

Linklaters' Response to the Joint Consultation Paper on Proposed Enhancements to The Stock Exchange of Hong Kong Limited's Decision-Making and Governance Structure for Listing Regulation

Set out below are our comments to the proposed changes described in the Joint Consultation Paper on Proposed Enhancements to The Stock Exchange of Hong Kong Limited's Decision-Making and Governance Structure for Listing Regulation (the "**Joint Consultation Paper**") published by the Securities and Futures Commission (the "**SFC**") and The Stock Exchange of Hong Kong Limited (the "**Exchange**").

1 Introduction

- 1.1** As the Joint Consultation Paper pointed out, the Hong Kong equities market has become increasingly large and complex, and strategic foresight in policy formulation and constant vigilance is required to address emerging market developments. Our regulatory system must be capable of evolving with the market in order to maintain its quality and to give all market participants confidence that it is a system which is fair, efficient, orderly, transparent and competitive.
- 1.2** We believe the best way to monitor and address such developments is to ensure that the frontline regulator of the Hong Kong equities market and, importantly, its key decision-makers, are in regular and direct contact with the market. Only then will the regulatory system keep pace with the latest developments, products and challenges in the market. A regulatory system where key decision-makers are in regular and direct contact with the market will also give it credibility and legitimacy in the eyes of the market.
- 1.3** We are concerned that the proposals in the Joint Consultation Paper are not conducive towards such an outcome. In particular, we believe a number of the proposals will result in key decisions in the regulatory system being made by decision-makers who are one step removed from the market. Our detailed comments are set out in Sections 2 to 9 below, and are grouped according to the headings requested in the Joint Consultation Paper. They are targeted at issues and concerns we have identified in each element of the proposed new decision-making and governance structure.
- 1.4** Our views can be summarised under three broad headings:

The value and the effectiveness of the Listing Committee must be preserved

We believe in the value of the Listing Committee and as a result disagree with the proposals to shift key decision-making power from the Listing Committee to the Listing Policy and Regulatory Committees. Due to its wide-ranging composition, the Listing Committee has a unique ability to monitor and understand the latest developments, products and challenges in the market. The Listing Committee is at its most effective (including by attracting the most capable senior stewards and thought-leaders in the market) when it has the ability to shape policy formulation and market regulation.

We believe the proposal to shift key decision-making power away from the Listing Committee to the Listing Policy and Regulatory Committees will reduce the Listing Committee's ability to attract the most capable individuals, thereby reducing its effectiveness – the role is plainly less attractive if it no longer carries with it a seat at the main table. Furthermore, vetting the adequacy of disclosures and applying existing policy decisions in plain vanilla listing applications cannot be the best use of the Listing

Committee's collective knowledge and experience. The Listing Committee's greatest value lies, as it does today, in shaping policy formulation and regulatory reform.

We note that the Joint Consultation Paper does not identify any concern with the benefits or effectiveness of the Listing Committee.

Any formal and active participation by the SFC in the regulatory system would be most efficient if made through the Listing Committee

One of the objectives of the Joint Consultation Paper is to increase the formal involvement of the SFC in the regulatory framework.

We welcome such a development. Indeed, we agree that the regulatory system in Hong Kong will be better served if its three prongs, the Government, the SFC and the Exchange, are more closely joined up on a day-to-day basis. However, we are of the view that any increase in the SFC's formal involvement should be in the form of adequate direct representation in the Listing Committee, and not through the separate, newly established Listing Policy and Regulatory Committees – in our view, a process is rarely made more efficient by the introduction of additional committees. In this way, the SFC will have the opportunity to listen to and actively participate directly in discussions with the market through its representation by members of the Listing Committee. Similarly, members of the Listing Committee will have a better opportunity to understand and discuss the SFC's longer term regulatory policies and objectives.

If the SFC's formal involvement is through the Listing Committee rather than the Listing Policy and Regulatory Committees, a number of corresponding changes in the Joint Consultation Paper, such as changes to the oversight of the listing function and the creation of the Listing Policy, Regulatory and Regulatory (Review) Committees, can be simplified or are no longer required. Furthermore, a number of concerns with the proposed changes which we have identified in the detailed comments below (e.g., difficulty in identifying matters with suitability concerns, consequences of an additional review body to listing applications) will be mitigated.

More frequent publication of reasons for decisions at all levels of the regulatory system will enhance transparency and accountability

Increased transparency and accountability is welcomed, in particular the proposal that the Listing Policy, Regulatory and Regulatory (Review) Committees should publish reasons for all of their decisions as a matter of routine. Indeed, we suggest that this enhancement can be extended, to a large extent, to decisions of the Listing Department and the Listing Committee. We believe there is currently a perception in the market that certain Listing Department interpretations and practices are not publicised to the wider market. These interpretations and practices may stem from case specific facts and circumstances, or from interpretations of ambiguous listing rules provisions. Overcoming this perception by more frequent publication of decisions (e.g., waivers or exceptions granted, even if they are not for general application) will be beneficial to the market.

The Listing Committee currently has the practice of annually reporting on listing policy matters considered by it, including proposals which are ultimately rejected. Regardless of the outcome of the Joint Consultation Paper, we believe this practice should continue, either through the Listing Committee or the Listing Policy Committee.

2 Policy development

- 2.1** In paragraph 14 of the Joint Consultation Paper, it is proposed that closer coordination between the SFC and the Exchange can be achieved through a single senior body on which the Exchange and the SFC are represented to simplify and more closely align policy decision-making amongst the Listing Department, the Listing Committee and the SFC.

We agree with this proposal. However, we believe that the Listing Committee, with appropriate SFC representation, would be a more effective senior body than the Listing Policy Committee.

Undermining the ability of the Listing Committee to attract high quality market participants

- 2.2** We believe part of Hong Kong's success as an equity market is the ability of the frontline regulator, through input from the Listing Committee, to respond to and understand the needs and concerns of the market. The Listing Committee plays a crucial role in this by harnessing the collective wisdom and experience of senior stewards and thought-leaders in the market. Notwithstanding the substantive workload that comes with being a Listing Committee member, market leaders are attracted to the Listing Committee due to its ability to shape Hong Kong policy and regulation.
- 2.3** We believe the changes in the Joint Consultation Paper will dissuade market leaders from joining the Listing Committee. If the changes are implemented, membership on the Listing Committee will continue to bring with it the substantive workload of vetting disclosures of plain vanilla listing applications. Whilst Listing Committee members can still engage in intellectual debates regarding Hong Kong policy and regulation, their input will be limited to just that – intellectual debates. There will be no way of knowing whether a Listing Regulatory Committee decision took into account the Listing Committee's views, nor will a Listing Committee member be able to engage in a discussion with the Listing Regulatory Committee. In this context, we expect it to become much harder to attract high quality market participants to the Listing Committee, with the result that the Listing Committee becomes less effective and, in the longer term, possibly irrelevant.

Retaining the diverse views of the Listing Committee

- 2.4** We believe a key disadvantage of the Listing Policy Committee is that it lacks the diverse views of the Listing Committee. Whilst it is true that the Chairperson and the Deputy Chairpersons of the Listing Committee will be members of the Listing Policy Committee, they are not on the Listing Policy Committee as representatives of the Listing Committee. In particular, the Chairperson and the Deputy Chairpersons are not required to exercise their votes on the Listing Policy Committee to reflect the views of the Listing Committee as a body. This means the views of the Listing Committee are not represented in any final policy decision-making.
- 2.5** We recognise that the Joint Consultation Paper proposes that the non-binding views of the Listing Committee will be made available to the Listing Policy Committee. However, we believe it would be less effective for members of the Listing Policy Committee to receive a paper setting out the views of the Listing Committee than if they are actually involved in live discussions with the Listing Committee. It would also be difficult to capture the diverse views of the Listing Committee in written comments to be presented to the Listing Regulatory Committee. For example, the SFC currently presents its views on decision-making on policy matters in written format to the Listing Department and the Listing Committee prior to a policy meeting. It is the recognition that this form of contribution to

the debate on policy matters to be ineffective which underpins the proposed reforms – why should it be any less applicable to the views of the Listing Committee?

Unclear benefits of escalating policy decisions to the Listing Policy Committee

- 2.6** It is also unclear to us what would be the benefits of escalating policy decisions from the more wide-ranging 28-person Listing Committee, to the smaller SFC-dominated eight-person Listing Policy Committee. It is expected that the Listing Policy Committee will meet four times a year to consider policy matters. This is the same number of times as the Listing Committee meets to consider policy decisions. As a result, there will be limited logistical benefits in having a smaller committee making policy decisions.
- 2.7** On the other hand, whilst we are not wedded to the Listing Committee comprising 28 members and would be open to adopting a slightly smaller size that balances the need to have meaningful SFC representation and contribution, as well as sufficiently diverse input from external market practitioners, the risk of a significantly smaller committee such as those proposed making policy decisions is that valuable opportunities for difficult policy decisions to be discussed and debated across a more diverse audience are lost.

Composition of the Listing Policy Committee

- 2.8** One curious point is the ability of some (but not all) members of the Listing Policy Committee to appoint alternates to attend meetings. The Joint Consultation Paper does not explain why, for example, the Chairperson and Deputy Chairperson of the Listing Committee (who are not investor representatives) are not allowed to appoint alternates, whereas the Deputy Chairperson of the Listing Committee who is an investor representative and the Chairperson of the Takeovers Panel is allowed to appoint an alternate. If the idea is that these individuals should be representatives of the Listing Committee and the Takeovers Panel respectively, it would appear logical for all such representatives to be permitted to appoint alternates with such alternates being chosen from other members of the Listing Committee and the Takeovers Panel.

3 Listing applications by new applicants

- 3.1** We agree that streamlining the process for making important or difficult listing decisions would be beneficial to the market. In paragraph 18 of the Joint Consultation Paper, it is suggested that this can be achieved through decisions of this nature being made by the Listing Regulatory Committee as the SFC would no longer need to separately exercise its power under the Stock Market Listing Rules if it objects to a listing.

As with the Listing Policy Committee, we believe this objective can be more effectively achieved in the form of adequate and direct SFC representation on the Listing Committee. The benefits of this approach, in particular the value of obtaining the input of different members of the Listing Committee during key decision-making, are similar to those set out in section 2 above. We recognise that a larger committee is inherently more unwieldy than a smaller committee but we do not see any reason why the size of the Listing Committee cannot be set at a level which is both efficient and effective. In addition, we make a number of comments below on the practicality of the Listing Regulatory Committee.

Operational uncertainty

- 3.2** The Joint Consultation Paper makes clear that the Listing Regulatory Committee will have *sole discretion* to issue in-principle approval for listing applications with suitability concerns. Yet a listing application will not be automatically referred to the Listing Regulatory

Committee simply because it features one or more of the factors featured in Guidance Letters on suitability for listing. Instead, the Listing Department will be responsible for deciding which listing applications have suitability concerns and should be referred to the Listing Regulatory Committee.

3.3 This discretion, without clear guidance on application, puts the Listing Department in a difficult position. For example, many issuers may have differing degrees of reliance on their controlling shareholders. Many issuers also have varying degrees of non-compliances. Whether these issues are so material that they become suitability concerns and therefore to be referred to the Listing Regulatory Committee is inherently subjective, and thus a difficult binary decision for the Listing Department to make. A decision to treat a listing application as having suitability concerns may result in a material extension to the transaction timetable; as a result, the Listing Department may be subject to lobbying from listing applicants not to treat an application as having suitability concerns. The Joint Consultation Paper also appears to suggest that an approval for listing granted by the Listing Committee may be invalid if it is determined after the fact that the listing applicant had suitability concerns. This is a serious consequence for a transaction, which magnifies the impact of the operational uncertainty.

3.4 Decisions to treat listing applications as having, or not having, suitability concerns will also need to be consistent and transparent. Unless such decisions are based on published criteria including reasons, this could be an area of the regulatory framework which listing applicants find unclear or arbitrary.

Separate comments of the SFC

3.5 The Joint Consultation Paper indicated that the SFC will no longer, as a matter of routine, issue separate sets of comments during reviews of listing applications. This is welcomed and will assist in streamlining the prospectus vetting process.

Increased complexity of the listing approval process

3.6 For listing applications which have been determined to have suitability concerns, the transaction timetable will be materially extended due to the need to have the listing application vetted by the Listing Department, then heard by the Listing Committee and subsequently by the Listing Regulatory Committee. Imposing an additional regulatory hurdle to any decision being made can only complicate, not simplify, the listing approval process.

3.7 Given the difficulty the Listing Department will face in identifying listing applications which have, or do not have, suitability concerns, it is not necessarily the case that the number of listing applications which will need to be approved by the Listing Regulatory Committee is going to be small. In that context, given its smaller membership and thus reduced ability to manage scheduling conflicts, will the Listing Regulatory Committee be readily available to meet and consider these listing applications?

3.8 In light of the above concerns, it is unclear why suitability concerns cannot be addressed by the Listing Committee. The benefits of a separate hearing by the Listing Regulatory Committee to consider suitability matters are not readily apparent and do not appear to justify an extension to the overall timetable for these listing applications.

4 Matters involving listed issuers

- 4.1** Our comments regarding listing applications by new applicants set out in section 3 above also apply to matters involving listed issuers. In particular, the loss of direct access to the views of the Listing Committee, and the uncertainty over whether or not a matter should be referred to the Listing Regulatory Committee, are also concerns in the context of decisions concerning listed issuers.

5 Reviews of listing decisions

Listing (Review) Committee

- 5.1** The Joint Consultation Paper proposes to replace the Listing (Review) Committee, comprising non-conflicted Listing Committee members who did not participate in the original listing decision, with the Listing Regulatory Committee as the body which will review decisions of the Listing Committee.

The Joint Consultation Paper suggests that persons responsible for reviewing decisions should be chosen based on experience and who is authoritative regarding the matter under review.

- 5.2** We agree it would be beneficial if members of the Listing Committee who are particularly authoritative on the relevant subject matter of a contested listing decision be identified to participate in the review body of the listing decision. However, this objective is not achieved through the Listing Regulatory Committee the membership of which is smaller and fixed. Indeed, having the ability to choose from the wider Listing Committee (which itself contains direct SFC representation) increases the likelihood of an expert in the relevant subject matter being identified. In that context, we believe it would be beneficial to retain the Listing (Review) Committee as the review body of the decisions of the Listing Committee, but to be more selective when identifying members of the Listing (Review) Committee to take into account the Listing Committee members' respective experience and expertise.

6 Oversight of the listing function

Decisions of the supervisory body must reflect currently acceptable standards in the market place

- 6.1** We are concerned that the Listing Policy Committee, in the form currently proposed in the Joint Consultation Paper, is not a body which will be in regular, direct contact with the market. This will make it less sensitive to the concerns of market participants. It will also lack the diverse views of the Listing Committee which would give it greater credibility and legitimacy. It is crucial that the supervisory body is one which, with the benefit of regular and direct contact with the market, can adequately reflect, set and impact the enforcement of currently acceptable standards in the market place.

Increased accountability

- 6.2** The Joint Consultation Paper commented that the Listing Department lacks sufficient accountability as it is supervised by a Listing Committee the members of which typically have outside professional commitments and are only available on a part-time basis.

Although we disagree with this criticism, even if it is accepted, it is unclear how accountability will be increased by moving the oversight function to the Listing Policy

Committee which will continue to comprise a mixture of Listing Committee members and full time Exchange and SFC staff. Ultimate responsibility and accountability for the Listing Department will remain shared between a number of bodies, potentially further blurring reporting lines and accountability, rather than enhancing it.

7 Publication of decisions

7.1 We support the proposal that the Listing Policy, Regulatory and Regulatory (Review) Committees publish reasons for all of its decisions as a matter of routine. Indeed, we suggest that this enhancement be extended, to a large extent, to decisions of the Listing Department and the Listing Committee (including a Listing Committee which contains direct SFC representation). As explained in section 1.4, we believe it is beneficial to the market that there be as much transparency as possible. We believe there is currently a market perception that certain Listing Department interpretations and practices are not publicised to the wider market and known only to those who have active dialogue with the Listing Department. Regular publication of decisions, for example waivers or exceptions, even if they are not for general application) will enhance transparency for the wider market. This will also encourage accountability as any inconsistencies in decision-making can be highlighted by the market.

7.2 We note the Listing Committee currently publishes an annual report detailing its work throughout the year, including policy proposals which have been considered during that year. We believe this practice should continue even if decision-making on policy matters is shifted to the Listing Policy Committee. If an annual report is to be published by the Listing Regulatory Committee, it will also be useful to the market if such report also includes the views of the Listing Committee to the extent they differ from those of the Listing Regulatory Committee.

8 Composition and procedures of the Listing Policy Committee, the Listing Regulatory Committee and the Listing Regulatory (Review) Committee

Independence of members of the Listing Policy, Regulatory and Regulatory (Review) Committees

8.1 If proposals for the Listing Policy, Regulatory and Regulatory (Review) Committees are adopted, it will be imperative that any potential or actual conflict of interest of members of such committees who are not full time SFC or Exchange staff is carefully managed. This is because, unlike a 28-member Listing Committee where conflicted members can be readily replaced, there will be much more limited ability to replace a conflicted member of the Listing Policy, Regulatory and Regulatory (Review) Committees.

The perception of conflict of interest of such members will also be heightened. Unlike a 28-member Listing Committee where the influence of individual members is subject to checks and balances, it will be much easier for a member of the Listing Policy, Regulatory and Regulatory (Review) Committees to influence outcomes.

As a result, we believe it is advisable that members of the Listing Policy, Regulatory and Regulatory (Review) Committees (other than full time representatives of the Exchange and the SFC) refrain from holding any concurrent active market-related office in order to avoid any actual or perceived conflict of interest.

9 Conclusion

- 9.1** We believe the guiding principle in reforming listing regulation in Hong Kong is that the relevant regulator and key decision-makers should be in regular and direct contact with the market. It is through this process that the regulator develops a sensitivity to the concerns of the market and gains universal credibility and legitimacy in the eyes of the market. Equally, it is through such regular and direct contact that the regulator is able to reflect, set and enforce acceptable standards in the market place.
- 9.2** In that context, we believe the most effective way of achieving the objectives of the Joint Consultation Paper is to introduce SFC representatives to the Listing Committee. Such a change will achieve the stated objectives of the Joint Consultation Paper of closer coordination and cooperation between the SFC and the Exchange, allow earlier and more direct input from the SFC on listing matters, simplify the process of IPO applications, and at the same time establish clearer accountability of the Exchange.
- 9.3** At the same time, such a change will retain the effectiveness of the Listing Committee, minimise operational uncertainty and timetable extensions to the listing process, and, most importantly, give the market confidence that the regulatory system is fair, efficient, orderly, transparent and competitive.
- 9.4** Other things being equal, this proposed change would increase the size of the Listing Committee (especially if the number of SFC representatives is large) but there is no reason why the number of other members of the Listing Committee could not be reduced to maintain a reasonable overall size of the Listing Committee.

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