

## **HKEX CONSULTATION PAPER**

“PROPOSALS TO INTRODUCE A PAPERLESS LISTING & SUBSCRIPTION REGIME, ONLINE DISPLAY OF DOCUMENTS AND REDUCTION OF THE TYPES OF DOCUMENTS ON DISPLAY”  
(JULY 2020)

### **JOINT SUBMISSION BY**

**Syren Johnstone**

*Executive Director of the LLM (Compliance & Regulation) Programme  
Faculty of Law, The University of Hong Kong*

and

**Frederick J. Long**

*Founding Managing Director  
Olympus Capital Asia*

### **Introductory remarks**

We congratulate HKEX on taking the initiative to seek a modernization of the process for new listing applicants, and to consult on proposals that would promote the transparency of the listed market by making information more accessible to investors and shareholders via the online medium.

For Hong Kong’s public offer practices to move forward on a sustainable basis it must do so on a legally firm footing. We are in principle strongly supportive of the HKEX’s initiative to modernize the listing process, facilitate electronic offerings and move the market away from environmentally wasteful practices, namely the bulk-printing of IPO prospectuses. However, we are concerned as to the utility of the proposals, which fall short of securing paperless outcomes because Hong Kong’s prospectus law remains unchanged. HKEX is of course unable to alter Hong Kong’s prospectus law; nor should HKEX be seen as seeking to subvert the law.

The failure of the MMO to cause a shift away from bulk-printing could be prognostic: there remains a possibility that the cultural preference for printed prospectuses could prevail. What is the evidence that the proposed changes to the Listing Rules are sufficient to alter entrenched practices? Listing applicants and underwriters may be reluctant to tamper with customary IPO practices that have proven successful if, as per our response to Question 1, they still have a choice to bulk-print when, commercially, environmental responsibility is typically a secondary consideration.

Moving the public offering and placement processes beyond the hybrid MMO solution would be a boon for the Hong Kong market if electronic methods capable of delivering greater efficiency were not merely accommodated but were actively incentivized. We believe that aligning established practices and continuing preferences with environmental aspirations may rely on regulators (HKEX and SFC) providing appropriate incentives to abandon the printed medium.

### **Questionnaire response**

Please find herewith our responses to the questions posed in the Consultation Paper. Our response to Question 1 is provided in an attachment owing to the length of the response.

We remain at your disposal should we be able to add clarification to any matter related to our Submission.

Syren Johnstone and Frederick J. Long  
01 September 2020

## Part B Consultation Questions

Please reply to the questions below that are raised in the Consultation Paper downloadable from the HKEX website at: <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/July-2020-Paperless-Listing/Consultation-Paper/cp202007.pdf>. Please indicate your preference by ticking the appropriate boxes.

Where there is insufficient space provided for your comments, please attach additional pages.

**We encourage you to read all of the following questions before responding.**

1. Do you agree with our proposal to amend the Listing Rules to require (i) all listing documents in a new listing (“**New Listing**”)<sup>1</sup> to be published solely in an online electronic format and cease printed form listing documents; and (ii) except for Mixed Media Offers<sup>2</sup>, all New Listing subscriptions, where applicable, to be made through online electronic channels only?

Yes

No

Please give reasons for your views.

The question as phrased is a compound question. We see no reason why the answer to both (i) and (ii) must be the same given that (i) solely concerns the Listing Rules whereas (ii) concerns subscriptions made in response to an offer governed by the applicable Ordinance.

As regards (i) our response is YES. In principle we support the proposal that all listing documents should be published solely in an online electronic format, subject to the caveats noted in paragraphs 12 to 21 of Attachment A - Response to Question 1.

As regards (ii) our response is NO. We are of the view that subscriptions should continue to be permitted in both electronic and paper-based form.

The reasons for our views are set out in Attachment A - Response to Question 1.

2. As a consequence of our proposal in Question 1, do you agree with our proposal to amend the Listing Rules to remove the requirement for listed issuers to make available physical copies of listing documents to the public at the address(es) set out in a formal notice?

<sup>1</sup> “New Listing” refers to an application for listing of equities (including stapled securities and depositary receipts), debt securities and collective investment schemes (“**CIS**”) on the Exchange by a new applicant where a listing document is required under the Listing Rules but excludes a Mixed Media Offer. For the purpose of the Consultation Paper, debt securities refer to debt securities (including debt issuance programmes) listed pursuant to chapters 22 to 36 of Main Board Listing Rules and chapters 26 to 29, 32 to 35 of GEM Listing Rules.

<sup>2</sup> “Mixed Media Offer” refers to an offer process whereby an issuer or a CIS offeror can distribute paper application forms for public offers of certain securities without a printed prospectus, so long as the prospectus is available on the HKEX website and the website of the issuer/CIS offeror and it makes printed prospectuses publicly available free of charge upon request at specified locations (which do not have to be the same locations as where the printed application forms are distributed).

Yes

No

Please give reasons for your views.

See our response in to Question 1 above, specifically, paragraph 7 of Attachment A - Response to Question 1.

The rule change should not spill over to imposing a prohibition on making physical copies available if the listing applicant so wishes for the reasons set out in paragraphs 12 to 21, and 23 of Attachment A - Response to Question 1.

3. Do you agree with our proposal to require issuers to only post documents<sup>3</sup> online on both the Exchange's e-Publication System and the issuer's website ("**Online Display Documents**") and to remove the requirement for their physical display?

Yes

No

Please give reasons for your views.

The reasons we have given in Question 1, specifically, paragraph 7 of Attachment A - Response to Question 1, applies equally to such documents posted by a listed issuer.

The rule change should not spill over to imposing a prohibition on making physical copies available if the listing applicant so wishes for the reasons set out in paragraphs 12 to 21, and 23 of Attachment A - Response to Question 1.

4. Do you agree that Online Display Documents should be displayed online for a specified period<sup>4</sup> except for those documents that are required by the Listing Rules to be made available on an ongoing basis?

Yes

No

Please give reasons for your views.

We assume this question is directed at the issue of whether documents displayed online may be removed following the expiry of the specified period.

We distinguish between (i) the time-limited display of such documents, which may or may not be available following the end of the specified period, and (ii) the continuing availability of such documents, which may be satisfied via appropriate archiving requirements.

We do not support a time-limited display of documents that may not subsequently be available. There appears to be no forceful reasoning given as to why all information that has been made publicly available should not be subjected to archiving requirements. Archived documents may serve as a source of valuable information to shareholders, investors and researchers long after their immediate relevance has faded.

For clarity, we agree that all document display requirements should be capable of being satisfied via an online display medium.

<sup>3</sup> Such documents are listed in Appendix I to the Consultation Paper, save for the changes proposed in respect of notifiable transactions and connected transactions as set out in Section G of the Consultation Paper.

<sup>4</sup> The time frames are set out in Appendix 1 to the Consultation Paper.

5. Do you agree that the Exchange should continue to allow redaction of Online Display Documents in only very limited circumstances?

Yes

No

Please give reasons for your views.

Increased accessibility of documents on display should be welcomed as an implementation of transparency principles. As such, this should not interact with the Exchange's redaction policy per se.

We note that listing documents in relation to IPOs are, save in relation to confidential filings such as issuers seeking a secondary listing in Hong Kong, in any event already available online following the submission of the Application Proof.

6. Do you agree that the current definition of “material contract” remains fit for purpose and that the Exchange should continue to apply it under our proposals?

Yes

No

Please give reasons for your views.

Increased accessibility of documents on display should be welcomed as an implementation of transparency principles. Accordingly, this should not, per se, be the cause of revising existing disclosure requirements relating to material contracts.

7. Do you agree that restrictions should not be placed on downloading and/or printing Online Display Documents?

Yes

No

Please give reasons for your views.

The listing rules should be enabling, not limiting, the access and maintenance of information, in whatever form members of the public may find useful.

8. Do you agree with our proposal not to put in place a system that would enable issuers to record and verify the identity of a person who accesses Online Display Documents?

Yes

No

Please give reasons for your views.

Information in a public market should be freely available without hurdles or requirements. It is difficult to see any benefit to the market by imposing identification requirements. Moreover, such a requirement may give rise to information asymmetries in the market in respect of persons exercising their right not to provide their personal data; this would be an undesirable outcome. In a public market, identity should not be tied to access to information.

9. In respect of a relevant notifiable transaction<sup>5</sup>, do you agree with our proposal to:
- i) require the issuer to display the contracts pertaining to the transaction only; and
  - ii) remove the requirement to display all material contracts entered into by the issuer within the last two years before the issue of the circular?

Yes

No

Please give reasons for your views.

Providing shareholders with all material contracts enables shareholders to obtain a more complete picture of the issuer's arrangements that may colour the way they approach the specific arrangement on which they are to vote. Removing this requirement creates the risk of shareholders attention being narrowly directed to contracts the issuer considers as "pertaining to" the transaction subject to shareholder approval. This creates potential opportunities for transparency abuse as shareholders impression of the scope and impact of the transaction on the issuer's business as a whole may be "recoloured" by selective disclosure.

To illustrate: a legal assessment of what contracts "pertain to" a notifiable transaction may yield a very narrow result; in contrast, a shareholder's perspective on what matters "pertain to" the total mix of information relevant to their voting decision may be significantly wider.

In the event the Exchange nevertheless proceeds with their proposal we would strongly recommend:

- (1) some sort of definition or guidance be provided as to what "pertaining to" is intended to encompass. We suggest a guidance letter would be appropriate having regard to the interests of shareholders and the total mix of information relevant to their voting decision;
- (2) the requirement be expanded from "contracts pertaining to", which ostensibly only covers legally binding contracts, to "arrangements pertaining to", which may cover other ancillary matters having a bearing on the transaction.

10. In respect of a connected transaction that is subject to the shareholders' approval requirement, do you agree with our proposal to:
- i) require the issuer to display the contracts pertaining to the transaction only; and

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<sup>5</sup> A relevant notifiable transaction refers to a major transaction, a very substantial disposal or a very substantial acquisition as defined in the Consultation Paper.

ii) remove the requirement to display contracts referred to in the circular and directors' service contracts<sup>6</sup>?

Yes

No

Please give reasons for your views.

The reasons are in essence the same as set out in Question 9 above. However, in the context of connected transactions we suggest there is a higher risk of abuse when determining what contracts are to be regarded as "pertaining to" the transactions. For this reason, there may also be a stronger case for expanding "contracts pertaining to" to "arrangements pertaining to".

- End -

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<sup>6</sup> Excluding contracts that are expiring or determinable by the employer within one year without payment of compensation (other than statutory compensation).

## ATTACHMENT A – RESPONSE TO QUESTION 1

**Question 1: Do you agree with our proposal to amend the Listing Rules to require (i) all listing documents in a New Listing to be published solely in an online electronic format and cease printed form listing documents; and (ii) except for MMOs, all New Listing subscriptions, where applicable, to be made through online electronic channels only? Please give reasons for your views.**

### Response to Question 1.

1. The question as phrased is a compound question. We see no reason why the answer to both (i) and (ii) must be the same given that (i) solely concerns the Listing Rules whereas (ii) concerns subscriptions made in response to an offer governed by the applicable Ordinance.
2. As regards proposal (i) our response is YES. In principle we support the proposal that all listing documents should be published solely in an online electronic format, subject to the caveats noted below.
3. As regards proposal (ii) our response is NO. We are of the view that subscriptions should continue to be permitted in both electronic and paper-based form.
4. The reasons for our views are set out below. While our discussion focusses exclusively on initial public offerings (IPO) that invoke the Companies (Winding-up and Miscellaneous Provisions) Ordinance (Cap. 32) (CWUMPO),<sup>1</sup> similar points may be made in relation to offers of other listed products including those governed by the Securities and Futures Ordinance (Cap. 571) (SFO) and codes issued by the Securities and Futures Commission (SFC).

**As regards (i), "all listing documents in a New Listing to be published solely in an online electronic format and cease printed form listing documents"**

5. Our response to proposal (i) is YES based on three compelling reasons in support of the HKEX's initiative, subject to the caveats set out further below.
6. *First: Desirability of modernizing the Hong Kong market.*
7. Modernization is necessary to keep Hong Kong up to date with international practices and expectations as regards sustainability objectives and market efficiency. A printing requirement is not in keeping with developments in international competitor markets that recognize publication of a prospectus in

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<sup>1</sup> I.e. the typical IPO structure in which the listing document is combined into a CWUMPO-compliant prospectus. This excludes listings by way of Introduction under MBLR 7.13 or GEMLR 10.17.

electronic form. This includes the United States<sup>2</sup> and the EU's Prospectus Directive<sup>3</sup> with which the UK complies. A printing requirement is not necessary to achieve regulatory objectives - the principle of access equals delivery is now widely accepted on the basis it is reasonable to assume in the current era that an investor in the listed market has access to the Internet. It is also consistent with the SFC and HKEX statement in 2008 that "we believe that our regulatory approach should concentrate on access as opposed to the medium of delivery".<sup>4</sup> It is suggested that in the Hong Kong context, the cost of servicing investors who do not have access to the Internet or do not have capability to read a document online via a requirement to print listing documents vastly outweighs any benefits achieved – such an investor may rely on either (a) an intermediary for advice, or (b) another person to print out the relevant materials from the Internet. Conversely, there seems to be no compelling argument to support maintaining a printing requirement.

8. *Second: Removal of ambiguity in the Listing Rules.*
9. The change would remove a lack of clarity in the Listing Rules (LR) as regards the need for the printed form, particularly LR 12.04(3), 12.07 and 12.11. This would facilitate listing applicants considering a fully electronic offering and subscription process without needing to obtain waivers from the Exchange (as was the case in Alibaba's secondary listing in November 2019).
10. *Third: Affirming HKEX as a global leader.*
11. The HKEX has demonstrated global leadership in advancing environmental practices and environmental disclosure. Continuing to impose a printing requirement would be inconsistent with HKEX's leadership in this regard. Listing documents combined into CWUMPO-compliant IPO prospectuses annually consume more than 750 tonnes of paper, forests covering land equivalent to 10 football pitches, and water equivalent to 28 Olympic sized swimming pools (source: see the authors' article, "Alibaba, HKEX & ESG: missed leadership opportunities", International Financial Law Review, 10 December 2019 - provided here as Attachment A-2). Per a 2007 survey by the SFC, around two-thirds of paper-based prospectuses were not taken up by retail investors.<sup>5</sup>

#### Caveats

12. *Caveat One: The proposal synchronizes poorly with the law.*

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<sup>2</sup> Rule 172 issued by the U.S. Securities and Exchange Commission. See SEC International Series Release No. 1294.

<sup>3</sup> Specifically, Article 14(2) of Directive 2003/71/EC and Art. 6 of Commission Delegated Regulation (EU) 2016/301.

<sup>4</sup> Paragraph 21, "Joint Consultation Paper on the Proposal to allow a Companies Ordinance (CO) Offeror to issue a CO Paper Application Form for Shares in or Debentures of a Company to be listed on SEHK, and a Collective Investment Scheme (CIS) Offeror to supply a CIS Paper Application Form for Interests in an SFC-authorized CIS to be listed on SEHK, with a Listing Document Displayed on Certain Websites", April 2008.

<sup>5</sup> Paragraph 15 of the SFC/SEHK Joint Consultation Paper in April 2008.

13. Changes made by the HKEX concerning the listing document does not affect the law relating to public offer prospectuses. Imposing a requirement in the Listing Rules to publish a listing document "solely in an online environment and cease printed form" has no bearing on the provisions of CWUMPO, which is silent, i.e. permissive as to the medium of a prospectus or application form,<sup>6</sup> save for the prohibition provided for in sections 38(3) and 342(3) of CWUMPO. Accordingly, listing applicants would in theory remain free to bulk-print a CWUMPO-compliant prospectus under CWUMPO and submit an online listing document to the Exchange. Such an outcome would be patently absurd insofar as it frustrates the intent of the HKEX proposal.
14. *Caveat Two: The utility of the proposal is open to doubt.*
15. Previous attempts to influence new listing applicants towards more environmentally responsible behaviour - namely the introduction of the Mixed Media Offer (MMO) in 2010 - have not been successful in shifting IPOs to electronic prospectuses. There may be numerous reasons for this.
16. In our view, the failure may be less to do with the availability of the legal and regulatory certainty provided by the MMO and more as a consequence of a cultural preference for printed prospectuses - listing applicants and underwriters may be reluctant to tamper with customary IPO practices that have proven successful in the past. IPO applications are also highly process-driven and conservatism, including among legal counsel needing to sign off on the offering arrangements, may mean that tried and trusted methods are difficult to disrupt. One might therefore reasonably query whether removing any ambiguities present in the Listing Rules as regards the need for the printed form<sup>7</sup> is a sufficient step to alter behaviour in practice.
17. To rephrase the above: is there sufficient evidence that listing applicants will prefer electronic-only prospectuses and applications and only balk at pursuing that path in view of the Listing Rule ambiguities, or are there other customary or market practice elements at work that may inhibit change?
18. *Caveat Three: The validity of the proposal, ostensibly regarding listing documents, could be open to doubt as regards its intent.*
19. The remit of the Listing Rules is defined by the Exchange's powers, as set out in the SFO, to make rules for the listing of securities. The Listing Rules are non-statutory and operate by way of contract between the Exchange and the listing applicant/issuer. The proposed rule change, while ostensibly directed at listing documents, could be construed as an attempt to impose, via contract law, controls

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<sup>6</sup> That CWUMPO does not itself require a prospectus to be printed is uncontroversial. As noted elsewhere (see Attachment A-1) the regulators appear to have already de facto accepted that CWUMPO (nor the listing rules) does not require application forms to be printed where the prospectus is in electronic form. Evidence of this is seen in the listing document cum prospectus for Alibaba's secondary listing in November 2019 in which there is no mention of a waiver being necessary in respect of the application form being paperless.

<sup>7</sup> Such as those which were found commercially desirable to obtain waivers from in Alibaba's secondary listing in November 2019 (namely, LR 12.04(3), 12.07 and 12.11).

on what is legally permitted under CWUMPO in relation to prospectuses. If so, this may create problems for the SFC to approve the rule change having regard to its statutory responsibilities.

20. *Caveat Four: The proposal goes beyond competitor markets.*
21. The approach taken in the U.S. market and the EU Directive is to recognize electronic prospectuses. This facilitates practices that are aligned with market efficiency and environmental objectives. However, they do not seek to prohibit the printed medium. In contrast, the HKEX proposals go beyond merely seeking to remove ambiguity from the Listing Rules and seek to establish a listing regime in which the printed listing document is not recognized as an acceptable medium. We query whether this is either necessary to achieve the stated objective.

#### Conclusions on (i)

22. We believe there is nothing wrong with the HKEX demonstrating leadership - leadership in environmental matters and market efficiency makes a great deal of sense for the Hong Kong market in the long term. However, leadership must be pursued on a firm legal footing, with good reason, and with a predictable outcome. The above caveats have raised issues that HKEX should address before considering whether to move forward with its proposals.
23. We suggest a better and firmer first step is for the Exchange to facilitate electronic listing documents cum prospectuses by making relatively simple clarifications in the Listing Rules to remove perceived ambiguities rather than seeking to "outlaw" printed listing documents.
24. As regards possible subsequent steps, we believe that if endemic cultural practices and preferences are to be re-aligned with Hong Kong's environmental aspirations, in the absence of a change in the permissive and media-neutral laws currently enjoyed by Hong Kong, regulators will need to be more proactive to promote paperless offerings. There are various ways this might be addressed by the HKEX,<sup>8</sup> or the coordinated efforts of the SFC and HKEX, such as via new requirements on sponsors.<sup>9</sup> Any such requirements would need to avoid being an attempt to circumvent the permissive provisions of CWUMPO and instead focus on imposing on listing applicants and sponsors a more transparent public responsibility as regards the medium of prospectus delivery.
25. In sum, we suggest that incentives will work better to change cultural habits than attempts to prohibit, unless a change in the law is implemented.

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<sup>8</sup> The listing application process might provide for incentives for not bulk-printing. A listing applicant that wished to bulk-print might be required to provide ahead of the Listing Committee hearing an explanation for bulk-printing which would form part of the disclosures in the listing document.

<sup>9</sup> Via Chapter 3A of the Listing Rules and/or paragraph 17 of the Code of Conduct for Persons Licensed by or Registered with the SFC. For example: in relation to advising the listing applicant on the medium of delivery; changes to the sponsor's declaration in LR Appendix 19.

**As regards (ii), "except for MMOs, all New Listing subscriptions, where applicable, to be made through online electronic channels only"**

26. Our response to proposal (ii) is NO based on two concerns.
27. *First: Sections 38(3) and 342(3) of CWUMPO cannot be read in reverse.*
28. The provisions in sections 38(3) and 342(3) of CWUMPO prohibit the form of application being issued otherwise than being "issued with a prospectus", not the other way around. Thus, even if the proposed rule change was valid and effective, it would not affect the operation of CWUMPO as regards prospectuses, which may be issued without a form of application (see *Caveat One* above). This gives rise to further ambiguities in a market that seeks clarity: for example, would a listing applicant with an electronic listing document cum prospectus and a bulk-printed prospectus be able to undertake an electronic only subscription process? It would seem so. While this would satisfy the efficiency aspect of modernizing the offer and subscription process it would not change environmentally damaging behaviour.
29. *Second: The proposal lacks relevant evidence.*
30. It would be premature to shift to an electronic-only subscription system before the position of retail investors and receiving banks is fully considered. The HKEX have not provided information concerning the number of retail investors who do or do not have access to electronic facilities that would enable them to participate in an IPO that only permitted electronic subscription. It would be highly desirable from the point of view of prevailing social policy to clearly understand how access might be distributed across various population demographics such as age, socio-economic status, or geographically. It is also necessary to consider the impact on banks participating as a receiving bank in an IPO. While the response of banks to the HKEX Consultation will be of considerable interest in this regard, there is a risk that such a shift may create competition among banks based around the characteristics of their customer base and how the bank serves them. This may result in some banks and their customer base being, depending on how one wants to look at it, either cut-out or left behind.

Conclusions on (ii)

31. We believe that at the present point in time, and pending further information on the state of readiness of the market, new listing applicants should, together with their sponsor(s) and other parties typically involved in an IPO, be at liberty to decide what mechanism to use to obtain subscriptions, which may be electronic-only, paper-based only, or both in tandem.

Features Regulatory &amp; Compliance | January 2020

## Hong Kong's Paperless Prospectus Law



With limited exceptions, companies seeking a listing for their equity shares in Hong Kong will normally also engage in a public offering that invokes the prospectus provisions of the Companies (Winding-up and Miscellaneous Provisions) Ordinance (Cap. 32) (CWUMPO). In addition to the requirements of the CWUMPO, it will be necessary to comply with the non-statutory listing rules of The Stock Exchange of Hong Kong Limited (SEHK), which require a listing document to be produced - this will be combined with the CWUMPO-compliant prospectus into a single document (together, the prospectus). While the prospectus is typically produced in a physical print run of around three to five thousand copies that are made available at banks and other financial services providers, Alibaba's recent secondary listing (26 November 2019) and public offer was achieved on a paperless basis – the prospectus and the application forms were only made available electronically.

As a wholly paperless public offering is a first for the Hong Kong market, this article explores the underlying legal and regulatory requirements and considers whether Hong Kong must remain wedded to paper when competitor markets are not. It queries the necessity of the waivers obtained by Alibaba to go paperless and suggests that that regulatory clarity - and regulator proaction - is required to facilitate Hong Kong more clearly moving forward to a paperless system that reflects the modernisation of public offering and placement processes. This has become essential in view of developments internationally, commercial and environmental considerations, and local realities.

### The Legal Requirements

Parts II and XII of the CWUMPO set out the requirements for the prospectus, the former being concerned with Hong Kong incorporated companies and the latter being concerned with all other companies. Both are in substance identical in the relevant regards and are concerned with the act to have "issued" or to "issue" a prospectus that complies with the relevant dating and other content requirements (ss. 38 and 342(1) CWUMPO – the latter also referring to "circulate or distribute"). The defined term "prospectus" in s. 2(1) CWUMPO refers to "prospectus, notice, circular, brochure, advertisement, or other document" and to "a publication". Sections 39A and 39B CWUMPO contemplate that a prospectus may consist of more than one "document" and s. 41A CWUMPO contemplates the incorporation in a prospectus of statements made in "any report or memorandum".

As the foregoing quoted phrases are not further defined in the CWUMPO, it is a question of statutory interpretation as to whether they require a prospectus to be in a physically printed medium. It is well established law “that the language of a statutory provision is to be construed having regard to its context and purpose” (per Mr Justice Fok PJ in *Pacific Sun Advisors Ltd v Securities and Futures Commission* [2015] HKCFA 27, [34]), and that statutory language is to bear its “natural and ordinary meaning unless the context or purpose points to a different meaning” (per Li CJ in *HKSAR v Cheung Kwun Yin* (2009) 12 HKCFAR 568, [12]). Reflecting this purposive approach, s. 19 of the Interpretation and General Clauses Ordinance (Cap. 1) (IGCO) provides that Ordinances of Hong Kong, including CWUMPO, “shall be deemed to be remedial and shall receive such fair, large and liberal construction and interpretation as will best ensure the attainment of the object of the Ordinance according to its true intent, meaning and spirit.”

The origins of the CWUMPO sit at a time when paper was the only way of issuing a prospectus. However, legislation is intended to be flexible to achieve statutory objectives, which in the case of CWUMPO concerns the protection of investors via disclosures that give rise to legal means of redress for mis-disclosure, which are provided for in ss. 40, 40A, 342E and 342F CWUMPO, as well as an orderly system for the registration of prospectuses. Viewed from today's perspective, paper is far from being necessary to achieve these objectives. It may also be noted that the definitions of “document” and “publication” in s. 3 IGCO indicates considerable breadth and flexibility as to the medium in which matters may be written and published, including by electronic means.

While these considerations point to there being no requirement for a paper-based prospectus, it is also necessary to consider the means by which persons can apply for shares in a public offer, which has traditionally been by way of a printed application form that is distributed with the printed prospectus. Sections 38(3) and 342(3) CWUMPO both refer to a “form of application” that may only be “issued with” the prospectus. This had in practice been interpreted as requiring a printed application form to accompany a printed prospectus. The introduction in 2010 of s. 9A of the Companies (Exemption of Companies and Prospectuses from Compliance with Provisions) Notice (Cap. 32L) (s. 9A) permitted a public offering in connection with a listing to use paper application forms and an electronic prospectus, subject to compliance with the requirements set out in s. 9A thereof (normally referred to as a Mixed Media Offering or MMO).

However, Alibaba's offering was not an MMO conducted under s. 9A - its electronic prospectus was accompanied by a wholly electronic application process. While Alibaba's prospectus sets out the various waivers obtained, they did not include any waiver from the provisions of CWUMPO concerning the application forms. The process of statutory interpretation discussed above in relation to prospectuses is equally applicable to application forms, particularly in view of the Electronic Transactions Ordinance (Cap. 553) (ETO) which allows binding contracts to be formed electronically. Indeed, the Securities and Futures Commission (SFC) and SEHK have previously expressed the view that CWUMPO is not concerned with the medium used to issue either a prospectus or an application form (paragraph 8 of their Joint Consultation Paper April 2008), and this now seems to be de facto accepted by the two regulators in practice.

The final matter to consider is the prospectus authorisation and registration requirements, which present slightly different issues from those discussed above. Sections 38D(3) and 342C(3) CWUMPO require an application for authorisation to be made “in writing” and contemplates the registration of a “copy of the prospectus” which has been signed or certified (s.3 IGCO defines “writing” to include any mode of representing words in a visible form; IGCO does not define “copy” but does contemplate a copy of an electronic publication). Section 39C CWUMPO requires “a true copy of the document” to be certified (by a director or company secretary of the company or their authorised agent, a solicitor, a certified public accountant, or notary public) and submitted to the Registrar of Companies. There is no guidance in CWUMPO or IGCO on the certification or other requirements, however, the ETO does provide for electronic certification. It is understood that the Registrar of Companies required paper copies of the Alibaba prospectus and, while the legal necessity of this may be debatable, s. 38D(7)(a)(iv) & (7A)(b)(ii) CWUMPO empowers the Registrar to set requirements, including for the purpose of “enabling the Registrar to make copies or image records of documents and to make and keep records of the information contained in them.” The small number of printed copies required by the Registrar does not at this stage appear to warrant concern and having a paper-based record may well be prudent.

## The Regulatory Requirements

Similar to the position under the law, the SEHK's listing rules (LR) do not expressly provide for paper-based requirements. LR 2.07A provides that the electronic format is capable of satisfying any specific LR requirement for a printed form, however, that is limited to corporate communications made by listed issuers to holders of its securities,

and so does not apply to listing applicants. Various requirements of the listing rules concerning the SEHK's procedural requirements specify printed copies of the prospectus to be lodged with the SEHK, such as those related to the SEHK's power to authorise prospectuses (LR 9.11(33)(b) and 11A.08).

In contrast to the foregoing requirements that specifically refer to the printed form the rules contemplating availability of the prospectus to the public do not. This includes LR 12.04(3) concerning "the address(es) at which copies of the listing document (if any) are available to the public", and LR 12.07 which requires that "the issuer must make sufficient copies of the listing document available to the public". On the other hand, LR 12.11 provides that "Listing documents published by a new applicant must include copies available in printed form".

Unlike the statutory interpretation process discussed above, as non-statutory regulations the interpretation process is internally governed by LR 1.06 and 2A.02 which provide that the listing rules are to be interpreted by the SEHK, ie the Listing Division and the Listing Committee. It is nevertheless relevant to recall that the power to make the listing rules derives from the Securities and Futures Ordinance (Cap. 571) (SFO) which grants rule making power "for the proper regulation and efficient operation of the market which it operates" and in relation to "applications for the listing of securities and the requirements to be met before securities may be listed" (s. 23(1)(a) and (2)(a) SFO). The listing rules themselves state the principal function of the SEHK "is to provide a fair, orderly and efficient market for the trading of securities" and that the listing rules have been made in furtherance of this function (LR 2.01). Such provisions do place boundaries on how the relevant listing rules may be properly interpreted.

### **The Waivers Alibaba Obtained**

The Alibaba prospectus states it obtained waivers from strict compliance with LR 12.04(3), 12.07 and 12.11 in respect of the "availability of copies of the prospectus in printed form" (pages 133 and 150). While the implication is that a printed prospectus would have been required in the absence of such waivers, uncertainties remain.

First, there is no mention of a waiver being necessary in respect of the application form being paperless. This appears to indicate the regulators have, as suggested above, de facto accepted that CWUMPO does not require application forms to be printed (nor do the listing rules), at least where the prospectus is in electronic form.

Second, it is less clear how the statutory phrase "issued with", discussed above, should be properly understood. The Alibaba prospectus, which was available on the websites of HKEX and Alibaba, states (page 412) the application form was available at other, independently operated, websites. Given that the Internet is not a singular, undifferentiated space, "issued with" appears to have been given a more liberal or functional interpretation that did not necessitate any exemption being granted (under s. 38A CWUMPO) from the requirement - perhaps along the lines of "readily available at the same time as" (compare Rule 172, discussed below). If so, this would appear to render the format-dependent basis of s. 9A redundant.

Third, LR 12.04(3) and 12.07 are primarily concerned with availability of the listing document. It would seem a stretch to interpret the requirement in LR 12.11 that a prospectus must be "available in printed form" as mandating a printed copy of the listing document to be made widely available to every person considering applying for shares. Moreover, LR 12.11A(2), which applies to an MMO employing an electronic prospectus, only provides for an amendment to LR 12.04(3), suggesting that LR 12.07 and 12.11 do not mandate printed prospectuses being made widely available (ie, where this is not required under the law). The amending provisions of LR 12.11A(2)(d) & (f) concerning access to a printed prospectus reflect s. 9A (3)(b) & (c) (Cap. 32L). Indeed, it would be odd, and possibly ultra vires the powers of the SEHK's rule-making power under s. 23 SFO (and beyond LR 2.01), to make a listing rule mandating printed prospectuses in connection with a public offer where the governing statute did not require it – here the SEHK's rule-making powers would appear to be confined to the listing document rather than the prospectus per se.

Finally, the waivers appear to have been obtained "based on the specific and prevailing circumstances of the Company" without further elaboration (Alibaba prospectus, page 150).

Alibaba would understandably need commercial certainty they are complying with the listing rules. However, the foregoing considerations raise doubt over whether the waivers were strictly necessary and create uncertainty as to what "issued with" now requires. It is suggested that the regulators should make the position clear to the market, particularly in view of developments internationally, environmental considerations, and local realities, as discussed next.

### **The Bigger Picture: Sustainable Stock Exchange Practices**

Hong Kong's main competitor markets internationally have made the position on electronic public offerings clear. Over a decade ago, the U.S. Securities and Exchange Commission recognised "the need to modernise the [prospectus delivery] obligations in view of technological and market structure developments" (SEC International Series Release No. 1294; square brackets added for clarity). It introduced Rule 172 to reflect an "access equals delivery" model for prospectuses in which investors are presumed to have access to the Internet. The UK complies with the EU's Prospectus Directive, which permits a prospectus to be delivered in electronic only form provided it is easily accessible, searchable, downloadable and printable (Art. 6, Commission Delegated Regulation (EU) 2016/301).

To this may be added environmental concerns. It has been estimated that in a typical year in Hong Kong, around 750 tonnes of paper are used in printing IPO prospectuses, consuming around 10 football pitches of forest land and water equivalent to 28 Olympic sized swimming pools ("Alibaba, HKEX & ESG: missed leadership opportunities", International Financial Law Review, 10 December 2019). The extent of avoidable environmental waste is more disturbing when one considers that, per a 2007 survey by the SFC, around two-thirds of paper-based prospectuses were not taken up by retail investors (para 15 of the SFC/SEHK Joint Consultation Paper April 2008).

The incongruity here is that Hong Kong's regulators have been at the forefront of environmental initiatives. The SFC has actively supported positioning Hong Kong as an international green finance centre. The SEHK has, as a signatory to the United Nation's Sustainable Stock Exchanges Initiative (SSE) commitment letter, shown global leadership in terms of developing the listing rules toward sustainability objectives as compared to peer signatory markets such as NYSE, Nasdaq and LSE. Stock exchanges in particular must assess themselves under the same lens that they apply to those issuers that utilise their resources. Despite these considerations, more than 95 percent of Hong Kong IPOs continue to print prospectuses.

Hong Kong must modernise its public offering and placement processes beyond MMOs to accommodate electronic methods capable of delivering greater efficiency. If practices are to be aligned with environmental aspirations, regulators will need to be more proactive to clarify and promote paperless offerings. Doing so would send a strong signal to the global market.



## Syren Johnstone

Syren Johnstone is the Executive Director of the LLM (Compliance & Regulation) Programme at the University of Hong Kong and a Director of Keel Consulting. He has undertaken senior management roles regulated by the SFC and The Stock Exchange of Hong Kong, been engaged for expert work by Hong Kong's statutory regulators, and has been an influential voice in shaping high profile regulatory matters that have been referenced in LegCo and the Court of Appeal. He is a member of the SFC's Fintech Advisory Group since its 2016 formation.



## Frederick J. Long

### Founding Managing Director, Olympus Capital Asia

Frederick Long is a Founding Managing Director of Olympus Capital Asia, an Asia-dedicated private equity firm. Since inception, Olympus has invested US\$2.5 billion in more than 50 Asian companies. In 2009, he spearheaded an initiative by Olympus to invest in sustainability-related companies. This led to the formation of Asia Environmental Partners (AEP), a fund program which has invested US\$600 million in renewable energy, water services, and circular economy and sustainability solutions. Long holds an MBA degree from the Stanford Graduate School of Business and an AB degree from Brown University.



CAPITAL MARKETS  
ALIBABA, HKEX & ESG

# Missed leadership opportunities

To meet rising investor expectations, Alibaba and HKEX must both provide roadmaps to deeper engagement with environmental, social and governance issues

Alibaba Group's secondary listing on the Hong Kong Stock Exchange (HKEX) on November 26 2019, raising over \$11 billion (around 2.3% of Alibaba's market cap), represents the most significant offering on the bourse this decade. It opens up an important pathway for Chinese issuers listed in New York and London who may now be looking to Hong Kong SAR as a venue for tapping into pools of Chinese capital. However, the high-profile listing also raises important questions related to environmental, social and governance (ESG) concerns.

As a central actor in the internet economy, Alibaba's ESG disclosures and the HKEX's disclosure requirements applying to new listings deserve closer scrutiny. It is suggested that both fall short of legitimate investor expectations. As HKEX's first wholly electronic prospectus, the Alibaba offering returns the market to the question of whether printed prospectuses remain justifiable in an era of electronic connectivity and heightened awareness of environment concerns.

Following HKEX's rejection of Alibaba in 2014 because of its weighted voting rights (WVR) shareholding structure, the secondary listing now represents the third company with WVR to be admitted to the exchange's relatively new listing regime for WVR companies, which was introduced in April 2018. Alibaba's subsidiary, Alibaba.com, had previously been listed in Hong Kong SAR in 2007, until it was privatised in 2012.

It is also the first company with WVR to list following a change to the southbound Stock Connect Scheme, which now allows the stock of eligible WVR companies to be traded. Stock Connect is an important consideration for a mainland China enterprise choosing to list on the HKEX because it permits investors in mainland China to participate in the Hong Kong market via their local brokers. WVR stock trading was previously banned on the basis that WVR structures are not permitted on the Shanghai or Shenzhen exchanges, and that it presents investor risks.

While it is widely expected that Alibaba's shares will eventually be traded via Stock Connect, the situation is at present unclear as the WVR eligibility rules are relatively new.

## 1 MINUTE READ

Alibaba's secondary listing on HKEX represents a significant milestone for the bourse, and for Chinese issuers listed in New York and London. But it also represents missed opportunities and raises questions about the pace of ESG reform in Hong Kong SAR. Alibaba's ESG disclosures reveal concerns about corporate practices and the adequacy of exchange disclosure rules. The fact it is the HKEX's first wholly electronic offering begs the question why environmentally damaging printed prospectuses are still being used.

## A milestone for all Greater China issuers

Until recently, the joint policy of the HKEX and SFC [Securities and Futures Commission] had been that companies with a centre of gravity in China (Greater China entities) which were already listed on a foreign exchange – typically the New York Stock Exchange or Nasdaq – would not be allowed to take out a secondary listing. The stated objective of the restriction was to avoid regulatory arbitrage. A consequence of the introduction of the Stock Connect Scheme in November 2014 was that the joint policy effectively prevented foreign-listed Greater China entities from accessing mainland China capital via the HKEX.

Alibaba's secondary listing is a milestone as it is the first Greater China entity to obtain a secondary listing in Hong Kong SAR following the introduction of Chapter 19C of the listing rules. As such it paves the way for qualifying innovative Chinese companies listed on the NYSE, Nasdaq, or the main market of the London Stock Exchange to seek a secondary listing on the HKEX.

## Tree-free prospectuses

In a typical year in Hong Kong SAR, over 750 tonnes of paper are consumed in printing IPO prospectuses. That paper production equates to more than 10 football pitches of forest land and consumes around 70 megalitres of water (28 Olympic size swimming pools). Yet these figures are conservative when one considers the other paper-based offering documents used in the public capital market.

That Alibaba's prospectus, which is entirely electronic, is the first public offering in a HKEX listing *sans* a major print-run of prospectuses might come as a surprise to international readers. While this is the second notable feature of Alibaba's listing, it is premature to regard it as a milestone. The prospectus suggests it was necessary to obtain a waiver from strict compliance with provisions requiring copies of the prospectus in printed form (page 133).

There is nothing in Hong Kong SAR's prospectus law that requires a prospectus to be produced as a paper-based document. The law merely refers to concepts such as publication and distribution, and the usual process of statutory interpretation suggests nothing that would demand a prospectus to be printed on paper in order to fulfil the purposes of the statute. Indeed, the waiver obtained is from

HKEX's non-statutory listing rules, which require copies of listing documents to be 'available in printed form'.

While the prospectus makes it clear that it can be downloaded and printed, this somewhat vague listing rule appears to be interpreted by the regulators as if it mandates a printed copy of the prospectus to be made widely available to the investing public. The other waived provisions of the listing rules do not refer to printed documents, but are concerned with ensuring adequate accessibility.

The US and the UK, both competitor markets for Hong Kong SAR, allow wholly electronic public offerings (ePO). In 2005 the US moved to an access-equals-delivery model for prospectuses, in which investors are presumed to have access to the internet. When implementing Rule 172, the US SEC specifically recognised 'the need to modernize the [prospectus delivery] obligations in view of technological and market structure developments'.

The UK complies with the EU's Prospectus Directive, which also permits a prospectus to be delivered in electronic-only form, provided it is easily accessible, searchable, downloadable and printable (Art. 6, Commission Delegated Regulation (EU) 2016/301).

Hong Kong SAR has not been entirely devoid of progress. Emphasis on access (over means of delivery) was reflected in the SFC/HKEX 2008 consultation paper for mixed media offerings. The concept of an ePO has been in place since at least April 2003, however, this is generally understood as only applying to the components of a traditional paper-based offering that take place over the internet.

Despite these developments, prior to Alibaba there has been no other indication of a shift away from producing tree-guzzling prospectuses. The jurisdiction's relatively high retail investor composition (compared to other international markets) is sometimes cited as a relevant consideration. To what extent the Alibaba ePO will set a precedent is not known, but the market will now be looking to the regulators to make the position clear for other companies.

The question left on the table is whether any potential damage done to the investing retail public in an ePO is outweighed by the environmental damage incurred under a paper-based prospectus regime. Failing to pave the way for a waiver-free ePO option may render Hong Kong SAR not only less competitive – printing prospectuses is another cost burden – but also environmentally out of date.

## Shortcomings in listing disclosure requirements

As noted above, qualifying Greater China entities listed on the NYSE, Nasdaq or LSE are eligible to apply for a secondary listing in Hong Kong SAR. Although all four exchanges have signed up to the UN's Sustainable Stock Exchanges Initiative (SSE) commitment letter, the landscape for ESG disclosures varies across each exchange. Only the listing rules for HKEX and LSE subject issuers to ESG disclosure requirements, in each case on a comply-or-explain and recommended disclosures approach – an enlightened approach in the context of global exchanges. In Hong Kong SAR these are expected to be strengthened with the addition of mandatory disclosure requirements (per HKEX's consultation paper in May 2019). In the UK, amendments to the Companies Act have, since October 2013, required ESG matters to be covered in the directors' strategic report. This includes information about environmental matters, employees, and social, community and human rights issues. The NYSE and Nasdaq both only provide ESG-related training, although Nasdaq has committed to publishing guidance on ESG reporting.

The HKEX's listing rules do, however, come with an ESG disclosure gap: the ESG disclosure obligations that apply to listed issuers do not apply to listing applicants, who are not required to make ESG disclosures. While Alibaba may be congratulated for volunteering ESG disclosures, they fall well short of the disclosures the company will be required to make annually as a listed issuer pursuant to Appendix 27 of HKEX's listing rules. This includes: identification and statement of board responsibility for ESG matters, enunciation of ESG strategy and how it relates to the company's business, determination of materiality of specific ESG issues for business operations, key performance indicators, and identifying specific environmental and social categories that the company tracks and reports.

None of the four exchanges have as yet recognised that the absence of ESG disclosures in an offering document denies investors the opportunity to gain insights about a company's ESG practices at the time of listing. How the company, once listed, will be positioned to comply with ESG disclosure requirements and expectations of investors is unknown. In the case of Alibaba, because it is not subject to ESG disclosure requirements under its NYSE listing, investors in the secondary listing have no information beyond its voluntary disclosures.

This amounts to an inexplicable gap for exchanges (HKEX and LSE) where listed issuers are subject to ESG disclosure obligations.

Setting the tone of an issuer's ESG practices from the outset is arguably more likely to foster higher standards of real compliance. Analysis by Grant Thornton in 2015 and 2016 of corporate governance practices in the UK suggests that it takes around four years for a majority of newly-listed issuers to begin to address the underlying intent of the new provisions applicable to them. In the interim, the issuer engages in box-ticking.

As such, there is a strong argument that ESG compliance would be fostered by requiring a listing applicant to disclose its current ESG practices, and how these will be developed in view of listing rule requirements that will apply following its listing. This should be seen as part and parcel of getting a company prepared for life as a listed issuer, much as other elements of a company's management and internal controls are. A similar argument has been made, in relation to corporate governance, in recommendation C4.7.1 of HKICPA's Report on Improving Corporate Governance in Hong Kong of December 2017.

## The quality of Alibaba's ESG disclosures

One of Alibaba's core strategies, reflected in its use of proceeds statement, is to 'facilitate digital transformation and improve operational efficiency' (page 391 of the prospectus). The company appears attentive to 'acting in a socially responsible way' (page 216), including environmentally. The prospectus specifically references: Alibaba's poverty relief programme, efficiencies brought about via cloud computing, Cainiao's green packages and green delivery initiatives, and inclusive financial services initiatives provided by its related party Ant Financial (pages 209, 216-218).

Such disclosures indicate the power of Alibaba's infrastructure to create potentially strong linkages between its business model and sustainable development principles. The positive intent that management is capable of bringing to social objectives is of particular relevance given that Alibaba is one of the world's 10 most valuable companies by market cap.

However, disclosures in the prospectus provide no specific metrics about the scale of such commitments, nor the resulting beneficial outcomes. Alibaba's first ESG report issued for the US market in 2018 provided only

marginally more information. For example, while initiatives in cloud computing can be seen as environmentally beneficial in reducing individual companies' on-site equipment, there is no indication of whether this has been benchmarked against industry norms, even while other technology companies such as Google have attempted to do so across their entire operations.

When examined more closely, disclosures in the prospectus provide scant information on matters that a discerning investor might want to know. Ten such matters, typically of concern to investors, include:

- Does Alibaba have a clear policy and system of accountability for ESG stewardship that identifies who at Alibaba is responsible for ESG strategy, evaluation and reporting, and which provides for dedicated human resources for implementing these initiatives?
- Are examples such as innovative water cooling to reduce energy consumption merely demonstration projects, or do they represent companywide commitments?
- What are Alibaba's contributions to greenhouse gas emissions?
- Given Alibaba's significant involvement in logistics, packaging, and delivery systems for a wide range of products, is Alibaba able to assess the scale of its transport and packaging footprint, and design metrics for improvement?
- How does Alibaba source power, especially for its power-intensive cloud computing activities, and is there a renewable energy target or programme?
- Are there other key discharge issues, including generation of hazardous waste, or requirements pertaining to water access and use?
- How does Alibaba address ESG concerns in managing its diversified supply chain?
- How do employment and labour practices meet or exceed local or international best practice standards?
- What are worker safety/accident metrics?
- How does Alibaba intend to respond to its ESG obligations under Appendix 27 of the HKEX listing rules – does it intend to comply or to explain?

Investors might also ask whether Alibaba and industry peers have established guidelines for ESG performance, and if and how they benchmark with competitors. It may be too lofty a comparison (and unfair to expect Alibaba to implement similar so-called beyond compliance measures), but looking at Google's ESG reporting there are notable differences.

Google: maintains design efficiency and sustainability standards for all of its data centres; uses machine learning to operate the data centres to optimise energy use and reduce impact; matches its electricity consumption 100% by purchases of renewable energy; commits to re-use of components for machine upgrades; and seeks to design worker environments for health and wellbeing.

## Leadership, from where?

Globally, investors are demanding more information on the ESG profile of a company. It is now widely accepted that how issuers manage ESG risks goes beyond questions of reputation or social responsibility, and can present risks to the financial condition or sustainability of the company.

As one of the world's leading technology players, one might ask why Alibaba did not choose to provide a more comprehensive roadmap of its ESG responsibilities and group-wide strategy to demonstrate ESG leadership. As such, Alibaba missed an opportunity to provide disclosures that would enable investors to ascertain whether its ESG policies and commitments are proactively or reactively designed, and whether its current ESG status is de facto or merely aspirational.

One might also ask why the HKEX, which has actively moved on its SSE commitments and is a global IPO leader, remains wedded to paper-based prospectuses and does not require ESG disclosures from listing applicants. The latter represents a shortcoming in the gateway mechanisms that ensure minimum standards for newly-listed companies. It also means that investors are deprived of information relevant to their investment decision, and capital may be misdirected to companies with substandard ESG practices.

In a time of rising expectations, both HKEX and Alibaba are missing leadership opportunities to provide a roadmap for deeper ESG engagement.



**Syren Johnstone**

Founding director  
Keel Consulting, Hong Kong SAR



**Frederick Long**

Founding managing director  
Olympus Capital Asia, Hong Kong SAR