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**Sent:** 02 September 2016 22:06  
**To:** response  
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**Subject:** Consultation Paper on Proposed Enhancements to the Exchange's Decision-Making and Governance Structure for Listing Regulation  
**Attachments:** Linklaters Submission.pdf; ATT00001.htm

Please take the attached paper, written by a top law firm in Hong Kong, as a response submission to the Consultation Paper.

August 2016

## SFC and SEHK joint consultation on listing regulation

The death of the Listing Committee in the guise of better governance?

On 17 June 2016, the Securities and Futures Commission (the "SFC") and The Stock Exchange of Hong Kong Limited (the "Exchange") published a joint consultation paper on listing regulation (the "Consultation"). The stated objectives of the Consultation proposals are certainly pleasing to the ear: "enhancing the coordination and cooperation when developing new policy in listing regulation and regulatory decision-making", "clearer reporting structure for decision-making" and "simplify the process for IPO applications".

If these really are the SFC's only objectives, then the Consultation needs to go no further. All the proposals are in fact already in place – refer simply to the Memorandum of Understanding governing listing matters between the SFC and the Exchange signed in 2003 (the "2003 MOU") (more on this later).

What the Consultation appears to be really about is a rebalancing of regulatory power from the Exchange back to the SFC. There is nothing inherently wrong with this objective – many of the world's other leading financial markets (e.g., US, UK) have independent regulatory authorities which are each unaffiliated with the operator of the local securities exchange.

However, before the SFC dives head-first into these proposals, it is worth being clear what the practical effects of the Consultation proposals may be:

- With significantly reduced powers (but no reduction in workload), will the Listing Committee still be able to attract the best and brightest of our equities market?
- Will the regulatory attitude of the Exchange's Listing Department become more conservative given its performance will no longer be judged by the market (through representation on the Listing Committee) but by the SFC?
- Will the listing process really be simplified? Logic suggests that an additional layer of regulatory oversight through the creation of an additional regulatory body should reduce, not improve, efficiency.

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- Will concentrating power with the Listing Policy and Regulatory Committees, as compared to a more widely represented Listing Committee, really improve transparency and accountability? Or will the changes simply silence the Listing Committee and the Exchange's Listing Department before they have a chance to speak?

These practical effects all point to one thing: the increasing omnipotence of the SFC. Yet, the SFC is not a frontline regulator in daily interaction with the market. If the Listing Committee can no longer attract our best and brightest, can the SFC ensure that the listing regime continues to "reflect currently acceptable standards in the market place", the key tenet of our Listing Rules?

## **The Consultation proposals vs the 2003 MOU**

The first thing to clear up is whether the Consultation proposals are necessary to achieve the stated objectives. The Consultation proposes two key changes:

- The creation of a Listing Policy Committee to steer the Exchange's work on Listing Rule amendments and overall listing policy. This Listing Policy Committee will comprise the Chairperson and two Deputy Chairpersons of the Listing Committee, the Chief Executive of HKEx, the Chairperson of the Takeovers Panel, the CEO of the SFC, and two senior executives from the SFC Corporate Finance Division.

According to the Consultation, this new committee represents a single senior body in which the Exchange and the SFC are represented, and will simplify and more closely align policy decision-making amongst the Listing Department, the Listing Committee and the SFC. The SFC will also have earlier and more direct input on listing policy matters and listing regulation.

- A new Listing Regulatory Committee to decide on day-to-day listing matters concerning individual listing applicants or listed issuers that have suitability concerns or broader policy implications. The Listing Regulatory Committee will comprise three SFC executives as well as the Chairperson and two Deputy Chairpersons of the Listing Committee.

The Listing Regulatory Committee is said to simplify the decision-making process involving the Listing Department, the Listing Committee and the SFC, as the SFC would in effect be able to exercise its existing power to object to a listing through its participation on the Listing Regulatory Committee. As part of the proposal, the SFC will no longer as a matter of routine issue a separate set of vetting comments.

What the Consultation does not emphasise is the fact that similar committees or arrangements are already in place.

- As set out in the 2003 MOU, a "High-Level Group" comprising the Chairperson of HKEx, the Chief Executive of HKEx, the Head of Listing of HKEx, the Chairperson of the Listing Committee, the Chairperson of the SFC, the Executive Director the SFC Corporate Finance division and the Chairperson of the Takeovers Panel should have been meeting from time to time to review systemic and policy issues concerning listing-related matters. The Listing Department should have been guided by the Listing Committee and the High-Level Group when reviewing and, where appropriate, proposing amendments to the Listing Rules.

The 2003 MOU also provides that the Listing Department may at any time seek, and the SFC staff will in response provide, policy advice and comments and an indication of the SFC staff's support on any proposals for potential amendments.

- As set out in the 2003 MOU, the Exchange should have been informing the SFC, as soon as is reasonably practicable, of any matter of a novel or potentially controversial or sensitive nature, or which appear to involve public policy implications, whether arising from a listing application, a transaction by a listed issuer or otherwise. The 2003 MOU also notes that the SFC does not intend to comment upon matters of, and shall not be responsible for ensuring, compliance of a listing application with the specific requirements of the Listing Rules.

If the substance of the key changes proposed in the Consultation is already reflected in the 2003 MOU, it would seem more efficient to ensure that the 2003 MOU arrangements are more effectively applied than to undergo wholesale changes to the structure of the listing regime.

## **The unintended consequences**

Sometimes change is good; it shakes things up and focuses people's minds. But be mindful of the unintended consequences.

### *What will come of the Listing Committee?*

The most glaring consequence of the Consultation proposals is the removal of substantive power from the Listing Committee as a body. Under the current structure, the Listing Committee is a key tool to ensuring that the Listing Rules reflect currently acceptable standards in the market place. The Listing Committee, comprising representatives of investors, listed companies and market practitioners, provides commercial and business knowledge and experience of market users for policy formulation and regulatory decision-making.

To be effective, the Listing Committee must be able to attract members who are senior stewards and thought-leaders in their respective professions. Notwithstanding the substantive workload, the Listing Committee currently is able to achieve this as membership on the Committee brings with it a degree of market prestige, and the ability to

shape and drive Hong Kong policy and regulation satisfies the intellectual curiosity of thought-leaders.

Following the proposed changes, the Listing Committee will be responsible for approving plain vanilla IPO applications and listed issuer matters without any suitability concerns or broader policy implications. This means the Listing Committee's key role becomes one of vetting the adequacy of disclosures and applying existing policy decisions (except for the Chairperson and Deputy Chairperson who can become kingmakers via the new Committees – but that's a different story). Is this the best use of the knowledge and experience of our senior stewards and thought-leaders or should this simply be left to the Listing Department? Without any reduction in workload (members will still need to review multiple prospectuses ahead of Listing Committee hearings), can the Listing Committee still attract the requisite market leaders?

If the Listing Committee as a body can no longer provide business knowledge and market insights to policy formulation and regulatory decision-making, who is going to guide the SFC in the exercise of its new powers? Is it good for the Hong Kong listing regime to lose access to the unique insights of market leaders? Or to have that access further consolidated into just a couple of Listing Committee members who join these newly formed Committees?

The stated view in the consultation is that the "Listing Committee will continue as current to be the decision-maker for IPO applications and ... matters involving listed issuers that do not involve suitability concerns or broader policy implications, which should be the large majority of cases". Held up to the light, this position can take on an almost circular edge – "You will continue to be as important as ever, dear Listing Committee members, except you will no longer do anything important". Not a great pitch for attracting the best and brightest in Hong Kong

### *A change to the regulatory attitude of the Listing Department*

One anecdotal feedback market practitioners often share about the Listing Department is its tendency to refuse to allow a new approach or product even if the approach or product falls within the letter and spirit of the Listing Rules and has good, sound commercial rationales. These complaints are slightly unfair as the Listing Department always has to regulate for the worst case scenario, lest a flexibility which would be reasonable for a bona fide well-intentioned issuer becomes a glaring loophole for issuers intent on bending the rules to their limits.

However, even in that context, the SFC still considers the Listing Department to be too "liberal" and "market friendly". This much can be gathered from the SFC's response to the weighted voting rights debate and more recently the SFC's report card on the Exchange's listing functions published on 24 June 2016. Indeed, the new Listing Policy and Regulatory Committees are designed to give the SFC an ability to reject Exchange proposals without having to use its existing statutory veto power.

If the SFC will have primary responsibility for appraising senior executives of the Listing Department in the performance of their regulatory responsibilities, one would expect the Listing Department to increasingly sing to the tune of the SFC. In that case, even without any overt influence from the SFC, the Listing Department may well become more conservative in its application of the Listing Rules.

The Consultation expressly states that while it expects the "large majority of cases" to still be determined by the Listing Committee and Listing Department, the "Listing Department will be responsible for deciding whether an IPO application or a post-IPO matter has suitability concerns or broader policy implications and, if so, will refer it to the Listing Regulatory Committee for decision". It is hardly the case that the SFC rewards the Listing Department for making difficult on balance decisions, the consequence of which will likely mean that any issue with a scintilla of suitability or broader policy aspects to it will be promptly elevated away from the Listing Committee and Listing Department, to the Listing Regulatory Committee. This further undermines the value of the Listing Committee.

### *Simplified listing process?*

One of the key objectives of the proposals is to simplify the listing process. Yet, the effect of the Listing Regulatory Committee is to impose an additional regulatory hurdle to any decision being made. Where previously a decision will be made by the Listing Committee after vetting by the Listing Department, a decision may now need to go through the Listing Department, the Listing Committee, and then the Listing Regulatory Committee. Whilst the Listing Committee (by rotation through its pooled system) meets regularly on Thursdays, Listing Regulatory Committee meetings are convened on an ad hoc basis. With less members available, one could imagine difficulty in calling meetings of the Listing Regulatory Committee on short notice. Representatives of the applicants with suitability issues will also now expect to attend two hearings instead of one.

If the SFC having a formal voice during the Listing Committee's decision-making process is so game-changing, would a far simpler solution not be to add SFC representatives to the Listing Committee? This way, there need not be one additional level of regulatory oversight, but the SFC's knowledge and perspectives can still be shared and leveraged upon during decision-making.

Another significant point to bear in mind is, whilst the SFC says it will no longer as a matter of routine issue a separate set of comments on IPO applications, the dual-filing system will remain and an IPO application will still only be finally approved if the SFC has no objections.

### *More transparency and accountability for decision-making?*

Under the existing regime, decisions are made by a 28-member Listing Committee after consultation with the SFC (with the SFC retaining a final statutory veto). Listing Committee members are nominated by the Listing

Nominating Committee which is equally represented by non-executive directors of HKEx and the representatives of the SFC. The Listing Committee must comprise eight individuals which the Listing Nominating Committee considers will represent the interests of investors, with the rest being a balance of representatives of listed issuers and market practitioners. In other words, the Listing Committee is purposely designed to be a widely represented body, members of which have been jointly vetted and approved by the Exchange and the SFC. Decisions affecting the listing regime are debated, and then decided, amongst this 28-member, widely represented body.

What the Consultation proposal does is to invite debate amongst this 28-member body. However, once the debate has been had, decision-making will be escalated to a closed-door meeting of a select few, with or without regard to the widely represented views of the Listing Committee. Even if the Listing Committee were to be overwhelmingly supportive of a proposal, if the SFC disagrees, such proposal would not see the light of day. The Listing Committee and the Exchange would not be in a position to articulate such views to the market.

Is it necessary to escalate decision-making to such a small group in order to increase transparency and accountability? Many commentators have noted that the consultation proposals have the effect of avoiding the SFC's public rebuke of the Exchange's proposal on weighted voting rights in 2015. But perhaps that debate between the Exchange and the SFC was a healthy one that should be had in the open. The market can only benefit from more transparent exchanges of views, rather than outcomes that are negotiated behind closed doors.

### **Is there an alternative way?**

For the Consultation to be effective, there needs to be transparency as to its real objectives.

If the objectives are as stated in the Consultation – enhanced coordination and cooperation, clearer reporting structure and simplified IPO processes, then a more effective and simpler solution would be to introduce SFC representatives onto the Listing Committee. Decisions can still be made at the Listing Committee forum, taking into account the widely represented views of Listing Committee members, while at the same time having the benefit of the knowledge and perspectives of the SFC. The SFC would also certainly be involved from an earlier stage – indeed, earlier than the proposed Listing Policy Committee and the Listing Regulatory Committee would have.

On the other hand, if the real objective is to reclaim regulatory power from the Exchange, the SFC must ensure that a narrow dictatorship does not develop over control of the Hong Kong listing regime – this is the case irrespective of whether the Listing Department remains a part of the Exchange or is subsumed into the SFC itself, which is arguably the greater policy debate we should be having. If decision-making power is going to

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be concentrated with the Listing Policy Committee and the Listing Regulatory Committee (in contrast to the considerably broader bodies that regulate takeover and buy-back transactions in Hong Kong, namely the SFC's Takeovers Panel), there are two fundamental issues which the SFC must resolve:

- The SFC must ensure the Listing Committee continues to attract senior stewards and thought-leaders who can share commercial and business insight and experience. One solution may be to turn the Listing Committee into a purely advisory body with no responsibility for reviewing and approving (plain vanilla only) listing applications.
- Any potential conflict of interest in members of the Listing Policy Committee and the Listing Regulatory Committee must be carefully managed. Unlike in a 28-member body, each member of the Listing Policy Committee and/or the Listing Regulatory Committee is capable of being kingmaker in any decision. As a result, it would be advisable that members of the Listing Policy Committee and Listing Regulatory Committee (other than full-time Exchange or SFC employees) do not hold any concurrent active market-related offices in order to rebut any actual or perceived conflict of interest.

Only then would the market have confidence that the SFC can ensure that our listing regime continues to reflect currently acceptable standards in the market place.

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