

November 18, 2016

Corporate Communications Department
c/o Hong Kong Exchanges and Clearing Limited
12/F, One International Finance Centre
1 Harbour View Street
Central, Hong Kong

Dear Sirs,

Re: Consultation Paper on Proposed Enhancements to the Exchange's Decision-Making and Governance Structure for Listing Regulation

I, Francis Leung Pak To, am pleased to make a submission in response to the *"Joint Consultation Paper: Proposed Enhancements to the Stock Exchange of Hong Kong Limited's Decision-making and Governance Structure for Listing Regulation"* published by the Exchange and the SFC (the **Consultation**). I am the Chairman (Greater China) of CVC Capital Partners (one of the top five private equity firms in the world), but I am making this submission in my personal capacity. I set out below the key issues arising from the proposals contained in the Consultation from my vantage point as a venture capitalist, private equity investor and former investment banker.

Introduction

While it is difficult to argue with the Consultation's basic premise that the Exchange and SFC should ensure the quality and efficiency of the Hong Kong market, the Consultation's stated objectives are already achievable under the existing regime and its proposals will do nothing to improve either the efficiency of listing procedures or the quality of listed companies. On the other hand, the proposals will significantly increase the SFC's powers to reject companies for listing on the Exchange and to determine policy while removing vital checks and balances on its powers. This is inconsistent both with the Exchange's role as front-line regulator and the SFC's statutory role as monitor and supervisor of the Exchange.

The current three-tier regulatory regime comprising the government, the SFC and the Exchange has worked well: the Exchange was the world's top IPO fund-raising market in 2015 and in 2016, Hong Kong was ranked first worldwide for protection of minority investors' interests by the World Bank.¹ The current Listing Committee comprises 27 senior professionals representative of the interests of the Hong Kong IPO market (investors, market practitioners and listed companies) and the CEO of the

¹ The World Bank's report *"Doing Business 2016, Measuring Regulatory Quality and Efficiency"*.

Exchange. It acts both as an independent administrative decision maker and an advisory body for the Exchange.²

The existing regime has been in place for some 20 years and has proved itself to be resilient, having withstood a number of serious challenges including the listing of H-share companies, the Asian financial crisis of 1997 and the 2008 global financial crisis. The Hong Kong regime has been tried and tested; has proved itself capable of withstanding external shocks and has successfully adapted to market developments most obviously in establishing links with the Mainland markets and introducing new products such as RMB-traded and commodity-linked products.

Under the proposals, the Listing Committee will lose its decision making powers on the most important listing applications and matters (i.e. those involving suitability or broader policy concerns) and its power to determine policy. These powers will be vested instead in two new super-committees, both of which will be under the effective control of the SFC. While the Listing Committee will comment on matters to be determined by the new committees, it is being side-lined for all intents and purposes since the new committees are under no obligation to take account of its comments or to give reasons for ignoring them. The Consultation's proposals will give the SFC new powers to control which companies are permitted to list and remain listed on the Exchange, as well as the general policy direction of the Exchange. The SFC's role will thus shift from the monitor and supervisor of the Exchange in exercising its listing function to the Exchange's front-line decision maker and policy setter. These are major changes which will fundamentally alter the process for all significant decisions relating to the Hong Kong listed securities market. However, the rationale for these major reforms is not convincingly articulated by the Consultation. On the contrary, they risk severely restricting the types of companies which list in Hong Kong and imposing a stranglehold on market development and innovation which will be detrimental to the Exchange's competitiveness as an international fundraising market.

The proposals are more likely to reduce than improve the efficiency of the listing approval process and it is highly doubtful that they will succeed in the legitimate aim of tackling abusive practices, such as shell company and backdoor listings. Before undertaking the wholesale regime changes proposed, the regulators should perhaps attempt more robust enforcement of the existing rules on cash companies, de-listings of long-suspended companies and reverse takeovers to clamp down on activities such as shell listings which have the potential to damage the market's reputation.

If, ultimately, the regulators feel that the SFC needs to play a more direct role in cases involving LRC Matters and policy setting, this could instead be facilitated by allowing SFC representatives to attend Listing Committee meetings considering LRC Matters or policy issues. As recommended by the Financial Services Development Council in its response to the Consultation, SFC representatives should attend Listing Committee meetings as observers rather than as committee members to avoid potential conflicts with the SFC's role as supervisor. The tremendous benefit of this suggestion is that matters could be discussed by representatives of all parties involved in Hong Kong's IPO market, investors, listed companies, market practitioners and the regulators. Listing applicants and their sponsors are often invited to attend the Listing Committee hearing: attendance of the SFC representatives would allow direct discussion and questioning which is not provided for by the

² HKEC. "Listing Committee Report 2015". Page 26.

Consultation's proposals. The proposed relegation of the independent Listing Committee to a role largely rubber-stamping plain vanilla listing applications will squander its vital and valuable expertise and might jeopardise its very existence, since this watered-down role is unlikely to attract the experienced professionals it has attracted to date.

It is also questionable whether the SFC's extended powers to determine listing matters involving LRC Matters and policy can be exercised without amendment of the Securities and Futures Ordinance (the **SFO**) and the Securities and Futures (Stock Market Listing) Rules (**Stock Market Listing Rules**), as the Consultation asserts.

The Consultation's proposals are strongly opposed for the reasons set out in this paper. In short, the Consultation's already achievable objectives and hypothetical "enhancements" are little more than a smoke screen for a significant increase in the SFC's powers in relation to listings on the Exchange and policy setting which is contrary both to the Exchange's role as front-line regulator and the SFC's role as regulator of the Exchange. Maintaining the quality of listed companies would be better achieved by more robust enforcement of the existing rules on delisting long-suspended companies, cash companies and reverse takeovers, rather than the wholesale regime changes proposed which risk exacerbating the problem of Hong Kong's already onerous and expensive listing process and undermining the Exchange's competitiveness.

Capitalised terms have the same meaning as in the Consultation, except where otherwise stated.

1. The Consultation's stated objectives are already achievable under the existing regime

The Consultation's stated objectives do not justify the regime changes proposed as they are either already achieved, or are achievable, under the current regime as set out below.

- (i) *"achiev[ing] closer coordination and cooperation between the SFC and the Exchange on policy formulation".³*

As set out in Annex 1, the current regulatory regime already stipulates that SFC approval is a pre-condition for all Listing Rule amendments,⁴ waivers or modifications of the Listing Rules which will have general effect,⁵ and policy decisions that will have mandatory effect or be of general application.⁶ The Memorandum of Understanding Governing Listing Matters entered into between the SFC and the Exchange (the **MOU**) further requires the Exchange to inform the SFC of any matter of a novel or potentially controversial or sensitive nature, or which appears to involve public policy implications. Close coordination and cooperation between the SFC and the Exchange on policy setting is already facilitated by the monthly Listing Matters Liaison Meetings and by meetings of the High-Level Group whose function under the MOU is to review systemic and policy issues concerning listing-related matters.⁷ The necessary provisions and forums for close cooperation between the

³ Paragraph 1(b) of the Consultation Paper.

⁴ Section 24 of the Securities and Futures Ordinance.

⁵ Listing Rule 2.04.

⁶ Paragraph 6.4 of the Memorandum of Understanding Governing Listing Matters entered into between the SFC and the Exchange.

⁷ Paragraph 5.1 of the MOU.

SFC and Exchange on policy formation are therefore already in place and do not require any further change to the listing regime.

- (ii) *“provid[ing] the SFC with earlier and more direct input on listing policy matters and listing regulation.”*⁸

The present regime already gives the SFC the right to intervene at the very outset of the listing approval process: the Stock Market Listing Rules allow the SFC to object to a listing application within 10 business days of its submission on the grounds specified in Rule 6(2), which include where the SFC considers that the listing applicant does not meet the Listing Rules’ requirements for listing (such as the requirement that the applicant and its business must be suitable for listing) and where the SFC considers the listing to be contrary to public policy. The professed need for the SFC to have earlier input is not therefore borne out.

- (iii) *“streamlin[ing] the processes for making important or difficult listing decisions”*⁹ and *“simplify[ing] the process for IPO applications so that they can be vetted and approved more efficiently”*.¹⁰

It is difficult to see how the addition of a further layer of regulatory approvals for listing decisions involving LRC Matters will make the approval process more efficient. A further inefficiency of the proposed regime is that the non-binding views of the Listing Committee on cases involving LRC Matters will be conveyed to the LRC only indirectly, through the Listing Division, with no opportunity for these views to be discussed between members of the Listing Committee and the LRC.

As the SFC proposes to cease commenting on listing applications not involving LRC Matters, these applications may be approved more quickly than at present. However, there is a danger that designation of listing applications as routine (i.e. not involving LRC Matters) at the Listing Department assessment stage, will mean that cases presented to the Listing Committee for decision will come with the presumption that they are straightforward. There may however be other issues, such as suspicious financials, which the Listing Department may not pick up on, but which merit serious scrutiny. The risk that problems will be missed is exacerbated by the fact that these applications will no longer be subject to the SFC scrutiny to which all listing applications are currently subjected under the dual filing process, which operates as an important check on the Listing Department’s work.

- (iv) *“establish[ing] clearer accountability for decision-making within the Exchange and enhance oversight of the administration of the Listing Rules”*.¹¹

One of the Consultation’s most problematic proposals is that the LPC will replace the Listing Committee as the body responsible for oversight of the listing function and,

⁸ Paragraph 1(a) of the Consultation Paper.

⁹ Paragraph 1(b) of the Consultation Paper.

¹⁰ Paragraph 1(c) of the Consultation Paper.

¹¹ Paragraph 1(d) of the Consultation Paper.

generally, the performance of the Listing Department's regulatory responsibilities.¹² The LPC would be given "*primary responsibility for appraising senior executives of the Listing Department in the performance of their regulatory responsibilities*" and the Exchange's Remuneration Committee, which is responsible for determining the overall compensation of the Listing Department and its senior executives, "*will take into account the assessment of the Listing Policy Committee when determining such compensation*".¹³

The proposed transfer of responsibility for oversight of the Listing Department from the independent Listing Committee to the body which is also indirectly responsible for setting Listing Department remuneration is unacceptable. The regulatory oversight function must be independent of the setting of remuneration.

Furthermore, the oversight of the Listing Department's administration of the Listing Rules will be reduced rather than improved by the proposals as listing applications categorised as routine by the Listing Department will no longer be commented on by the SFC. This will deprive them of vital SFC scrutiny.

2 The case for the reforms is not made out

General market sentiment is that the existing regime works well and there is no need for fundamental change. The Exchange ranked as the world's top IPO-fundraising exchange in 2015 and the first half of 2016 and has ranked among the top five IPO fundraising exchanges for the last 14 consecutive years. These rankings strongly suggest that there are no convincing reasons for change.

Hong Kong's listing approval process has become significantly more efficient since the substantial regime changes implemented in October 2013. Thanks largely to the requirement for submission of substantially complete Application Proofs at the listing application stage and the Exchange's focus on substantive issues, 72% of listing applications were reviewed by the Listing Committee within 120 days of submission in 2014,¹⁴ compared to just 33% in 2012.¹⁵ Market participants surveyed by the SFC for the purposes of its annual reports are generally satisfied with the Exchange's efficiency and fairness in vetting listings.¹⁶ The stated need to improve the efficiency of Hong Kong's listing procedures does not appear to be borne out.

If anything, the proposals are likely to significantly reduce the efficiency of the listing vetting and approval process. Quite apart from the added layer of regulatory approvals for listing applications involving suitability or wider policy concerns, there must be a real possibility that the Listing Department which would be responsible for the initial categorisation of listing applications as either "routine" or as ones involving these concerns, will err on the side of caution. Realistically therefore, the number of listing applications referred to the LRC for decision is likely to be significantly higher than envisaged by the SFC, which has estimated that these will only involve some 10% of all listing

¹² Paragraphs 28 and 129 of the Consultation Paper.

¹³ Ibid.

¹⁴ SFC. "*Report on the Securities and Futures Commission's 2015 annual review of the Exchange's performance in its regulation on listing matters*". June 2016. Paragraph 30.

¹⁵ SFC. "*Report on the Securities and Futures Commission's 2013 annual review of the Exchange's performance in its regulation of listing matters*". December 2013. Paragraph 33.

¹⁶ Ibid. at Appendix A.

applications. This in turn raises questions as to whether the LRC will cope with the additional workload given that it is intended to meet less frequently than the Listing Committee.

3 Legislative amendment is required for proposed increase in SFC powers

Despite the SFC's assertions to the contrary, the proposals represent a substantial increase in the SFC's powers to reject listing applicants and thus require amendment to the Stock Market Listing Rules.

The SFC has denied that the proposals will increase its powers on the basis that it can already veto new cases.¹⁷ The Consultation states that in determining listing applications involving LRC Matters, the SFC's members of the LRC will "*in effect be able to exercise its power under [section 6 of] the Stock Market Listing Rules*".¹⁸ Yet the SFC's proposed ability, through membership of the LRC, to block a listing application at the comparatively late stage of the LRC committee hearing, will significantly increase its powers to object to listing applications. The SFC's current right of veto can be exercised only during the 10 business days after the submission of a listing application or during the 10 business days after the listing applicant provides any further information requested by the SFC.¹⁹ The Consultation's Proposals on the other hand will allow the SFC, through its members of the LRC, to object to a listing application at a meeting of the LRC held at any time. This would only be permitted by the Stock Market Listing Rules if the SFC, in respect of each listing application involving LRC Matters, were to extend its right to object to the application beyond the 10 business days following its submission by making repeated requests for further information under Rule 6(1) of those rules. This is clearly not what is intended by the proposals and would in any event be administratively unworkable given that there will be situations where requests for further information can no longer be justified. Thus amendments to Rule 6(2) of the Stock Market Listing Rules are required to ensure that the exercise of the SFC's powers as proposed by the Consultation is within the SFC's statutory remit.

It is also questionable whether the SFC, as the supervisor of the Exchange, has the right to be represented (through its staff) on committees of the Exchange, as proposed by the Consultation, without amendment to the SFO and its subsidiary legislation. It is clear in the SFO that the SFC and Exchange are intended to operate as separate entities: Section 25, for example, provides for the transfer of functions from the SFC to the Exchange. The proposal that SFC representatives should participate as members of committees of the Exchange would merge the roles of the SFC (as statutory supervisor) and the Exchange (as supervisee) contrary to the provisions of the SFO.

It should also be noted that while the SFC seeks the power to determine only those matters involving LRC Matters, these are the most significant listing decisions since they permit the rejection of a listing applicant which otherwise meets all objective listing criteria. Thus the SFC's influence on listings could be disproportionate to the number of listing applications it determines through participation in the LRC.

¹⁷The Standard. "*SFC allays fears on power*". 5 August 2016.

¹⁸Paragraph 18 of the Consultation.

¹⁹Rules 6(2) and 6(6) of the Stock Market Listing Rules.

4 Conflict between the SFC's role as statutory regulator and the need to develop the Exchange as a highly performing and innovative international market

The SFC's statutory role in relation to the Hong Kong IPO market under the SFO is "to supervise, monitor and regulate ... the activities carried on by recognized exchange companies".²⁰ It is further tasked with securing "an appropriate degree of protection for members of the public investing in or holding financial products".²¹

While there is provision for the SFC to have regard to "the desirability of maintaining the status of Hong Kong as a competitive international financial centre" in performing its functions,²² this is very much a secondary consideration. The SFC's current role is a much watered-down version of its previous role under the Securities and Futures Commission Ordinance (Cap. 24) (the **SFCO**) (the SFO's predecessor ordinance, now repealed) which included "to encourage the development of securities and futures markets in Hong Kong and the increased use of such markets by investors in Hong Kong and elsewhere".²³ With the dropping of that specific function, the SFC's role today is primarily that of market regulator and protector of investors' interests.

The SFC's primary function of regulating the market and protecting investors is thus antithetical to the very real need to enhance the development of Hong Kong's securities market, which requires an innovative and pragmatic approach to regulation. There is a real risk that the LRC and LPC SFC members' legitimate focus on preventing potential problems and protecting investors' interests (in their capacity as regulators), will be unduly risk-averse in setting policy and in determining cases involving LRC Matters. There is thus concern that the proposals will stifle market development and innovation which may adversely affect the competitiveness of the Hong Kong market. A case in point is the SFC's refusal to allow a public consultation on the Exchange's draft proposal on weighted voting rights structures despite market support for a second stage consultation.²⁴ The Listing Committee, with its broad-based representation and commercial expertise should therefore continue to be responsible for policy setting subject to the final approval of the SFC as regulator.

5 Lack of conflict in Exchange's existing role

The much remarked upon conflict of the Exchange (as a profit making company) is more perceived than real. As acknowledged in the Consultation, the Exchange's board delegated all its powers and functions in respect of all listing matters to the Listing Committee precisely in order to "manage potential conflicts of interest and ensure the independence of the listing function".²⁵ Of the Listing Committee's²⁸ members, only one represents the Exchange, its Chief Executive.

6 Vital role played by the Listing Committee's market practitioners

²⁰ Section 5(1)(b)(i) of the SFO.

²¹ Section 5(1)(l) of the SFO.

²² Section 6(2)(a) of the SFO.

²³ Section 4(1)(j) of the Securities and Futures Commission Ordinance (Cap. 24).

²⁴ HKEC. "Consultation Conclusions to Concept Paper on Weighted Voting Rights". June 2015. Chapter 5.

²⁵ At paragraph 40 of the Consultation Paper.

The rationale for the Listing Committee's role lies in its make-up by market practitioners. The Hay Davison Report was adamant in its view that a practitioner-based regulatory system was best suited to Hong Kong as it would *"avoid the danger of straight-jacketing the securities market by a strict regulatory regime which might all too easily lead to insensitive or heavy handed over-regulation"*.²⁶ Noting that *"market management and regulation by practitioners offers scope for flexibility and adaptability in a rapidly changing market"* and that *"statutory regulators will not always have the necessary knowledge and expertise"*, the Hay Davison report concluded that there was no alternative to practitioner-based regulation.²⁷

The presence of market practitioners, as well as investor and listed company representatives on the Listing Committee, means that the Listing Committee is close to the market and able to provide valuable input in formulating policy, which remains subject to the safeguard of final SFC approval. The highly experienced members of the independent Listing Committee contribute much to ensuring that the Exchange remains competitive. If its reform initiatives fail to see the light of day, there is a real risk that the Exchange will lose out to the Chinese exchanges which are possibly already ahead in their proposals to adopt a disclosure-based listing regime.

7 Listing decisions need to be made by a broad-based committee with commercial experience

Under the proposals, the determination of suitability for listing (a requirement virtually unique to Hong Kong) will generally be made by the six members of the LRC. Of all the issues to be determined in respect of a listing, this is the most subjective and arguably the most difficult. Suitability defies precise definition. Thus the factors the Exchange (through the Listing Committee) takes into account in determining suitability as stated in its Guidance Letters²⁸ are non-exhaustive and are outlined in broad terms only. Decisions on suitability are highly subjective decisions which require careful consideration of the particular facts and circumstances by those with appropriate commercial and market expertise. It is precisely these complicated decisions which benefit most from the broad expertise of the Listing Committee.²⁸

The Consultation's proposals will mean instead that the most complex decisions will be made by just six individuals, three of whom are regulators with little recent commercial experience, while the three Listing Committee representatives do not include a corporate finance adviser. It is also stipulated that one of the three Listing Committee representatives on the two new committees must be an investor representative. Given that the SFC's statutory functions include securing protection for members of the investing public²⁹ and the SFC has three representatives on the LRC, the interests of the investing public are arguably already sufficiently safeguarded without a further requirement for an investor representative to be one of the three Listing Committee members.

8 Problems with the composition of the LRC and LPC

²⁶ Hay Davison Report. May 1988. At paragraph 3.24.

²⁷ Ibid. at paragraph 3.26.

²⁸ Guidance Letters HKEx-GL68.13 (Guidance on suitability for listing) and HKEx-GL68-13A (Guidance on IPO vetting and suitability for listing).

²⁹ Section 5(1)(l) of the SFO.

Although the Consultation suggests that control of the new committees will be shared between the Exchange and the SFC, the SFC will in fact have effective control of the composition of both.

In the case of the LRC, three of its members will be SFC senior officials, while the other three will be the Chairman and two Deputy Chairmen of the Listing Committee nominated by the Listing Nominating Committee (**LNC**), itself composed of equal numbers of HKEC and SFC representatives. The absence of a casting vote on the Listing Nominating Committee means that the SFC can effectively veto any individual's appointment to the Listing Committee (and hence to the LRC). Neither the Exchange nor the Listing Committee will have a comparable influence over who are the SFC representatives on the LRC.

As for the LPC, the SFC will directly control the composition of half its members, the SFC's CEO, two senior executives of the SFC's Corporate Finance Division and the Chairman of the Takeovers Panel, who is appointed by the SFC under Section 8(3) of the SFO, notwithstanding that the Takeovers Panel would have the right to elect its own Chairman under Section 8(6) of the SFO, if the SFC had not already appointed him. The other four members of the LPC will be the Exchange's Chief Executive, and the Chairman and two Deputy Chairmen of the Listing Committee (the appointment of the latter three being within the SFC's control as already discussed). It is therefore a fallacy to suggest that there will be no increase in the SFC's powers since it will effectively control the make-up of both new committees.

The wisdom of concentrating the power to approve listing applications and set policy in largely the same small group of individuals is also questionable. The Consultation's argument that aligning important listing decisions with the policy direction set by the LPC makes it preferable for the composition of the LRC to replicate that of the LPC to the extent practicable³⁰ is flawed. While alignment may be achieved, this will be at the expense of exposing the group's decisions to challenge and opposing viewpoints. Whereas the current Listing Committee allows discussion among those with different perspectives and opinions, the new committees risk concentrating decision making power in a small group of individuals who are isolated from real opposition.

A further benefit of the current 28-member Listing Committee is that it is incorruptible given that there is no way of knowing which members will attend any particular meeting of the Listing Committee. This advantage will be lost if the proposal that listing decisions involving LRC Matters are made by the same six individuals is adopted.

9 Lack of Chairman's casting vote is contrary to the Exchange's Articles and will make new committees ineffective

Under the proposals, decisions of the new committees require majority approval. Yet this may be impossible due to the lack of a Chairman's casting vote. The proposal is also contrary to the Articles of Association of the Exchange and HKEC which require that the Chairman of their committees

³⁰ Paragraph 76 of the Consultation.

should have a second and casting vote stating in the article relating to “Procedures at Committee meetings”³¹ that:

“Questions arising at any meeting shall be determined by a majority of votes of the members present and, in the case of an equality of votes, the chairman of a meeting shall have a second or casting vote.”

The Articles will therefore need to be amended to give effect to the Consultation’s proposal that the chairmen of the new committees should not have a casting vote. Alternatively, the chairmen, who will be the Listing Committee Chairman, could be given a casting vote in the event of deadlock.

Further clarity is also required as to what will happen in the event of deadlock. For example, on a decision as to suitability, will the listing be approved because a majority failed to find the applicant unsuitable for listing, or rejected because there was not a majority vote finding the applicant suitable for listing? For decisions relating to listed issuers, such as the suspension of an issuer which is in breach of Listing Rule 13.24 due to insufficient operations to warrant its continued listing, would a tied vote mean that the issuer remains listed since there is no majority finding of breach of Rule 13.24?

10 *Preferable methods of dealing with shell company listings*

Media comments³² have suggested that a key driver of the proposed reforms is the SFC’s desire to clamp down on certain practices it regards as undesirable, particularly shell listings and reverse takeovers. These practices which have the potential to negatively impact the market’s reputation can however be addressed under the existing regime for regulation of listed issuers, without the wholesale regime changes proposed which risk exacerbating an already difficult and expensive listing process and undermining the competitiveness of the Exchange.

Efforts to clamp down on shell listings and reverse takeovers could be effected through more robust regulation of listed issuers. The Listing Committee has considerably tightened the regulation of shell companies and reverse takeovers in recent years³³ and keeps these matters under review. The remaining concerns are best dealt with through more robust post-listing enforcement, such as more efficient delistings to remove so-called “zombie” shell companies from the market. This must be preferable to the necessarily speculative and subjective process of trying to ascertain pre-listing whether particular listing applicants are prospective shells on the basis of the very broad criteria outlined in the Exchange’s latest guidance on IPO vetting and suitability for listing.³⁴

³¹ Article 93 of the Articles of Association of The Stock Exchange of Hong Kong Limited and Article 105 of the Articles of Association of Hong Kong Exchanges and Clearing Limited.

³² The Standard. *Bourse split over listing row*. 2 August 2016. Reuters. *“Update 1-Hong Kong proposes changes to stock market listing regime”*.

³³ Examples include: the tightening of reverse takeover regulation (“*Guidance Letter 78-2014*”, May 2014); requiring issuers to demonstrate the viability and sustainability of remaining businesses after significant asset disposals (or distributions in specie)(Listing Committee 2015 Report at para 37); and application of the cash company rules to substantial cash injections into listed issuers (Listing Committee 2015 Report at para 41).

³⁴ HKEX. *“Guidance Letter HKEX-GL68-13A”*. June 2016.

The danger in trying to screen out shells at the listing application stage is that the listings of genuine SMEs could be stymied in the process. There is already considerable uncertainty surrounding “suitability” of listing applicants and their businesses which is making it increasingly difficult for corporate finance advisers to reliably advise new applicants. A case in point is the Exchange’s recent guidance on shell listings:³⁵ no one has the slightest idea how to apply this and instead new listing applicants, particularly on GEM, are volunteering absurdly long lock-up periods on controlling shareholders in an attempt to pre-empt suggestions that the applicant is seeking to become a listed shell. This is manifestly unfair on genuine SME listing applicants and risks discouraging the listing of SMEs in genuine need of investment. Care must also be taken to ensure that any post-listing restrictions imposed, e.g. further restrictions on change in the nature of business, do not prevent genuine cases of expansion into new business sectors to the detriment of both listed issuers and their shareholders.

Consideration could also be given to whether the regulators require greater enforcement powers to tackle the issue of listed shells. The advantage of dealing with shells once they are listed is that the regulators can take action at a stage when there is a real likelihood that a company is seeking to profit from its status as a listed shell, rather than a mere possibility which is the case pre-listing. Increased monitoring of post-listing acquisitions and disposals (i.e. shell cleansing) could potentially catch a number of reverse takeovers.

11 Need for greater certainty for listing applicants to avoid waste of time and money

There is a danger that the proposed changes will cause further uncertainty which may adversely affect the attractiveness of the Exchange as a listing venue.

The Consultation makes the very sensible suggestion that prospective listing applicants will continue to be able to seek informal guidance from the Listing Department before submitting a listing application and that the LRC may give a preliminary indication of its position on an LRC matter, including whether a particular issuer or its business is suitable for listing.³⁶ Given the considerable expense that listing applicants incur in the preliminary stages of a listing application, primarily with respect to due diligence which must be substantially complete before submission of the application, it would clearly be in listing applicants’ interest if they could have a reasonable degree of certainty that they will not be rejected on suitability grounds, at the earliest possible stage of the listing process.

For listing applications involving LRC Matters, much would be gained from an informal and confidential guidance/consultation exercise between a listing applicant and its advisers and suitable representatives of the Exchange and the SFC at an early stage, i.e. before listing application submission. This would enable listing applicants to make a more informed decision as to whether their realistic chances of listing justify the substantial work and expense involved. Any guidance given would not of course be binding on the regulators as further facts and circumstances affecting suitability may come to light later.

³⁵ Ibid.

³⁶ Paragraph 11 of the Consultation Paper.

Otherwise, there is a danger that the degree of uncertainty involved in the listing application process will result in only those companies who most obviously meet the suitability criteria applying to list in Hong Kong. This could restrict listing applicants to the very largest financial and property companies which would limit investor choice, deprive SMEs of the funding they require for growth, and potentially deprive investors of the opportunity to invest in the stars of tomorrow.

All three candidates for the financial services industry seat at the recent Legco elections oppose the Consultation's proposals³⁷ and have called for the establishment of a new third board and efforts to attract more tech companies to list in Hong Kong. Market sentiment thus seems to favour greater diversity in the companies listing in Hong Kong, the very opposite of what will be achieved if the Consultation's proposals are implemented.

12 Loss of checks and balances

The Consultation's proposals will remove the vital checks and balances which are a fundamental part of the existing regime.

Where the SFC objects to a listing application under the Stock Market Listing Rules, the listing applicant currently has a right to apply for a review of the SFC's decision by the Securities and Futures Appeal Tribunal (the **SFAT**).³⁸ The SFAT is chaired by a judge and its statutory purpose is to act as a safeguard to ensure that regulatory decisions made by the SFC are reasonable and fair and thus to enhance the SFC's accountability.³⁹ If a listing applicant is dissatisfied with a decision of the SFAT, it has a right of appeal to the Court of Appeal on a point of law.⁴⁰

Under the proposals, an LRC decision to reject a listing application will only be entitled to a further review by the Listing Regulatory Review Committee (**LRRC**) composed of the SFC Chairperson and CEO, a non-executive director of the SFC nominated by the SFC board, and three former Listing Committee members nominated by the Listing Nominating Committee.

In practice, and certainly in terms of outcome for the listing applicant, there will be little difference between the SFC objecting to listing under Rule 6(2) of the Stock Market Listing Rules and the SFC members of the new LRC blocking a listing application at the LRC hearing. Yet the right of review available to the applicant will be significantly different. This may be seen as a disincentive for the SFC to exercise its powers under the Stock Market Listing Rules where it has concerns as to a listing applicant's suitability, prompting it instead to wait until the LRC hearing. However, this would be unfair on the listing applicant which will continue to incur expenses in the expectation of its listing application proceeding, and in the event that the application is rejected by the LRC, the review body which may review the decision at its request is arguably inferior, and less independent than would have been the case had the SFC objected under the Stock Market Listing Rules. The loss of this vital check and balance on the SFC's exercise of its power is a concern.

³⁷South China Morning Post. "Hong Kong should change listing rules to attract tech companies to raise funds, candidates say". 28 August 2016.

³⁸Section 217 of the SFO.

³⁹Homepage of the Securities and Futures Appeals Tribunal at <http://www.sfat.gov.hk/english/aboutus/welcome/>.

⁴⁰Section 229 of the SFO.

A further question which is not addressed in the Consultation is how the existing powers of the SFC under the Stock Market Listing Rules and the MOU will interact with its powers exercised through its membership of the LRC and LPC. For example, the LRRRC will be the review body for decisions of the LRC. Half of the LRRRC's membership will be composed of senior SFC officials. This raises the question of whether the SFC members of the LRRRC will be bound to support the decisions of the SFC members of the LRC, or whether they can regard those decisions as "staff" level decisions, which the LRRRC SFC members could then overturn.

13 Problems inherent in the proposed 2-track approval process

The Consultation essentially proposes a new 2-track approval process for listing applications. Those assessed by the Listing Department as not giving rise to suitability issues or broader policy implications, i.e. as routine or safe, will be submitted for decision to the Listing Committee, while those considered to raise suitability concerns or broader policy implications will be regarded as problematic, and will be decided by the new LRC, with the benefit of the non-binding comments of the Listing Committee.

The dangers are that:

- (i) those tasked with deciding "routine" cases (i.e. the Listing Committee) will be de-professionalised as a result of being deprived of experience of deciding problematic cases. Although the Listing Committee will continue to review all listing applications (including ones to be decided by the LRC), a review and commenting process is different in key respects from the decision making process;
- (ii) as mentioned above, the cases presented to the Listing Committee for decision will come with the presumption that they require a lower level of scrutiny. Moreover, cases categorised as routine will no longer be commented on by the SFC and thus deprived of the SFC's important check on the Listing Division's performance of its listing function; and
- (iii) the Consultation puts great rhetorical emphasis on 'consensus' as a good in itself. Yet one of the greatest dangers in systemic or case-based failures of regulation is a misguided prevalence of group-think. Pressure for consensus is antithetical to proper and full scrutiny and oversight. Excessive emphasis on the desirability of consensus as a good in itself may discourage the expression of dissenting opinions which need to be heard and properly considered. The concentration of policy-making and regulatory decision making on LRC Matters in the hands of such a small group of individuals whose decisions are deprived of the opportunity for open discussion and challenge, could be highly detrimental.

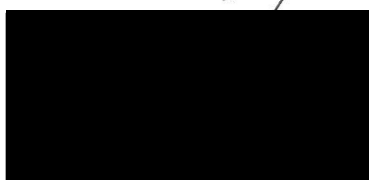
Conclusion

In conclusion, the regulators are urged to reconsider the proposed reforms and to focus instead on discouraging practices such as shell listings through the allocation of enhanced resources for active surveillance and monitoring of listed issuers' activities and parties engaged in suspected price rigging of "shell companies" and reverse takeovers. Concentrating efforts on post-listing enforcement and delisting long suspended companies, rather than submitting all new listing applicants to the imperfect and expensive screening process for potential shells, would both improve the quality of

the market and provide better access to capital to the many companies genuinely in need of funds. Moreover, more robust post-listing enforcement would avoid the very real danger in the proposals of making the listing application process more complicated and expensive than is already the case. This must be avoided if the competitiveness of the Exchange as an international fund raising platform is to be maintained and enhanced.

If after increasing post-listing enforcement measures, the regulators still feel that SFC representatives need more direct involvement in the listing application approval process, the suggestion that SFC representatives should attend all Listing Committee hearings involving LRC Matters and policy setting could be pursued. Listing applicants would then benefit from the input of all those involved in the IPO market and the committee meetings would facilitate the coordinated and cooperative approach sought by the SFC. Finally, it is important that the roles of the Exchange and the SFC remain distinct, but complementary. Primary responsibility for approving listing applications and cancellations of listing, as well as listing policy and market development properly lies with the Exchange. The SFC, on the other hand, rather than seeking to assume the role of decision maker and policy setter, should instead focus on its vital role as regulator of the Exchange and protector of investors' interests. Likewise, it is essential that the SFC itself remains accountable and that its decisions remain subject to judicial review and review by the Securities and Futures Appeal Tribunal, and not a watered down review process by the proposed LRRC.

Yours sincerely,

A large black rectangular redaction box covering the signature area.

Francis Leung Pak To

A handwritten signature in black ink, appearing to be 'Francis Leung Pak To', written over the typed name.

Annex 1

SFC's Existing Rights in relation to Listing Policy

1 Right to approve Listing Rule amendments

SFC approval is required for any amendment to the Listing Rules under section 24 of the SFO.

2 Right to approve waivers or decision not to require compliance having general effect

Listing Rule 2.04 requires the Exchange to obtain the SFC's prior approval of any proposed waiver or modification of any Listing Rule, or decision not to require compliance with any Listing Rule, which will have general effect (i.e. affect more than one issuer).

3 Right to approve Exchange policy decisions

Paragraph 6.4 of the MOU requires that the Exchange forward to the SFC any policy decision it intends to implement that will have mandatory effect or be of general application, including practice notes, guidance notes, and waivers from requirements. The Exchange may not publish, rely on, or impose on any person any such note, waiver or decision until the SFC has approved it in writing.

4 Right to be informed of novel or controversial issues

The Exchange must inform the SFC, as soon as is reasonably practicable, of any matter of a novel or potentially controversial or sensitive nature, or which appears to involve public policy implications, arising from a listing application, a transaction by a listed issuer, or otherwise (Paragraph 6.5 of the MOU).

5 Monthly Liaison Meetings

Paragraph 10.3 of the MOU provides for the SFC and Exchange to hold "Listing Matters Liaison Meetings" monthly to discuss, among others, matters or issues relating to the Exchange's regulation of listed companies and policy or other matters, including potential changes to the Listing Rules, relating to the functions and responsibilities of the Exchange or the SFC.

6 Review of Systemic and Policy Issues

Paragraph 5.1 of the MOU envisages that the "High-Level Group" of Exchange and SFC representatives that has been established should meet from time to time to review systemic and policy issues concerning listing-related matters. The High-Level Group's membership comprises: the Chairmen of the Exchange, the Listing Committee, the GEM Listing Committee, the Takeovers Panel, and the SFC and the Executive Director of the Corporate Finance Division of the SFC, the Chief Executive of the Exchange and the Exchange's Head of Listing, Regulation and Risk Management.⁴¹

⁴¹Appendix II to the MOU.