market from 2015 to 2023<sup>13</sup>

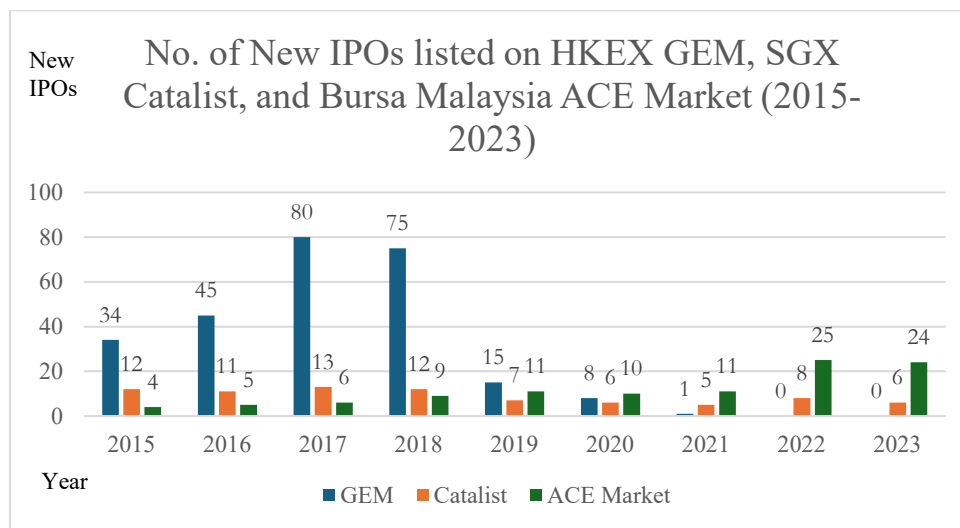


Figure 4: No. of New IPOs listed on GEM, Catalyst, and the ACE Market (2015-2023)<sup>14</sup>

From the data presented above, it may be observed that the market capitalization of GEM steadily declined from 2017 to 2020, after it reached a high of close to HKD300 billion in 2017. While there was a slight rebound in 2021, the trend of declining market capitalization has continued to hold from 2022 to 2023 alongside a drastic decrease in market capitalization as compared to 2015. The Catalyst market also experienced a similar trajectory in which the average market capitalization for 2017 was nearly SGD13 billion, which was a dramatic increase from the low of SGD9.23 billion

<sup>13</sup> CEIC data

<sup>14</sup> CEIC data, SGX, 'IPO Performance' <<https://www.sgx.com/securities/ipo-performance>> accessed 20 April 2024; Bursa Malaysia, 'Listing Statistics' <[https://www.bursamalaysia.com/listing/listing\\_resources/ipo/listing\\_statistic](https://www.bursamalaysia.com/listing/listing_resources/ipo/listing_statistic)> accessed 20 April 2024

recorded in 2016. Catalist then experienced a decrease of its average market capitalization from 2017 to 2019, although it picked up in 2020 with an average market capitalization of SGD10.974 billion which has since dropped to about SGD7 billion in 2023. The average market capitalization of the ACE Market from 2015 to 2019 witnessed steady, slow growth until an exponential upsurge in 2020 to RM27.3 billion from RM14.9 billion in 2019. This was followed by a further build up in 2021, a slight dip in 2022 and a sharp increase in 2023 to RM38.1 billion. This marked an expansion in three times of value from the initial average market capitalization of RM10.9 billion in 2015.

In terms of new IPOs listed on these markets, it is interesting to note that from 2015 to 2018, GEM was the leader of the pack with 34 new IPOs in 2015 and 45 new IPOs in 2016. It then reached the heights of 80 and 75 new IPOs in 2017 and 2018 respectively before a steep decline to 15 new IPOs in 2019 and only 8 new IPOs in 2020. During the Covid-19 years, there was a precipitous drop to only 1 IPO in 2021 and no IPOs at all in 2022 and 2023. As regards Catalist, the number of new IPOs hovered steadily between 11 to 13 in the years of 2015 to 2018. In 2017, Catalist reached a peak of 13 listings<sup>15</sup> before declining to 7 in 2019 and 6 in 2020. The IPO numbers since then have hovered between 5 to 8 IPOs annually. Consistent with the growth in the size of its average market capitalization, the ACE Market also had a steady upward movement from 4 new IPOs in 2015 to 11 new IPOs in 2019 before a slight drop to 10 new IPOs in 2020 and 11 new IPOs in 2021. Nevertheless, what is most striking is the exponential increase in the number of new IPOs in 2022 and 2023 in which there were 25 and 24 new IPOs respectively. Indeed, it has been found that the number of late-stage growth companies listed on the LEAP and ACE markets have more than doubled over the same period and now constitute 80-90% of the total number of IPOs.<sup>16</sup>

Investor interest in the markets is also a relevant factor in determining whether the markets have met their objectives. While a large percentage i.e. 96% of stock investors invested in the Hong Kong Main Board in 2022, only 27% reported that they had invested in the GEM board during the same time, which marks a significant decline from the previous level of 45% in 2021.<sup>17</sup> In Singapore, retail investor participation in the stock market including Catalist has been a challenge<sup>18</sup> and has been compounded by the prohibition for state pension fund monies to be invested in Catalist companies.<sup>19</sup>

<sup>15</sup> Ching Sua Mae, 'Half-Time Report: How Are The IPOs In Singapore In 2017 Faring?' (Dollars and Sense, 24 July 2017) <<http://dollarsandsense.sg/half-time-report-ipos-singapore-2017-faring/>> accessed 1 October 2022

<sup>16</sup> Securities Commission Malaysia, 'Capital Market Masterplan 3' (*Securities Commission Malaysia*, September 2021), <<https://www.sc.com.my/upload/cmp3/cmp3.html>>, 50

<sup>17</sup> Investor and Financial Education Center, 'Retail Investor Study 2023' <<https://www.ifec.org.hk/web/common/pdf/about-ifec/retail-investor-study-2023.pdf>> accessed 10 April 2024; Li Jiaxing, 'As retail investors rush back into Hong Kong stocks, market bulls face Fed test and strategists warn of pitfalls' (12 June 2023, South China Morning Post); <https://www-scmp-com.libproxy1.nus.edu.sg/business/markets/article/3223704/retail-investors-rush-back-hong-kong-stocks-market-bulls-face-fed-test-and-strategists-warn-pitfalls>;

<sup>18</sup> Tang See Kit, 'IN FOCUS: Singapore's stock market at 'rock bottom'. What will it take to shake things up?' (13 July 2024, Channel News Asia) <<https://www.channelnewsasia.com/business/singapore-stock-market-sgx-gic-focus-4471856>> accessed 15 November 2024

<sup>19</sup> Central Provident Fund Board, 'FAQ: What are the criteria for inclusion of Shares under the CPF Investment Scheme (CPFIS)?' (*Central Provident Fund Board*) <<https://www.cpf.gov.sg/member/faq/growing-your-savings/cpf-investment-schemes/what-are-the-criteria-for-inclusion-of-shares-under-the-cpf-inve>> accessed 18 November 2022. See also Goh Eng Yeow, 'Catalist: What's next after a fruitful decade?' (ST Online, 23 Jan 2017) 16 August 2018 and Mak Yuen Teen and Mark Lai, Catalist: A platform for growth firms or ICU for mainboard patients? (*Business Times*, 16

It is worth noting that there are other deeper structural factors affecting the overall attractiveness of the Singaporean equity markets.<sup>20</sup> As regards Malaysia, overall retail participation in the stock market including the ACE Market has been at about 30% at the end of 2023 with a steady rise since 2018 and a peak in participation during the pandemic years of 2020 and 2021.<sup>21</sup> It is understood that increasing investor participation in the stock markets remains an important priority for Bursa Malaysia.<sup>22</sup>

## II. Capital Market Regulatory Design and Operationalisation: The Role of the Stock Exchange

It is argued that capital market regulatory design is built on two foundational objectives: enabling capital formation and ensuring investor protection which are essential in attracting new listings and maintaining issuer, investor and societal trust and confidence in the capital markets. Nevertheless, given the unique characteristics of the alternative markets, these objectives must address the constraints faced by companies seeking to list on the alternative market. Accordingly, the stock exchange operationalises these objectives in its capacity as the frontline regulator of the alternative market through various mechanisms, particularly the alternative market listing rules. This section will first examine the foundational objectives of capital market regulatory design before setting out considerations specific to alternative market issuers and investors and how the stock exchange operationalises these considerations as a frontline regulator of the capital markets.

### *The Foundations of Capital Market Regulatory Design: Capital Formation and Investor Protection*

The foundations of capital market regulatory design rest on enabling capital formation and ensuring investor protection. Capital is central to raise the capacity for economic production.<sup>23</sup> Access to capital is needed by companies to grow, purchase new production equipment and find raw materials or hire workers, especially new companies which do not have profits to reinvest.<sup>24</sup> Indeed, going public on the capital markets is a prime opportunity to raise equity finance from a broader range of investors than its existing shareholders which may be used for the aforementioned purposes.<sup>25</sup> Publicly traded shares can also be used for the consideration payment of share

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January 2019) <<https://www.businesstimes.com.sg/opinion/catalist-a-platform-for-growth-firms-or-icu-for-mainboard-patients>> accessed 25 November 2022

<sup>20</sup> Monetary Authority of Singapore, 'MAS sets up Review Group to Strengthen Equities Market Development', <<https://www.mas.gov.sg/news/media-releases/2024/mas-sets-up-review-group-to-strengthen-equities-market-development>> accessed 10 November 2024. See also John Cheng, Low De Wei, Ishika Mookerjee and Chanyaporn Chanjaroen, 'Singapore Exchange insiders cast doubt on stock-market revival', Bloomberg, 27 September 2024

<sup>21</sup> See for e.g. <https://www.nst.com.my/business/corporate/2024/03/1029982/bursa-malaysias-plan-keep-retail-investors-coming-exchange-bttv>; Securities Commission, 'Increase Retail Participation' <<https://www.sc.com.my/api/documentms/download.ashx?id=3d991fec-887a-4575-a79d-d2ed44ae8954>>

<sup>22</sup> *ibid*

<sup>23</sup> Simon Kuznets, *International Differences in Capital Formation and Financing in Capital Formation and Economic Growth*, (Princeton University Press 1955) <http://www.nber.org/books/univ55-2>

<sup>24</sup> Richard W. Jennings and others, *Securities Regulation Cases and Materials* (8th edn, University Casebook Series, 1998), 2. Also see section 2 of the US Securities Exchange Act 1934, 5

<sup>25</sup> Louise Gullifer and Jennifer Payne, *Corporate Finance Law: Principles and Policy* (2nd edn, Bloomsbury 2015) 474

acquisitions<sup>26</sup> and a form of remuneration for current and future employees. In addition, capital markets have been argued as promoting allocative efficiency whereby capital is allocated among competing users; through the determination of the cost of capital for corporate issuers, the securities markets encourage the flow of capital to firms with superior prospects and penalises less efficient firms by requiring them to pay more for capital.<sup>27</sup> Therefore, the stock market provides efficiency and economic growth by providing market discipline.<sup>28</sup>

As a corollary to the above, capital is required at different stages of enterprise development; various forms of available financing are needed at different stages of a firm's growth. These range from the inception phase to the seed or early growth phase followed by the mid-cap or expansion phase and the final or 'next push' phase in which the enterprise goes public and is listed on the stock market or makes use of debt markets. The diagram below illustrates these concepts in the form of a 'Funding Escalator'.

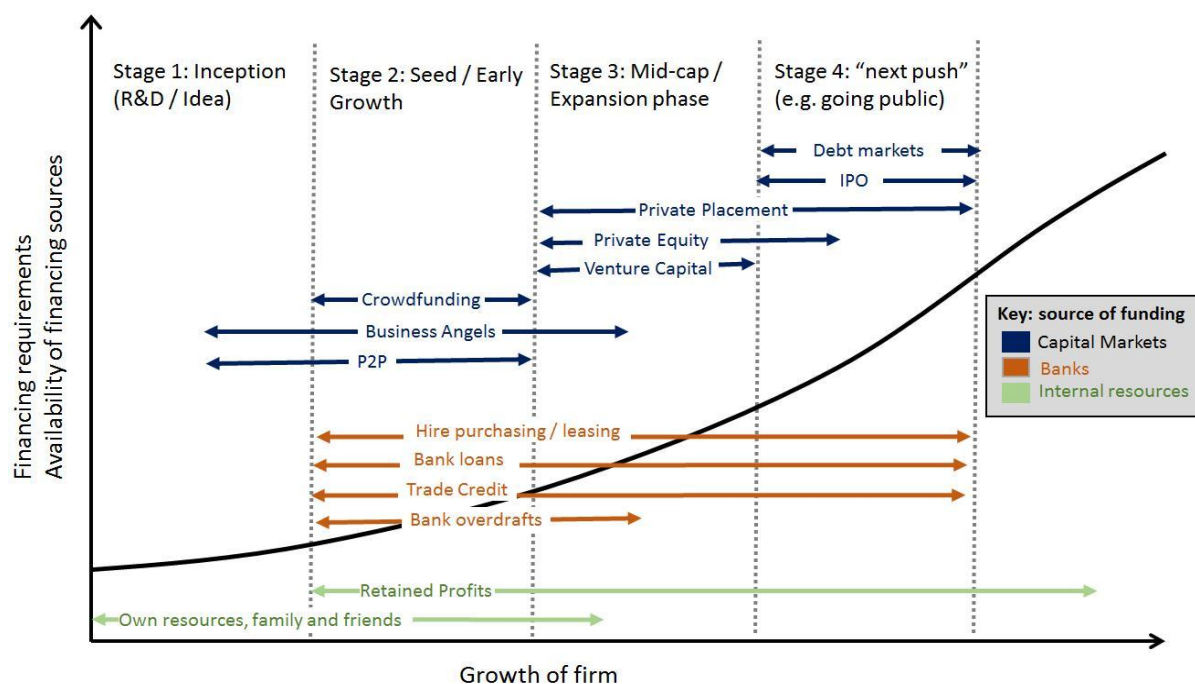


Figure 5: The Funding Escalator<sup>29</sup>

At the point of the IPO, the company is generally considered to be at a mature stage in its growth journey. This means that the company is established, has a proven track record and stable cash flow and is accordingly ready to tap into the equity capital markets to access a larger pool of capital. However, even at this stage, there are distinctions between the relative state of development of the company and its track record, thus giving rise to the differentiation between issuers which qualify for the main markets and those which qualify for the alternative markets.

<sup>26</sup> See for e.g., James C. Brau and Stanley E. Fawcett, 'Initial Public Offerings: An Analysis of Theory and Practice' (2006) 61(1) *Journal of Finance* 399

<sup>27</sup> James D. Cox, Robert W. Hillman and Donald C. Langevoort, '*Securities Regulation: Cases and Materials*' (5th edn, Aspen Publishers, 2006), 107. An alternative view posited by Professor Berle holds that the stock market is an allocator, not of capital, but of wealth. See Adolf A. Berle, 'Modern Functions of the Corporate System' (1962) 62(3) *Columbia Law Review* 433, 447

<sup>28</sup> *ibid*

<sup>29</sup> European Commission, 'Crowdfunding' (Newsroom, 31 January 2020) <<https://ec.europa.eu/newsroom/fisma/items/667392/en>> accessed 8 November 2022

Enabling capital formation also ensures investor diversification, whether in terms of a diverse range of investors or a wider range of investment opportunities open to investors. The range of investors in a company also means that minority shareholder protection has become increasingly important as reflected by its inclusion in the World Bank Doing Business Report<sup>30</sup>, modernised companies law provisions and the introduction of corporate governance codes worldwide which serve to strengthen the position of minority shareholders. The expansion in investor presence on the equity markets is tied to the broader shift from a welfare state in which individual citizens are now strongly encouraged to manage their own retirement by investing in their personal capacity or through mutual funds rather than relying on the state to provide safety nets.<sup>31</sup>

It follows that investor protection is an essential goal in view of the rise of equity culture and its normative implications: indeed, the answer to the question of who the stockholder is refers to you and me. As highlighted by Professor Karmel, if individuals are allowed to choose their own investment, substantive changes may need to be made to securities and other laws to ensure equity investments are not made in highly risky ventures.<sup>32</sup> The importance of equity culture is also reflected in the increasing media prominence given to financial news as indicators of the health and well-being of society as a whole. The growth of ‘social security capital’ has also led to a new culture of dependency, as a growing number of workers look to, and depend on the performance of financial markets and publicly listed corporations for security in old age. These developments have played an important role in garnering support for, and legitimating, shareholder value-oriented corporations and the prioritisation of investor protection as a policy goal.

In this connection, investor protection has been framed as a means of addressing the concerns pertaining to the vulnerability of investors in a manipulated marketplace and the suffering of others when investors disinvested in the market.<sup>33</sup> The financial economist, Stigler further detailed this notion as ‘the protection of the innocent (but avaricious) investor’.<sup>34</sup> In relation to issuers of securities, investor protection is understood largely in terms of mandating the disclosure of relevant information. The

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<sup>30</sup> The World Bank, ‘Doing Business, Measuring Business Regulations: Protecting Minority Investors’ <<http://www.doingbusiness.org/en/data/exploretopics/protecting-minority-investors>> accessed 13 September 2022. While influential, the measures used by the World Bank still have room for improvement. See Lin Lin and Michael Ewing-Chow, ‘The Doing Business Index on Minority Investor Protection: The Case Of Singapore’ [2016] Singapore Journal of Legal Studies 46. This project has since been discontinued and replaced with a new Business Enabling Environment (BEE) project which seeks to assess the business and investment climate in economies worldwide. See The World Bank, ‘Business Enabling Environment’ <<https://www.worldbank.org/en/programs/business-enabling-environment>> accessed 13 November 2022 for more details.

<sup>31</sup> This is especially true in the USA where a substantial percentage of American households have an increasingly significant portion of their savings in stocks, particularly through mutual funds. See Joel Seligman, *Misalignment: The New Financial Order and the Failure of Financial Regulation* (Wolters Kluwer 2020) xiii in which he states that during the first quarter of 2008, approximately 47% of US households owned equities or bonds and that a dramatic deterioration in stock prices affected the retirement plans and livelihood of millions of Americans which was brought about by the Global Financial Crisis of 2007-2009.

<sup>32</sup> See generally Roberta S. Karmel, ‘The Challenge to Financial Regulators Posed by Social Security Privatization’ (1998) 64(3) Brooklyn Law Review 1043

<sup>33</sup> Richard W. Jennings and others, *Securities Regulation Case and Materials* (8th edn, University Casebook Series, 1998), 2. Also see section 2 of the US Securities Exchange Act 1934

<sup>34</sup> George Stigler, ‘Public Regulation of the Securities Markets’ (1964) 37(2) Business Law Journal 117, 120. See also George Stigler ‘The Theory of Economic Regulation’ (1971) 2(1) The Bell Journal of Economics and Management Science 3 in which he highlights the essentially economic roots of the regulatory enterprise, although it is not without socio-political impact and implications.

concern is that without this information, would-be investors will be unable to clearly assess the risks they are taking on and will consequently be unwilling to advance funds. This may be characterised as the issue of information asymmetry giving rise to adverse selection. It has been argued that investors may be classified based on differing interests and functions; where such protection avoids losses by certain investors, but the losses are no more than the inevitable outcome of competitive markets, such protection is likely to reduce rather than enhance efficiency,<sup>35</sup> giving rise to the issue of moral hazard. Further, an excessive, paternalistic focus on investor protection has been argued as resulting in the exclusion of other equally important considerations of cost justifications and allocative efficiency.<sup>36</sup>

### *Alternative Market Regulatory Design Considerations*

The broad foundational principles of capital formation and investor protection are operationalised by the stock exchange in an alternative market context. To begin with, the stock exchange balances varying interests of different groups of capital market participants in a technical arena in which it acts as an umpire between competing interest groups.<sup>37</sup> The desire to attract both investors and issuers leads to the stock exchange choosing listing standards which balance those competing interests.<sup>38</sup> As a commercial entity, the stock exchange is most interested in attracting issuers to list on its market but it also needs to ensure investors are protected during this process.

One of the key mechanisms in determining the balance are the regulatory requirements which the stock exchange imposes on issuers seeking to list on the alternative market. As contrasted against wider market factors beyond the control of the stock exchange, regulatory requirements represent one of the policy levers which can be deployed in seeking to attract potential listings. It has been found that adverse selection is a more serious problem for newly listed younger companies than larger companies which typically list on the main market.<sup>39</sup> The information asymmetry issues alluded to above which are inherent in IPOs negatively affects the market's expectations about the future prospects of the firm going public and impacts the selling price of their shares.<sup>40</sup> This issue is particularly acute for growth companies or SMEs that are newly established and may not have a financial or performance-driven track record which can form the basis for mandated disclosure to potential investors to evaluate their investment suitability. As such, other mechanisms to vouch for their investment potential need to be put in place e.g. a sponsorship regime in which Sponsors and other gatekeepers evaluate the investment potential of such companies.

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<sup>35</sup> Ralph K. Winter, 'On "Protecting the Ordinary Investor"' (1988) 63(4) Washington Law Review 882. See also Tom C. W. Lin 'Reasonable Investor(s)' [2015] 95 Boston University Law Review 461

<sup>36</sup> James D. Cox, Robert W. Hillman and Donald C. Langevoort, *Securities Regulation: Cases and Materials* (5th edn, Aspen Publishers, 2006), 13

<sup>37</sup> Paul Tucker, 'Fundamental Challenges for Securities Regulation: A Political Economy Crisis in the Making?' in Pablo Gasós, Ernest Gnan and Morten Balling (eds), *Challenges in Securities Markets Regulation: Investor Protection and Corporate Governance*, Challenges in Securities Markets Regulation: Investor Protection and Corporate Governance, SUERF - The European Money and Finance Forum 2015, 14

<sup>38</sup> Paul Mahoney, 'The Exchange as Regulator', [1997] 83 Virginia Law Review, 1453, 1457-1459

<sup>39</sup> Thomas J. Chemmanur and Paolo Fulghieri, 'A Theory of the Going-Public Decision' *The Review of Financial Studies*, (1999) 12(2), 249-279

<sup>40</sup> Richard Brealey, Hayne E. Leland and David H. Pyle, 'Informational asymmetries, financial structure and financial intermediation' *Journal of Finance* (1977) 32(2) 371. See also Chris Yung and Jaime F. Zender, 'Moral hazard, asymmetric information and IPO lockups' (2010) 16(3) *Journal of Corporate Finance*, 320-332

With regard to listing, an issuer considering accessing the public capital markets must consider the regulatory costs and benefits, both of the listing process and the requirements to remain listed.<sup>41</sup> Accordingly, capital market regulation of the listing process which gives rise to information asymmetry issues and agency costs<sup>42</sup>, should align with the creation of efficient markets for raising capital, including capital-raising via IPOs and investor protection discussed earlier. While listing on the public capital market may meet the need for external capital, this consideration must be weighed against the fact that listing is generally a costly exercise, both at the point of listing as well as over the long run because of the additional disclosures required to maintain the listing and to keep new shareholders abreast of corporate developments.<sup>43</sup> The transparency of a listed company can be advantageous to competitors, suppliers, and customers, but is a large time and resource commitment on the part of the management to meet both regulatory and market expectations. Nevertheless, the reputational branding effect of listing standards contained in the admission requirements do make them an effective tool for companies who wish to signal their commitment to corporate governance in order to reap reputational gains<sup>44</sup> which are a vital competitive advantage for stock exchanges<sup>45</sup> and fundamental to understanding their rule-making orientation.<sup>46</sup>

Further to the above, as growth companies may not have the resources for listing costs and would likely be more sensitive to them, the regulatory design of listing rules would need to account for the direct and indirect costs associated with listing and remaining listed on the capital market. A central issue arising from the mandatory disclosure of IPOs was that of fixed compliance costs which rendered admission to trading itself unable to facilitate access to capital for SMEs.<sup>47</sup> The importance of cost savings – whether admission, continuing or further issuance costs were also a relevant consideration.<sup>48</sup> Conversely, companies which qualified for a main market segment listing but chose to list on the alternative market were shown to have taken the IPO route to meet financing needs and tended to implement seasoned equity offerings after the conclusion of the IPO.<sup>49</sup>

The complexity relating to management of these costs is underscored by factors such as the lack of incentives on the part of service providers to support these smaller-sized companies and the relatively scant coverage of these companies to enable professional investors to make informed decisions about them. There is also a tendency for such company shares to be less liquid than those of larger companies,

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<sup>41</sup> Kevin K. Boeh and Craig Dunbar, 'IPO Regulators Gone Wild' in Douglas Cumming (ed), *The Oxford Handbook of IPOs*, (OUP 2018), 52. See also what Gao, Ritter, and Zhu (2013) call the 'regulatory overreach hypothesis' in Xiaohui Gao, Jay R. Ritter and Zhongyan Zhu, 'Where Have All the IPOs Gone?' (2014) 48(6) *Journal of Financial and Quantitative Analysis*, 1663, 52

<sup>42</sup> Paul Mahoney, 'Mandatory Disclosure as a Solution to Agency Problems' (1995) 62(3) *University of Chicago Law Review* 1047

<sup>43</sup> Philippe Espinasse, *IPO: A Global Guide*, (2<sup>nd</sup> expanded edn, Hong Kong University Press 2014), 4

<sup>44</sup> Karessa Cain, 'New Efforts to Strengthen Corporate Governance: Why Use SRO Listing Standards' [2003] *Columbia Business Law Review* 619, 622

<sup>45</sup> James D. Cox, 'Brands vs. Generics: Self-Regulation by Competitors', (2000) *Columbia Business Law Review* 15, 19. See also Jonathan R. Macey and Maureen O'Hara, 'Regulating Exchanges and Alternative Trading Systems: A Law and Economics Perspective' (1999) 28(1) *The Journal of Legal Studies* 17, 40

<sup>46</sup> n 44 above, 636

<sup>47</sup> Hsu-Ye Chiu Iris, 'Can UK small businesses obtain growth capital in the public equity markets? An Overview of the Shortcomings in UK and European Securities Regulation and Considerations for Reform' (2004) 28(3) *Delaware Journal of Corporate Law*, 933

<sup>48</sup> Kim W, Weisbach M, 'Motivations for public equity offers: An international perspective', *Journal of Financial Economics*, [2008] 87, 281

<sup>49</sup> John A. Doukas and Hafiz Hoque 'Why firms favour the AIM when they can list on the Main Market?' *Journal of International Money and Finance* [2016] (60) 378, 380-381

disincentivising investment and intermediation and driving up the equity cost of capital.<sup>50</sup> Nevertheless, for SME issuers it has been shown that they consider liquidity enhancing mechanisms to be important<sup>51</sup> which challenges the commonly held view that this is only a problem for investors.<sup>52</sup> Interestingly, liquidity is also valued by intermediaries<sup>53</sup> which means that resolving this issue is crucial to making the market work more effectively for all parties concerned. While liquidity is encouraged through the rules as discussed below, encouraging the entry of more service providers is beyond the remit of the rules and enabled through other means.

An alternative market's success is also dependent on attracting and maintaining sufficient investment interest. This requires the creation of a diversified investor base by encouraging various investors to invest in growth companies listed on the market. Indeed, companies seeking to be listed can make appropriate choices to achieve its desired investor mix by understanding a market's rules and characteristics as to whether it has a strong retail investor bias or otherwise.<sup>54</sup> The stock exchange therefore needs to consider whether the alternative market should be open to all classes of investors or to limit market access to institutional investors which are generally regarded as better informed and better able to tolerate the investing and other risks associated with growth companies. In doing so, the public interest of allowing individuals to grow their wealth through their choice of investments and in accordance with their risk threshold is paramount.

However, in the case of alternative markets, a particular challenge in developing a broad investor base is the fact that certain institutional investors do not have the mandate to invest in the alternative markets e.g. in Singapore, where pension funds are prohibited from investment in Catalist stocks.<sup>55</sup> In addition, many institutional investors such as private equity funds or hedge funds look for short-term benefits and are uninterested in small cap or mid-cap issuers.<sup>56</sup> The uptick in passive investing in recent years favours large cap stocks as low-cost index funds tend to track large companies with liquid shares rather than small companies with inherently illiquid shares which makes small cap stocks even more unattractive to the remaining active investors in public markets.<sup>57</sup> Essentially, this means that retail investors would need to take up the shortfall in investor interest in the alternative market, underscoring the need for more investor protection measures in place. This stands in contrast to the situation

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<sup>50</sup> World Federation of Exchanges, 'SME Financing and Equity Markets', 8

<sup>51</sup> World Federation of Exchanges, 'SME Financing and Equity Markets' March 2017, 26. The importance of liquidity is consistent with the literature that suggests that low liquidity increases the equity cost of capital (Wuyts 2007) and increases the likelihood that an IPO could be underpriced (Ellul and Pagano 2006). See also Gunther Wuyts 'Stock Market Liquidity. Determinants and Implications', [2007] 2 Review of Business and Economic Literature, 279-316; Andrew Ellul and Marco Pagano, 'IPO Underpricing and After-Market Liquidity' (2006) 19(2) Review of Financial Studies, Society for Financial Studies, 381-421

<sup>52</sup> *ibid.*

<sup>53</sup> World Federation of Exchanges, 'SME Financing and Equity Markets' March 2017, 30

<sup>54</sup> Philippe Espinasse, *IPO: A Global Guide*, (2nd expanded edn, Hong Kong University Press 2014), 20

<sup>55</sup> Mak Yuen Teen and Mark Lai, Catalist: A platform for growth firms or ICU for mainboard patients? (*Business Times*, 16 January 2019) <<https://www.businesstimes.com.sg/opinion/catalist-a-platform-for-growth-firms-or-icu-for-mainboard-patients>> accessed 10 September 2022 and Goh Eng Yeow, 'Catalist: What's next after a fruitful decade?' (ST Online, 23 Jan 2017) 16 August 2018

<sup>56</sup> Joel Seligman, *The transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance* (3rd edn, Wolters Kluwer, 2003), 427

<sup>57</sup> The Economist, 'Privacy and its limits' 1 Feb 2020 'Right now almost everyone believes that private markets are better than public ones ... institutional investors are rushing headlong onto private markets, especially into venture capital, private equity, and private debt.'

in AIM where institutional investors form a significant part of the investing landscape<sup>58</sup> as well as markets such as the Malaysian LEAP Market which are limited to institutional or sophisticated investors by design.<sup>59</sup> Similarly, SGX retail investors may not use their retirement savings kept in the Central Provident Fund (CPF) to invest in Catalyst counters.<sup>60</sup>

### III. A Comparative Analysis of the Alternative Market Listing Rules and Reform Initiatives

The capital formation and investor protection concerns outlined in the preceding section are addressed in the listing rules (LR) of the stock exchange which sets out the admission criteria to the alternative markets. The LR's essential role is in standard setting and the enabling of an efficient market for the purposes of market confidence and public trading interest through the setting of minimum standards for capitalisation, disclosure rules and related shareholder protection or corporate governance mechanisms.<sup>61</sup> These standards are also essential to ensure that a reasonable expectation of liquidity can be sustained in the secondary market; the liquidity commitment of the stock exchange ensures the suitability of listed securities for retail investment as secondary market trading has long displaced dividend policies and share buybacks as the means by which investors receive a return on their shares.<sup>62</sup> An alternative conceptualisation of these standards regards them as strategies to regulate the conflict between corporate insiders and outsiders, differentiating between governance strategies which regulate oversight of issuers, affiliation strategies which encapsulate the characteristics and behaviour of publicly traded firms and mandatory disclosure rules.<sup>63</sup>

It follows that the LR encapsulates the listing agreement with the issuer in which it agrees to be bound by the rules set out in the LR in exchange for being listed on the capital market.<sup>64</sup> The listing agreement is thus a means for the stock exchange to govern aspects of the issuer's internal affairs<sup>65</sup> with the failure to observe such requirements

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<sup>58</sup> See for e.g. LSE, 'AIM: London Stock Exchange's market for small and medium size growth companies' <<https://www.londonstockexchange.com/raise-finance/equity/aim>> accessed 10 September 2022

<sup>59</sup> Rule 2.24 LEAP Market Listing Requirements. See also Schedule 6 and 7 of the Capital Markets and Services Act 2007 which set out, among others, the definition of 'Sophisticated Investors'

<sup>60</sup> Central Provident Fund Board, 'FAQ: What are the criteria for inclusion of Shares under the CPF Investment Scheme (CPFIS)?' (*Central Provident Fund Board*) <<https://www.cpf.gov.sg/member/faq/growing-your-savings/cpf-investment-schemes/what-are-the-criteria-for-inclusion-of-shares-under-the-cpf-inve>> accessed 14 October 2022> accessed 18 November 2022

<sup>61</sup> Onnig H. Dombalagian, 'Exchanges, Listless? The Disintermediation of the Listing Function' (2015) 50(3) Wake Forest Law Review 579, 583. See also Roberta S. Karmel, 'Turning Seats into Shares: Causes and Implications of Demutualization of Stock and Futures Exchanges' [2002] 53 Hastings Law Journal 367, 421 and Douglas C. Michael, 'Untenable Status of Corporate Governance Listing Standards under the Securities Exchange Act', [1992] 74 Business Law 1461, 1465

<sup>62</sup> Onnig H. Dombalagian, 'Exchanges, Listless? The Disintermediation of the Listing Function' (2015) 50(3) Wake Forest Law Review 579, 584

<sup>63</sup> Louise Gullifer and Jennifer Payne, *Corporate Finance Law: Principles and Policy* (2nd edn, Bloomsbury 2015), 489

<sup>64</sup> Editors, 'Stock Exchange Listing Agreements as a Vehicle for Corporate Governance', [1981] University of Pennsylvania Law Review 1427, <[https://scholarship.law.upenn.edu/penn\\_law\\_review/vol129/iss6/3](https://scholarship.law.upenn.edu/penn_law_review/vol129/iss6/3)>

<sup>65</sup> *ibid*

likely to result in a delisting.<sup>66</sup> A critical question which has been asked is whether the listing agreement and the LR should be characterised as contracts or rules. In this regard, the contractual nature of the LR is arguably evidenced by the lack of compulsion on the parties and the availability of alternative ways of doing business.<sup>67</sup> Nevertheless, the stock exchange is tasked with the mandate of investor protection and the enforcement of the LR is thus similar to an administrative agency enforcing laws or regulations for that purpose<sup>68</sup> which militates against a purely contractual conceptualisation of the LR. It is argued that the LR takes a hybrid form of contractually founded regulatory requirements under which the issuer and all other associated parties must abide by in exchange for remaining listed and trading on the alternative market. A further issue which arises is whether shareholders or third parties are able to sue the stock exchange or the issuer for breaches of the listing agreement; this has yet to be tested in Hong Kong, Singapore, or Malaysia and this may be a function of the prevalence of public over private enforcement of securities laws.<sup>69</sup>

Against the backdrop of the general objective of building trust and confidence in the markets<sup>70</sup> which are essential to realising capital formation and investor protection, a comparative analysis of the admission criteria set out in the LR of Hong Kong's GEM, Singapore's Catalist and Malaysia's ACE Market brings to light the following observations. It has been argued that light touch AIM-style regulation may make it easier for issuers to raise capital.<sup>71</sup> Therefore, the question is whether the GEM, Catalist, and ACE Market admission criteria apply a similar light-touch approach in contrast with the more prescriptive main market admission requirements which require a profit track record or meeting a market capitalization threshold. With regard to GEM, quantitative admission criteria are applied to potential issuers which makes for a relatively clearer bright-line test of listing suitability. By contrast, for Catalist and the ACE Market, there are no hard numerical indicators barring potential applicants. However, this lightness is supplemented by the reliance which the stock exchange places on the Sponsor to determine and confirm the suitability of issuers to be listed.<sup>72</sup> On this front, Catalist Practice Note 2B provides that a Sponsor must be satisfied, having made reasonable due diligence enquiries and considering all relevant matters, that a listing applicant is suitable to be listed and must also address whether the entity's structure or operations are suitable for the marketplace. The Practice Note is nevertheless silent on what elements constitute marketplace suitability, leaving it to the judgment of the Sponsor to determine the same. By contrast, ACE Market Guidance

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<sup>66</sup> Umakanth Varottil, 'Consequences of Listing Violations' (*Indian Corporate Law Blog*, 4 December 2009) <<https://indiacorplaw.in/2009/12/consequences-of-listing-violations.html>> accessed 15 October 2022

<sup>67</sup> n 66 above *ibid*

<sup>68</sup> *ibid*

<sup>69</sup> Wan Wai Yee, Christopher Chen and Goo Say Hak, 'Public and private enforcement of corporate and securities laws: An empirical comparison of Hong Kong and Singapore' (2019) 20(2) *European Business Organization Law Review* 319. See also Aiman Nariman Mohd Sulaiman, 'Challenges for Public and/or Private Enforcement of the Corporate Governance Code' [2007] *International and Comparative Corporate Law Journal*, 8 and Alexander FH Loke, 'The Efficacy of Securities Investors' Rights in Singapore' [2009] *Singapore Journal of Legal Studies* 109

<sup>70</sup> IOSCO, 'Objectives and Principles of Securities Regulation' (IOSCO, May 2017) <<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD561.pdf>> accessed 3 September 2022

<sup>71</sup> Chris Mallin and Kean Ow-Yong, 'The UK Alternative Investment Market – Ethical Dimensions', *Journal of Business Ethics* (2010) 95, 223

<sup>72</sup> Rule 225 Catalist LM; Rule 3.02(4) and Rule 4.07(2) ACE LR. See also Catalist LM Practice Note 2B 'Guidelines for Preparing a Listing Applicant for Admission or Advising an Issuer in a Very Substantial Acquisition or Reverse Takeover' and ACE LR Guidance Note 18 'Roles and Responsibilities of Sponsors'

Note 18 sets out the explicit circumstances when a Sponsor should not regard an applicant as suitable for listing, namely if the applicant's business is loss making, shows declining profits which may raise doubt on its potential or suffers from low profitability and without any growth in financial results unless the Sponsor is able to demonstrate to the exchange that the applicant is an innovative company involved either in technology-based business activities or research development, has taken steps to improve its financial performance or has a strategy to revive its business in the future and there are acceptable justifications on the prospects of the applicant's business.<sup>73</sup>

A related question is that of whether by placing the burden of determining the applicant's listing suitability on the Sponsor, is the alternative market admission framework based on a merit or disclosure-based model? This question is especially important from an investor protection perspective. There is no doubt that disclosure plays a prominent role in alternative market regulation as evidenced by the various documents which the issuer is required to furnish as part of its application for admission. With regard to investor protection, the maxim of caveat emptor remains the dominant philosophy in securities regulation.<sup>74</sup> Nevertheless, there is an undeniable element of merit regulation which operates in the alternative market regulatory sphere as the Sponsor is required to determine the suitability of the applicant to be listed on the exchange. Suitability here is founded on the growth potential and prospects of the applicant as well as considerations of investor interest, as noted in the most recent amendments to the ACE Market LR discussed below. In any event, all 3 stock exchanges in Hong Kong, Singapore, and Malaysia maintain an ultimate discretion to reject listings in accordance with their duty to act in the public interest.<sup>75</sup> Seen against this backdrop, the required disclosures may accordingly be conceived as the 'floor' or minimum standards which would allow companies to be listed and contributes to maintaining the quality of issuers and the overall quality of the market segment.

In view of the more speculative nature of companies listed on the alternative market, all 3 alternative markets in Hong Kong, Singapore, and Malaysia require issuers to carry a warning on the characteristics of the alternative market, the potential risks of investing in companies listed on such markets and the need for investors to invest only after careful consideration and in the case of Catalist, advice from registered professional advisers where appropriate.<sup>76</sup> It is interesting to note that both Catalist and ACE Market require the inclusion of a statement in the listing document that there is no assurance of a liquid market in the shares or units of shares traded on these markets and that there is higher risks associated with investing in these markets. This statement serves as an additional warning on the adverse possibilities from investing blindly in such markets. Such warnings are primarily targeted at retail investors as they are generally viewed as being more susceptible to sentiment-led investing which may potentially lead to disastrous outcomes.<sup>77</sup> Indeed, given the increased retail investor participation in these markets, the inclusion of such warnings is necessary to ensure that more vulnerable investors are protected.

Be that as it may, the mandated free float requirements are essential to ensure that there is a liquid market for the securities which is important for issuers, investors,

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<sup>73</sup> Paragraph 3.2, Guidance Note 18 ACE LR

<sup>74</sup> US Congressional Record, 73 Cong. 1st Sess, 23 March 1933, 937, 954 discussing the regulatory philosophy of the Securities Act 1933 which formed the model for many securities laws worldwide.

<sup>75</sup> Section 21(2) SFO; Section 15(1)(c) SFA; Section 11(3) CMA

<sup>76</sup> See Rule 2.20 of the GEM LR, Rule 407(5)(c)(iii) Catalist LM and Paragraph 1.01(f) and (j) of the SC Prospectus Guidelines

<sup>77</sup> The presumption of irrationality on the part of retail investors is founded on the insights of behavioural economics. See for e.g. Michelle Baddeley *Behavioural Economics and Finance* (2nd edn, Routledge 2018)

and intermediaries. However, the question then becomes what an optimal threshold for the minimum free float is. Here, both GEM and the ACE Market require a minimum free float of 25% although the Malaysian Stock Exchange may accept a lower percentage if it is satisfied that this lower percentage is sufficient for a liquid market in such shares. The Catalist market permits a lower threshold of 15% free float. Another relevant consideration is the minimum number of public shareholders, and here the GEM is an outlier which requires a minimum of 100 shareholders, while Catalist and ACE Market require a minimum of 200 public shareholders. The Catalist rules further state that the overall distribution of shareholdings should be expected to provide an orderly secondary market in the securities at the commencement of trading and be unlikely to lead to a corner situation in the securities.<sup>78</sup> At this juncture, it is pertinent to note that these free float and shareholding rules continue to be important throughout a company's listing on these markets. Should a listed company experience prolonged insufficient free float or public shareholders without remedial action, the stock exchanges retain the discretion to delist the company.<sup>79</sup>

With regard to the moratorium requirements, this may be construed as a means of ensuring the commitment of the founder and the controlling shareholders to the company after listing. Indeed, if companies diversify too rapidly after listing, this may be problematic as the listed business would not have had an opportunity to grow properly in line with its earlier projections which were communicated to potential shareholders and investors and accordingly formed the basis for investment in the company. Overly rapid diversification also suggests that the listing was merely an exercise for the founders to cash out early without delivering on their promise to shareholders to expand and grow the business. Such a position is inconsistent with the paradigmatic growth story of alternative market issuers and which the stock exchange had in mind when designing the admission and post-listing criteria of the companies seeking to be listed.

### *Reforming the Alternative Market Listing Rules*

The Malaysian Stock Exchange, Bursa Malaysia, and the Hong Kong Stock Exchange have both engaged in efforts to reform the alternative market LR. SGX Catalist has not been the subject of a major review exercise despite warnings sounded about its performance and future.<sup>80</sup> Nevertheless, the Monetary Authority of Singapore recently set up a review group to revitalise the Singapore stock market<sup>81</sup> which encompasses both the Mainboard and Catalist market segments. As the recommendations from the review group will be released in 2025, it will be interesting to observe whether there will be any Catalist-specific reforms in the pipeline.

Bursa Malaysia first reviewed the ACE Market listing requirements in 2015 to promote a more transparent framework with clearer admission criteria and ensure the continued attractiveness of the ACE Market as a listing and investment platform. Under the heading of promoting a more transparent framework, the stock exchange clarified the admission criteria and suitability assessment to be undertaken by a Sponsor with additional guidance and introduced a new pre-IPO consultation procedure to allow

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<sup>78</sup> Rule 406(1)(d) Catalist LM

<sup>79</sup> Rule 9.14 GEM LR; Rule 1305 Catalist LM; Rule 16.11 ACE LR.

<sup>80</sup> Livia Yap and Tom Redmond, 'The Incredible Shrinking Singapore Stock Market' (*The Straits Times*, 12 February 2019) <<https://www.straitstimes.com/business/companies-markets/the-incredible-shrinking-singapore-stock-market>>

<sup>81</sup> n 20

applicants to seek guidance on admission before commencing the official listing process. It would also now require an independent market research report to support a listing application.

A subsequent review of the ACE Market LR took place in 2021 in which the Malaysian Securities Commission (SC) and Bursa Malaysia embarked on a holistic review of the Malaysian IPO regulatory framework.<sup>82</sup> A major change was that Bursa Malaysia would now be the single approving authority for admission to the alternative market through the assumption of the ACE Market prospectus review and registration functions which were previously under the purview of the SC.<sup>83</sup> This was done in order to improve the overall IPO processes for greater efficiency and efficacy as well as to ensure quality submissions to the stock exchange and disclosures to investors.<sup>84</sup> Further, ACE LR prospectuses would also be a prospectus under the Capital Markets and Services Act 2007 insofar as it related to the liability of the applicant or its agent for any statement or information made in the prospectus.<sup>85</sup> This was also followed by an extension of the regulatory and enforcement ambit under the ACE LR to the promoter and chief executive officer of the applicant. ACE Market applicant directors would also be required to complete the Mandatory Accreditation Programme prior to listing. The pre-admission consultation process introduced in 2015 would now require a Sponsor to consider investor interest as one of the key focus areas for admission<sup>86</sup> and the previous mandatory requirement for an independent market research report was now on a voluntary basis. Further, the requirements applicable to an ACE Market applicant listing via a corporate proposal which would result in a significant change in business direction or policy were harmonised to promote parity of regulation and prevent regulatory arbitrage. The moratorium requirements were also amended to be broader in scope.<sup>87</sup> While not within the purview of this paper, other relevant reforms included enhancements to the Sponsorship framework of the ACE Market.

For the Hong Kong Stock Exchange, the most recent reform with regard to GEM was precipitated by the decline in GEM listing activity in terms of new issuers and amounts raised by existing listed issuers<sup>88</sup> as a result of the Covid-19 pandemic and the broadened availability of alternative SME listing venues.<sup>89</sup> This was also bolstered by stakeholder feedback which highlighted the need for changes to the initial eligibility tests, high listing costs, the lack of a streamlined transfer mechanism and ensuring investor protection.<sup>90</sup> In relation to specific admission criteria, a new alternative eligibility test in terms of the financial eligibility of the issuer was proposed and targeted at high growth enterprises heavily engaged in R&D (research and development) activities. GEM listing applicants using this route would now need to have an adequate trading record of at least 2 financial years, an expected market capitalisation of at least

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<sup>82</sup> Bursa Malaysia, 'Amendments to Bursa Malaysia Securities Berhad ACE Market Listing Requirements Relating to ACE Market One-Stop Centre (20 December 2021) <[https://www.bursamalaysia.com/sites/5bb54be15f36ca0af339077a/content\\_entry5ce3b50239fba2627b2864be/61c02d925b711a31facf9314/files/ACE\\_LR\\_Circular\\_Ace\\_One-Stop\\_Centre\\_fair\\_20Dec2021.pdf?1639998504](https://www.bursamalaysia.com/sites/5bb54be15f36ca0af339077a/content_entry5ce3b50239fba2627b2864be/61c02d925b711a31facf9314/files/ACE_LR_Circular_Ace_One-Stop_Centre_fair_20Dec2021.pdf?1639998504)>

<sup>83</sup> Part III, Schedules 6 and 7 of the Capital Markets and Services Act 2007

<sup>84</sup> n 83 above

<sup>85</sup> *ibid*

<sup>86</sup> Rule 4.07(2) and Guidance Note 18 ACE LR

<sup>87</sup> The term used is now 'pre-IPO investor who is not a specified shareholder' which means a controlling shareholder, a person connected to a controlling shareholder, and an executive director who is a substantial shareholder, of the applicant or listed corporation, or any other person as specified by the Exchange.

<sup>88</sup> Section I of this paper

<sup>89</sup> HKEx, 'GEM Listing Reforms' 2023, 1

<sup>90</sup> HKEx, 'GEM Listing Reforms' 2023, 2-3

HKD250 million at the time of listing, revenue of at least HKD100 million in aggregate for the 2 most recent audited financial years, with year-on-year growth over the 2 financial years, and incurred R&D expenditure of at least HKD30 million in aggregate for the 2 financial years prior to listing, where the R&D expenditure incurred for each financial year must be at least 15% of its total operating expenditure for the same period. This test would be open to companies from all industries and not restricted to enterprises from technology related industries.<sup>91</sup> The prior post-IPO 24-month lock-up period on controlling shareholders would now be reduced to 12 months and in line with Main Board requirements. Other changes beyond the scope of this paper included the removal of a GEM issuer director to act as a compliance officer, the removal of the quarterly financial reporting requirement and a new streamlined transfer mechanism to enable qualified GEM issuers to transfer their listings to the Main Board.

It remains to be seen whether these market reforms will yield tangible results over the longer term. The GEM reforms only took effect on 1 January 2024.<sup>92</sup> As of June 2024, UBoT Holding, the first new listing on the Hong Kong stock exchange's secondary board in more than three years, surged on debut, with one analyst saying the listing bodes well for the market.<sup>93</sup> The ACE Market reform initiative appears to have shown positive effects in the form of increased ACE Market IPOs and market capitalization as seen in Section I of this paper. An industry observer also noted that many of the current speculative penny stocks on the ACE Market were not those listed on recent years, but rather legacy companies wherein their original shareholders had long sold out and now appeared to be controlled by nominees or syndicates whose real identities were unknown to the general public.<sup>94</sup>

## Conclusion

Based on the foregoing discussion, the stock exchange operationalises the foundational goals of capital market regulation i.e. enabling capital formation and ensuring investor protection by tailoring alternative market admission rules in its capacity as a frontline regulator. In doing so, the stock exchange manages various interests within the boundaries of its regulatory mandate of public interest to balance both capital formation and investor protection to contribute to the success of the alternative market as listing and trading platform. The combination of strict and relaxed requirements in the admission criteria facilitate capital formation both at the issuer and market segment level. The role of the Sponsor in acting as a gatekeeper in determining suitability is also a critical element in making these markets work, necessitating oversight of the Sponsor by both the stock exchange and the statutory regulator. While disclosure is an essential element in the regulatory design of the admission criteria and serves to protect investors, there is also the use of conduct restrictions to prevent issuers and early-stage investors from exploiting the listing process to their benefit and the detriment of later investors which are likely to include a majority of retail investors.

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<sup>91</sup> HKEx, GEM Listing Reforms: Consultation Conclusions, 13

<sup>92</sup> HKEx, GEM Listing Reforms: Consultation Conclusions, 13

<sup>93</sup> South China Morning Post, 'Hong Kong IPO: GEM board welcomes its first small-firm listing in 3 years as UBoT soars 36% in trading debut' <[https://finance.yahoo.com/news/hong-kong-ipo-gem-board-093000346.html?guccounter=1&guce\\_referrer=aHR0cHM6Ly93d3cuZ29vZ2xlLmNvbS8&guce\\_referrer\\_sig=AQAAAWQaAuRf3WkwcLVc23ftCiUwu28oE2GzLA\\_Pr2BLuHdR15mc0i6fcnQIVrZuNTjwrVMOydTiLk0oSmS117jjXKhrynypodTYHoJRxn9nViByOkExLYkK6QaLidJmeIybqtJil2Eacme mKa0ZevQVIHOrhzEolnKB-bsG-IQpDwG>](https://finance.yahoo.com/news/hong-kong-ipo-gem-board-093000346.html?guccounter=1&guce_referrer=aHR0cHM6Ly93d3cuZ29vZ2xlLmNvbS8&guce_referrer_sig=AQAAAWQaAuRf3WkwcLVc23ftCiUwu28oE2GzLA_Pr2BLuHdR15mc0i6fcnQIVrZuNTjwrVMOydTiLk0oSmS117jjXKhrynypodTYHoJRxn9nViByOkExLYkK6QaLidJmeIybqtJil2Eacme mKa0ZevQVIHOrhzEolnKB-bsG-IQpDwG>) accessed 22 November 2024

<sup>94</sup> Liew Jia Teng, 'ACE Market enters a new regulatory regime' The Edge Malaysia, 18 Jan 2022.

The analysis here provides a nuanced understanding of the balance between regulatory flexibility to facilitate capital formation and investor protection in alternative markets.

Regulation contributes to the attractiveness of the alternative market by articulating baseline requirements to be met by issuers. Transparent and clear guidelines enhances efficiency in terms of speedier time-to-market and the effectiveness of the market as a listing and trading destination that both facilitates capital formation and ensures investor protection. In summary, it is important to take a holistic approach to the regulatory design of admission market rules to ensure that public markets continue to play their role to serve issuers, investors, and broader society even as trends such as the displacement of public markets by venture capital and private equity unfold, leading to a blurring of the boundaries between public and private markets.<sup>95</sup> SMEs continue to be important in today's economy and helping them find a place in a financing framework is a challenging but necessary task.

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<sup>95</sup> George S. Georgiev, 'The Breakdown of the Public-Private Divide in Securities Law: Causes, Consequences and Reforms' (2021) 18(1) New York University Journal of Law & Business 221, 280