

Boase Cohen & Collins

布 高 江 律 師 行

SOLICITORS & NOTARIES

PARTNERS

2303-7 Dominion Centre
43-59 Queen's Road East
Hong Kong

香港灣仔皇后大道東43至59號
東美中心23樓2303至2307室

General Line: (852) 3416-1711

Telefax: (852) 2529-5035

DX-225056 Wanchai 1

CONSULTANTS

Email: partners@boasecohencollins.com

Website: www.boasecohencollins.com

ASSISTANT SOLICITORS

Our Ref:

Your Ref:

Please contact:

Direct Telephone:

Direct email

28th September, 2016

Corporate Finance Division,
Securities and Futures Commission,
35th Floor, Cheung Kong Center,
2 Queen's Road Central,
Hong Kong.

BY HAND

Dear Sirs,

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

We take this opportunity of enclosing a response to the Consultation Paper on behalf of a client, a sponsor and major investment bank, for your review and consideration.

If you have any questions regarding the response, please contact our _____ on the above number.

Yours faithfully,

BOASE COHEN & COLLINS

Encl.

SEPTEMBER 2016

**JOINT CONSULTATION PAPER: PROPOSED ENHANCEMENTS TO THE STOCK EXCHANGE OF HONG KONG
LIMITED'S DECISION-MAKING AND GOVERNANCE STRUCTURE FOR LISTING REGULATION**

REASONS FOR OPPOSING THE CONSULTATION'S PROPOSALS

Executive Summary

Set out below are key responses to the proposals set out in 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**). Please note that this summary is not intended to be read in isolation, and must be read in the context of the full responses set out in the following sections of this paper.

1 Reforms will reduce market efficiency and not improve market quality

The significant reforms proposed will adversely affect the efficiency of the listing approval process and do nothing to improve the quality of listed companies. The real concerns driving the proposals, the shell company listings and reverse takeovers with the potential to negatively impact the reputation of the market, would be better dealt with by more robust regulation of listed issuers through enforcement of the rules on reverse takeovers, cash companies and delisting of long-suspended companies.

2 Reforms will negatively impact the competitiveness of the Exchange

Uncertainty surrounding the issue of “suitability for listing” (a requirement unique to Hong Kong) will only discourage genuine listing applicants from seeking a Hong Kong listing, because of the resulting doubt as to listing eligibility notwithstanding fulfilment of all objective listing criteria. Given the already high cost of listing in Hong Kong, due in part to IPO sponsors’ onerous due diligence obligations, this added uncertainty and the increase in costs which is likely to result, risk rendering the Exchange uncompetitive compared to other international listing venues.

Attempting to screen out shells at the listing application stage is a highly subjective and speculative process which may inadvertently result in genuine SMEs being rejected for listing, which is manifestly unfair. A focus instead on post-listing regulation of possible shells and delisting in appropriate cases, would do much to improve the quality of listed companies without further exacerbating the problem of an already onerous and expensive listing process.

3 Increase in SFC’s powers

Despite the regulators’ assertions to the contrary, the proposals represent a substantial increase in the SFC’s powers to approve or reject listing applicants, regulate listed issuers and determine listing policy, as set out below.

- i. The SFC denies any increase in its powers arguing that it can already veto new cases. Yet its 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 influence on the types of companies permitted to list in Hong Kong. The SFC’s current right of veto can be exercised only during the 10 business days after the submission of a listing application on the grounds specified in Section 6(2) of the

Securities and Futures (Stock Market Listing) Rules (**Stock Market Listing Rules**), or during the 10 business days after the listing applicant provides any further information requested by the SFC within 10 business days of the listing application submission pursuant to Section 6(1) of those rules.

- ii. Although the Consultation suggests that control of the new LRC will be shared between the Exchange and the SFC, the SFC will in fact have effective control of the composition 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, who are nominated for appointment 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 the SFC can effectively veto any individual's appointment to the Listing Committee (and hence to the LRC).
- iii. The SFC's influence on listing applications will be disproportionate to the number of applications it determines through membership of the LRC. Although it will only determine cases involving suitability concerns or broader policy implications, it will thus influence the most important decisions, i.e. the listing applications which may be rejected notwithstanding that all objective listing criteria are met, which intentionally or not, set precedents for future listing applicants.

When the Stock Market Listing Rules were originally put in place, the intention was that the SFC's power to object to a listing application under Section 5 would be a "reserve power".¹ The power of the SFC to determine listing applications involving LRC Matters through its proposed participation in the LRC will see the SFC assume a far more active role in the listing approval process, which was not envisaged when the Stock Market Listing Rules were first implemented.

4 Reforms require legislative change

The Consultation's proposals would appear to require legislative amendment despite its assertion to the contrary. The authors would challenge the Consultation's assertion that in determining listing applications involving LRC Matters, the SFC's members of the Listing Regulatory Committee (LRC) will "*in effect be able to exercise its power under [section 6 of] the Stock Market Listing Rules*".² Section 6 of the Stock Market Listing Rules only empowers the SFC to object to a listing application within the first 10 business days following its submission, or within 10 business days of its receipt of information requested within 10 business days of the listing application being submitted. It is submitted that the proposed ability of the SFC, through its three members of the proposed LRC, to approve or reject listing applications involving LRC Matters will represent an

¹ SFC. "A Consultation Paper on the Securities and Futures (Stock Market Listing) Rules and the Securities and Futures (Transfer of Functions - Stock Exchange Company) Order". May 2002. Paragraph 28.

² Paragraph 18 of the Consultation.

extension of the SFC's powers in relation to listing applications and thus requires amendments to the Stock Market Listing Rules.

The role of the SFC envisaged by the Consultation also requires clarification. The Consultation proposes that the SFC retain its current rights to object to a listing application under the Stock Market Listing Rules, and that it should also have a right to reject a listing application through its participation in LRC committee hearings, which will presumably occur after the expiry of the 10 business day period(s) during which the SFC can object under the Stock Market Listing Rules. If the SFC is to have these rights through membership of the LRC, its right to object to a listing within the initial 10 business days under the Stock Market Listing Rules should be removed, in order to avoid a blurring of the parameters of the SFC's powers to reject listing applications.

5 The SFC's representation on committees of the Exchange is inconsistent with its role as regulator

The Listing Rules are administered by the Exchange, which thus has the power to approve or reject listing applications, subject to the SFC's right to object under the Stock Market Listing Rules and its statutory duty to supervise and monitor the Exchange's performance of its listing-related functions and responsibilities.³ The Exchange's Board (**Board**) has in turn delegated its powers in respect of all listing matters to the Listing Committee and its delegates.

It is however 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. 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 SFO does not provide for the SFC to share the exercise of the Exchange's functions; their functions are complementary, but distinct. 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.

6 Lack of justification for proposed reforms

The existing regime works well. 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. It also ranked first worldwide for protection of minority investors' interests in 2016.⁴ These rankings strongly suggest that there are no convincing reasons for the changes proposed by the Consultation.

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

³ Section 5(1)(b) of the SFO.

⁴ The World Bank's report "*Doing Business 2016, Measuring Regulatory Quality and Efficiency*".

The SFC's statutory role in relation to the Hong Kong IPO market is to supervise and regulate the Exchange, and to protect the interests of the investing public. It is under no obligation to maintain or develop the international competitiveness of the Exchange. There is thus a fundamental and irresolvable conflict between the SFC's primary function of regulating the market and protecting investors and the very real need to further develop the Hong Kong 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 real concern that the proposals will stifle market development and innovation which may adversely affect the competitiveness of the Hong Kong market.

8 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 since its powers to approve listings have been delegated to the independent Listing Committee. Of the Listing Committee's 28 members, only one represents the Exchange, its Chief Executive.

9 Broad expertise of the Listing Committee is essential for the review of complex cases

Under the proposals, suitability for listing will be determined by the six members of the LRC. A listing applicant's suitability for listing is the most difficult and subjective determination to be made. Defying precise definition, the determination of suitability is highly subjective and requires careful consideration of the particular facts and circumstances by those with appropriate commercial and market expertise. These complicated decisions benefit most from the broad expertise of the Listing Committee's 28 members with its large number of highly experienced market professionals, listed company representatives and investor representatives. Yet it is proposed to relegate the Listing Committee to the role of rubber stamping the most straight-forward listing cases which will likely result in it ceasing to attract the experienced professionals it has attracted to date. Conversely, the most difficult decisions will be made in future by just six people, three regulators with little recent market experience and three Listing Committee members, none of whom are corporate finance advisers.

10 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 should have a second and casting vote. The Consultation's proposal would thus require amendment to the articles of the Exchange and HKEC.

Introduction

While it is difficult to argue with the Consultation's basic premise, that the Exchange and SFC should endeavour to ensure the quality and efficiency of the Hong Kong market, the significant reforms proposed will adversely affect efficiency while doing nothing to improve the quality of listed companies. The regulators' understandable concerns as to market quality, particularly with respect to the shell company listings the subject of recent media coverage, would be better dealt with by more robust regulation of listed issuers through enforcement of the Listing Rules on reverse takeovers, cash companies and delisting of long-suspended companies. More active monitoring of listed issuers and proactive enforcement of the Listing Rules would do far more to enhance the quality of the Hong Kong market than the Consultation's proposals, which risk undermining the competitive position of the Exchange as an international fund-raising venue as well as Hong Kong's broader status as Asia's premier international financial market.

The legitimacy under the existing regulatory regime of the SFC's assumption of control over listing applications and post-listing matters involving LRC matters, and of the Exchange's renunciation of its powers to determine such matters in favour of the SFC, is also open to question. It is the view of the authors of this paper that these significant changes to Hong Kong's regulatory regime could only be effected through amendments to the Securities and Futures Ordinance (SFO) and its subsidiary legislation.

The authors strongly object to the Consultation's proposals for the reasons set out in this paper and they urge the Exchange and SFC to focus instead on the few areas with the potential to damage the market's reputation, such as shell company listings and reverse takeovers. Except as otherwise stated, capitalised terms have the same meanings as in the Consultation.

Before setting out comments under the specific headings of the Consultation, outlined below are some of the more fundamental objections to the Consultation's proposals.

1 Legislative Amendments Required to Effect the Proposals

According to the Consultation,⁵ if the proposals are implemented, this will be effected by the SFC and Exchange entering into an addendum to the Memorandum of Understanding Governing Listing Matters entered into between the SFC and the Exchange⁶ (the **MOU**), resolutions of the Exchange's Board and amendments to the Listing Rules. It further states that there will be no legislative amendment of the SFO or the Stock Market Listing Rules as a result of the proposals.⁷

However, it is not clear what authority the SFC has to approve or reject listing applications involving LRC Matters through its three representatives on the proposed LRC. The Consultation states that "*The proposed voting arrangement means that, for those cases that are put to the Listing*

⁵ Paragraph 53 of the Consultation Paper.

⁶ "http://www.sfc.hk/web/doc/TC/aboutsfc/arrangements/local-org/hkex_sfc_mou.pdf" Memorandum of Understanding Governing Listing Matters

⁷ Paragraph 139 of the Consultation Paper.

*Regulatory Committee, the SFC would in effect be able to exercise its power under [section 6 of] the Stock Market Listing Rules to object to a listing through its participation on the Listing Regulatory Committee”.*⁸ The SFC’s existing statutory right of intervention is however limited to a right to object to a listing application *within 10 business days of its submission* on the grounds specified in section 6(2) of the Stock Market Listing Rules or within 10 business days of a listing applicant providing the SFC with the further information requested by the SFC within 10 business days of the submission of the listing application.⁹ There is no existing legislative provision which would allow the SFC members of the LRC to object to a listing at a meeting of the LRC held more than 10 business days after the listing application’s submission or, where the SFC requested further information within that period, more than 10 business days after the listing applicant supplies the requested information. Given that listing applications involving LRC Matters will be considered first by the Listing Committee before being heard by the LRC, it is highly unlikely that the LRC hearing will occur within 10 business days of the submission of a listing application or of the provision of information requested within the initial 10-business day period. The authors of this paper would thus question the Consultation’s assertion that the proposed changes do not require amendment to the Stock Market Listing Rules: on the contrary, amendments will be required to enable the SFC, through its participation in the LRC, to object to a listing application on the grounds set out in section 6(2) of the Stock Market Listing Rules at an LRC meeting held after the expiry of the statutory periods for objection under the Stock Market Listing Rules.

2 Need to Clarify the SFC’s Proposed Role

There is a need to clarify the role that the SFC proposes to play under the revised regime. The SFC is to retain its existing powers to object to a listing application within 10 business days of its submission under the Stock Market Listing Rules, as described under paragraph 1 above.¹⁰ Yet, through its representatives on the LRC, the SFC will have a further right to reject a listing application involving LRC Matters at the LRC meeting considering the application. It seems incongruous and grossly unfair from the listing applicant’s point of view, for the SFC to have a second bite of the cherry in this way. At least under the current system, 10 business days after submitting a listing application, the listing applicant should be able to be confident that its application will not be rejected on suitability/public policy grounds, unless further relevant facts come to light between the expiry of the 10-business day period and the Listing Committee hearing.

It is submitted that the SFC should be entitled to object to a listing on the grounds of suitability *either* within 10 business days of submission of the listing application (as is currently the case) *or* at the hearing of the LRC through its three representatives on the committee, but *not* in both circumstances. If, in practice, the SFC does not use its power under section 6(2) of the Stock Market Listing Rules to object to listing applications on suitability grounds, the Stock Market Listing

⁸ Paragraph 18 of the Consultation Paper.

⁹ Sections 6(2) and 6(6) of the Securities and Futures (Stock Market) Listing Rules (Cap. 571V).

¹⁰ *Ibid.* “The SFC and the Exchange will retain their separate powers and functions as provided by the SFO (including subsidiary legislation)”.

Rules should be revised to delete it, and provide for the SFC's proposed power, through its three members of the LRC, to object to listing applications on the grounds currently provided for under the Stock Market Listing Rules.

A complicating factor is that if the SFC objects to a listing application under the Stock Market Listing Rules, the listing applicant has a right to apply for a review of the SFC's decision by the Securities and Futures Appeal Tribunal (the SFAT).¹¹ 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.¹² 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.¹³

Under the new 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 its listing under section 6(2) of the Stock Market Listing Rules and the SFC members of the new LRC blocking it at the LRC hearing. Yet the right of review available to the applicant will be significantly different. If rejected under the Stock Market Listing Rules, the applicant has the right to have the decision reviewed by the SFAT, chaired by a High Court Judge. If, on the other hand, it is rejected by the LRC (having been blocked by the LRC's SFC members), the right of review is only to the LRRC.

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. Given that the Consultation acknowledges that the proposal to allow the SFC to decide LRC Matters through its representatives of the LRC will in effect allow it to exercise its statutory rights under the Stock Market Listing Rules,¹⁴ there must be a strong argument that a decision of the LRC to reject a listing application should have the same right to be reviewed by the SFAT, at least in cases where the listing application failed because the SFC representatives of the LRC voted against it.

¹¹ Section 217 of the SFO.

¹² Homepage of the Securities and Futures Appeals Tribunal at <http://www.sfat.gov.hk/english/aboutus/welcome/>.

¹³ Section 229 of the SFO.

¹⁴ See note 2 above.

3 The SFC's ability to be represented on committees of the Exchange is questionable

The SFO vests the right to operate the Hong Kong stock market in the Exchange¹⁵ and empowers it to make rules for its proper regulation including rules for the requirements to be met before securities can be listed, subject to the approval of the SFC.¹⁶ The Exchange thus has the inherent power to approve or reject listing applications, subject to the SFC's right to object to a listing application in the circumstances set out in the Stock Market Listing Rules. The Exchange's Board (**Board**) has in turn delegated its powers in respect of all listing matters to the Listing Committee and its delegates.¹⁷

The Exchange's Articles permit its directors to appoint themselves and/or "*such other persons as they think fit*" as members of committees of the Exchange.¹⁸ Technically, this may justify the Board in nominating SFC representatives to the proposed LRC and LPC. The Board is not however under any obligation to appoint the SFC representatives, and would only be entitled to do so if the Exchange's directors consider this to be in line with their fiduciary duties, e.g. to act in the best interests of the Exchange.

It is questionable however 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. The SFO makes clear that the SFC and Exchange operate as separate entities with distinct but complementary functions; hence section 25 of the SFO provides for the SFC to transfer its functions 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, with the result that it will effectively be supervising itself.

It is also questionable whether the Exchange is in fact entitled to effectively renounce its power to determine listing applications and matters related to listed issuers involving LRC Matters in favour of the SFC, which has no inherent right to reject listing applications except in the specific circumstances set out in the Stock Market Listing Rules.

Moreover, HKEX's statement of its vision requires it to "*carefully consider the broader interests of the market*" and to ensure that its initiatives "*should reinforce Hong Kong's standing as an international financial centre and support the country's further development.*"¹⁹ It is the view of the authors of this paper that the Consultation's proposals do not fulfil that objective.

4 Lack of Rationale for the Proposed Changes

4.1 Success of the Exchange

¹⁵ Section 19(1)(a) of the SFO.

¹⁶ Sections 23 and 24 of the SFO.

¹⁷ Main Board Listing Rule 2A.01 and GEM Listing Rule 3.01.

¹⁸ Article 92 of the Exchange's Articles of Association.

¹⁹ HKEX. "*Company Profile - Summary of vision and outlook*". 8 March 2016. HKEX website.

The need or rationale for the proposed changes to the Exchange's decision-making and governance structure has not been articulated in any convincing way in the Consultation. General market sentiment is that the current system, in place for more than 20 years, has worked well: the Exchange ranked as the world's top IPO fundraising exchange in 2015²⁰ and has ranked in the world's top five IPO-fundraising exchanges for the last 14 consecutive years.

The SFC's annual reports on the Exchange's performance of its regulation of listing matters consistently express its view²¹ that the Exchange's operational procedures and decision-making processes were appropriate to discharge its statutory obligation to ensure, so far as reasonably practicable, an orderly, informed and fair market.²² Those reports also record the finding that market participants surveyed by the SFC are generally satisfied with the Exchange's efficiency and fairness in its vetting process for listing and post listing matters.²³

The number of "problematic" listings is also relatively small given the number of private Chinese companies which have listed on the Exchange in recent years. Moreover, the Exchange has not seen anything like the number of scandals related to accounting irregularities and corporate governance failures that resulted in the delisting of many US-listed Chinese companies, despite the much larger number of Chinese companies listed in Hong Kong.

4.2 Considerable Powers of the SFC under the Existing Regime

A stated objective of the proposals is to allow the SFC to have earlier and more direct input on listing matters²⁴ which is to be achieved by decisions involving suitability issues or having broader policy implications being made by the proposed new LRC.

However, the SFC already has significant powers to intervene in listing applications and the regulation of listed issuers as set out in Annex 1. Very briefly, the SFC already has:

- i. the right to object to a listing application within the 10 business days after submission of the application on specified grounds, or where the SFC has made a request for further information within 10 business days after submission of the listing application, the SFC may object to the listing within 10 business days of the information being supplied.²⁵ The SFC's ability to object to a listing application within the initial 10 business days following filing of the listing application is facilitated by the filing of

²⁰ HKEx "Market Statistics 2015" at page 8.

²¹ See for example the SFC's "Report on the Securities and Futures Commission's 2015 annual review of the Exchange's performance in its regulation of listing matters". June 2016. Paragraph 24.

²² Section 21 of the SFO.

²³ See for example the SFC's "Report on the Securities and Futures Commission's 2015 annual review of the Exchange's performance in its regulation of listing matters". June 2016. Paragraph 27.

²⁴ Paragraph 1(b) of the Consultation Paper.

²⁵ Sections 6(2) and 6(6) of the Stock Market Listing Rules.

listing applications with the SFC, which gives the SFC access to the documentation at a much earlier stage than the Listing Committee;²⁶

- ii. the right to be notified of any potentially controversial or novel matter arising from a listing application.²⁷ The Consultation acknowledges that many novel and controversial issues are already resolved between the Listing Department and the SFC at the listing application stage as a result (i.e. before the involvement of the Listing Committee);²⁸ and
- iii. the right to require the Listing Committee and the Listing Appeals Committee to review any matter, including its own decision,²⁹ subject to the agreement of the SFC Chairman.³⁰ The SFC is thus empowered to call for a further review of any decision with which it disagrees.

The SFC thus has the right to intervene at the very outset of the listing approval process by virtue of its rights under the Stock Market Listing Rules referred to in paragraphs (i) and (ii) above. The stated justification that the Consultation's proposals will give the SFC earlier input on listing matters³¹ does not therefore seem to be borne out. Moreover, the Consultation proposes that the SFC should retain its existing rights and also have the additional right to participate in decisions on listing matters involving LRC Matters, as well as the right to set policy through membership of the LPC.

The additional powers to be given to the SFC under the proposals represent a substantial increase in its powers in respect of listing applications and matters. Yet it is not clear from the Consultation 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 Listing Regulatory (Review) Committee (LRRC) will be the review body for decisions of the LRC. Half of the LRRC's membership will be composed of senior SFC officials. This raises the question of whether the SFC members of the LRRC 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 LRRC SFC members could then overturn.

The SFC has similarly broad rights in relation to listed issuers, including the right to order the suspension of shell companies from trading. Section 8 of the Stock Market Listing Rules allows the SFC to direct the Exchange to suspend dealings in a listed issuer's securities in a range of circumstances, including, among others, where it appears to the SFC that:

²⁶ Section 5 of the Stock Market Listing Rules.

²⁷ Paragraph 6.6 of the MOU.

²⁸ Paragraphs 2 and 3 of Appendix B to the Consultation Paper.

²⁹ Paragraph 10.6 of the MOU.

³⁰ Paragraph 10.7 of the MOU.

³¹ At paragraph 1(b) of the Consultation Paper.

- (i) it is necessary or expedient in the interest of maintaining an orderly and fair market in securities traded through the facilities of a recognized exchange company:
- (ii) it is in the interest of the investing public or in the public interest, or it is appropriate for the protection of investors generally or for the protection of investors in any securities listed on a recognized stock market.

These statutory powers allow the SFC to perform its function as regulator to order the suspension of an issuer which has not been suspended by the Exchange. This is however very different from the SFC's proposed new power to decide on post-listing matters involving LRC matters through its representatives on the LRC, which will see the SFC taking a substantial step towards front-line regulation, which is at odds with its regulatory function.

4.3 Alternative Means of Dealing with Shell Company Listings

Comments in the media³² 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.

There are however a number of ways in which these practices can be addressed and the Exchange has indicated that a further review of relevant Listing Rules will be conducted in the near future.³³ Efforts to clamp down on shell listings and reverse takeovers should be effected through more robust regulation of listed issuers. 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. New listing applicants, particularly on GEM, are currently volunteering ridiculously 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.

The Listing Committee has considerably tightened the regulation of shell companies and reverse takeovers in recent years³⁴ and keeps these matters under review. The remaining

³² The Standard. "<http://www.thestandard.com.hk/section-news.php?id=172250>" *Bourse split over listing row*". 2 August 2016. Reuters. " [HYPERLINK "http://www.reuters.com/article/hongkong-listing-regulations-idUSL4N19931E"](http://www.reuters.com/article/hongkong-listing-regulations-idUSL4N19931E) *Update 1-Hong Kong proposes changes to stock market listing regime*

³³ The HKEC's "*Listing Committee Report 2015*" states that its policy agenda for 2016 and beyond includes reviewing the regulation of listed company activities including RTOs and cash companies, reviewing the handling of long suspended companies, delistings and related requirements, and reviewing the requirements for listed issuer's equity fund raisings, as well as reviewing the Growth Enterprise Market.

³⁴ 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

concerns relating to shell companies and reverse takeovers 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 thereby protecting its reputation. 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.³⁵

Consideration could also be given to whether the regulators should be given 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.

4.4 Existing provision for cooperation between the SFC and the Exchange

A further objective of the proposals is the perceived “*need for enhancing the coordination and cooperation [between the SFC and the Exchange] when developing new policy in listing regulation and in regulatory decision making*”.³⁶ Yet substantial interaction and cooperation between the SFC and the Exchange is already provided for by monthly Listing Matters Liaison Meetings³⁷ which should discuss, among others, “*any policy or other matters, including potential changes to the Listing Rules, relating to any of the functions and responsibilities of the [Exchange] or the SFC*”. It would seem that the stated objective can therefore be achieved without any change to the existing regime.

4.5 Questionable Need for Improvement in Efficiency

The Consultation claims that its proposed amendments will “*simplify the process for IPO applications so that they can be vetted and approved more efficiently*”.³⁸

Since the changes to the listing application process were implemented in October 2013, there have been improvements in the efficiency of the listing approval process 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. As a result, the time taken for the Exchange to comment and reach a decision on listing applications has been significantly reduced. In 2014, 72% of listing applications were reviewed by the Listing

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 (HKEX Guidance Letter GL84-15).

³⁵ HKEX. “*Guidance Letter HKEX-GL68-13A*”. June 2016.

³⁶ Paragraph 47 of the Consultation Paper.

³⁷ These are required to be held by paragraph 10.3 of the MOU.

³⁸ Ibid. at paragraph 1(c).

Committee within 120 days of submission³⁹ (compared to 33% in 2012).⁴⁰ Inefficiencies in the listing approval process have already been resolved by the substantial changes to the listing process implemented in 2013. The need to improve efficiency in the listing approval process is more perceived than real. 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.⁴¹ In any event, the proposal that listing applications involving LRC Matters would be reviewed by two separate committees, the Listing Committee and the LRC, would be more likely to decrease rather than increase efficiency.

The Listing Department will be responsible for the initial categorisation of cases as ones involving LRC Matters or not. Given the generally cautious approach of the Exchange, it is likely that matters showing the slightest possibility of involving an LRC Matter will be referred to the LRC for determination. For example, the implementation of the statutory inside information disclosure regime saw a vast increase in the number of issuer announcements due largely to the uncertainty of what is "inside information" and the better safe than sorry approach adopted by many. There is legitimate concern that the same approach could be adopted to whether or not cases involve LRC Matters. This could potentially result in a large number of cases being reviewed by the LRC and subject to the two-stage approval procedure.

4.6 Consultation's failure to make the case for significant reform

In summary, therefore, the Consultation has not made a sufficient case to justify the significant reforms proposed. With global IPO activity in the first half of 2016 significantly lower than in the same period last year,⁴² any proposal to substantively reform listing approval procedure, with its potential to cause listing applicants to go elsewhere, must be carefully and fully justified. While Hong Kong continued to rank as the world's top IPO fund-raising market in the first half of 2016,⁴³ the regulators must not risk complacency. Drastic regulatory change could have a significant detrimental effect on Hong Kong's attractiveness as a listing venue. There has been a noticeable lack of interest from overseas companies in listing on the Exchange: this contrasts with the position in 2010 and 2011 which saw the listings of a number of foreign companies in the luxury goods and mining sectors (including Prada, Samsonite, L'Occitane, Coach, Vale S.A. (since delisted), SouthGobi, and Rusal).

It should also be remembered that Hong Kong's regulatory regime, which comprises the SFO with its stringent Market Misconduct and inside information disclosure regimes, as well as the Takeovers Code and Code on Share Buy-backs, in addition to the Listing Rules, provides

³⁹ 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.

⁴⁰ 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.

⁴¹ Ibid. at Appendix A.

⁴² Ernst & Young. "EY Global IPO Trends 2016 2Q". Page 1.

⁴³ PwC. "Hong Kong led globally in both number of IPOs and funds raised in 1H 2016". 4 July 2016. http://www.pwchk.com/home/eng/pr_040716.html

substantial protections for investors in Hong Kong's securities market. Much is made of the benefits of the US class action regime, yet the SFC has been extremely successful in recent years in obtaining redress for investors who have suffered loss as a result of misconduct by Hong Kong listed companies.⁴⁴ In 2016, Hong Kong was ranked first worldwide for protection of minority investors' interests by the World Bank's report "*Doing Business 2016, Measuring Regulatory Quality and Efficiency*". In short, the existing regime has seen the Exchange top rankings for both IPO funds raised and the protection provided to minority shareholders. There are thus no convincing reasons for change.

While the Consultation bears the promising title, "*Proposed Enhancements to the Exchange's Decision-Making and Governance Structure*", its stated objectives are already provided for and are either already achieved, or are achievable, under the present regime. The Consultation does not set out the inefficiencies or mischief the proposals are intended to address and there is no elaboration of the "enhancements" promised by the paper's title. In short, the Consultation's stated objectives and vague promises of improvements to the existing regime appear to be a smokescreen for the SFC's consolidation of control over the companies which are allowed to list, and remain listed, on the Exchange, control which will be unfettered by the vital checks and balances which are built into the current regime.

5 Fundamental conflict of interest between the SFC's role as statutory regulator and the need to develop the Exchange as a high performing and innovative international market

The SFC's primary 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*".⁴⁵ It is further tasked with securing "*an appropriate degree of protection for members of the public investing in or holding financial products, having regard to their degree of understanding and expertise of investing in or holding financial products*".⁴⁶

The provision that the SFC should have regard to "*the desirability of maintaining the status of Hong Kong as a competitive international financial centre*" and "*the desirability of facilitating innovation in connection with financial products*" in performing its functions⁴⁷ is very much a secondary consideration. It is worth noting here that the SFC's role under the SFO is a much watered down version of its role under the SFO's predecessor ordinance, the Securities and Futures Commission Ordinance (Cap. 24) (the **SFCO**) (now repealed). The SFC's functions under the SFCO 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*".⁴⁸ Perhaps because of the inherent

⁴⁴ Using its powers under sections 213 and 214 SFO, the SFC obtained a HK\$1 million share repurchase order against Hong Kong-listed Hontex International Holdings Company Limited following false and misleading disclosure in its prospectus.

⁴⁵ S.5(1)(b)(i) of the SFO.

⁴⁶ S.5(1)(l) of the SFO.

⁴⁷ S.6(2)(a) of the SFO.

⁴⁸ S4(1)(j) of the Securities and Futures Commission Ordinance (Cap. 24).

incompatibility with its role as protector of investors' interests, that laudable objective has now been replaced with a secondary requirement to consider "maintaining" (not developing) Hong Kong's status as a competitive international financial centre. With the dropping of the specific function/obligation to develop the Hong Kong securities market, the role of the SFC today is primarily that of market regulator and protector of investors' interests.

It is disappointing that the requirement enshrined in the Basic Law, that "The Government of the Hong Kong Special Administrative Region shall provide an appropriate economic and legal environment for the maintenance of Hong Kong as an international financial centre",⁴⁹ is not provided for by any corresponding obligation on either the SFC or the Exchange to maintain the international status and competitiveness of its stock exchange. The Exchange's position as an international listing venue is clearly essential to Hong Kong's status as an international financial centre.

It is arguable therefore that the SFC is irredeemably conflicted: its primary function of regulating the market and protecting investors is antithetical to the very real need to develop the Hong Kong securities market. Development of Hong Kong's market requires both an innovative and pragmatic approach to regulation to secure Hong Kong's continued attractiveness to issuers and investors alike and to maintain its position as Asia's leading international Exchange.

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, notwithstanding the market's support for a second stage consultation.⁵⁰

If the Exchange fails to remain competitive, it will inevitably lose out to the Chinese exchanges which are possibly already ahead of the Exchange in the proposals to adopt a US-style registration- (i.e. disclosure-) based listing regime.

It should also be remembered that the rationale for the Listing Committee's role lies in its make-up by market practitioners. The Report of the Securities Review Committee on the Operation and Regulation of the Hong Kong Securities Industry, commonly referred to as 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".⁵¹ 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.⁵² The SFC members of the new LRC and LPC will be regulators, and are thus likely to be unduly risk-averse since they will be more intent on preventing

⁴⁹ Article 109 of the Basic Law of the Hong Kong SAR.

⁵⁰ HKEC. "Consultation Conclusions to Concept Paper on Weighted Voting Rights". June 2015. Chapter 5.

⁵¹ Hay Davison Report. May 1988. At paragraph 3.24.

⁵² Ibid. at paragraph 3.26.

potential problems and protecting investors' interests than on market development. There is a real concern therefore that the proposals will stifle market development and innovation which may adversely affect the competitiveness of the Hong Kong market and Hong Kong's position as Asia's premier financial centre.

6 Lack of conflict of interest under the current regime

Much is made of the perceived conflict of interest in the Exchange's role in the listing approval process. The argument goes something like this: the Exchange collects listing fees - thus it is in its interest to approve more new listings than may be objectively justifiable. Except that the Exchange currently has only one representative, its chief executive, on the 28-member Listing Committee which approves or rejects listing applications.

The Listing Committee acts an independent administrative decision maker and as an advisory body for the Exchange. As acknowledged in the Consultation, the Exchange 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 interests and ensure the independence of the listing function".⁵³ The independence and combined experience of the Listing Committee's 28 members enables the Listing Committee to perform the vitally important role of making the most important decisions and setting policy impartially and in the best interests of the market.

If maximising listing fees were the Exchange's primary motivation, then surely that objective would be in complete alignment with the objective of providing a high performing, innovative market which is in the interests of issuers, investors and the Hong Kong financial market in general. Moreover, profit would be extremely unlikely to provide a motive for accepting GEM listings given the far greater resources required to vet GEM listing applications and the minimal listing fees and trading fee income generated for the Exchange.

7 Increase in SFC's powers

The SFC has been at pains to deny that the proposals will increase its powers given that it is already able to veto new listing rules and cases.⁵⁴ In fact, the SFC's right to object to a new listing exists only in the circumstances provided under section 6 of the Stock Market Listing Rules. Provided that a listing applicant satisfies the listing requirements and complies with the prospectus disclosure requirements, its listing should be approved except where it is considered not to be suitable for listing. Decisions on suitability are currently made by the independent Listing Committee, although whether or not the applicant's listing is contrary to the public interest, which overlaps substantially with the suitability issue, is determined by the SFC who can object to the listing if it considers the listing to be contrary to the interests of the investing public. The determination of suitability for listing is currently made by an independent Listing Committee comprising 28 individuals, the

⁵³ At paragraph 40 of the Consultation Paper.

⁵⁴ The Standard. "SFC allays fears on power". Daisy Wu. 5 August 2016.

Exchange's CEO and 27 market practitioners (including lawyers, investment bankers and accountants), listed company and investor representatives.

The Consultation's proposals would significantly increase the SFC's powers in relation to listing approvals and regulation of listed issuers for the reasons set out below.

7.1 The SFC will effectively control LRC and LPC composition

Under the proposals, decisions on suitability and matters with broader policy implications will be made by the LRC consisting of just six individuals: three senior executives of the SFC's Corporate Finance Division and the Chairman and two Deputy Chairmen of the Exchange's Listing Committee. While this is presented as a sharing of power between the Exchange and the SFC, the SFC will in fact control and dominate the composition of the LRC and LPC.

The Chairman and Deputy Chairmen of the Listing Committee (i.e. the three LRC members under the proposals) are nominated by the Listing Nominating Committee (LNC) (Listing Rule 2A.21). The LNC is made up of three non-executive directors of the Exchange's Board and the Chairman and two executive directors of the SFC. This effectively gives both the SFC and the Exchange the ability to veto the nomination of any individual as Chairman or Deputy Chairman of the Listing Committee. The SFC's right to veto any individual's nomination to these positions (and thus to membership of the LRC) will give the SFC absolute control over who is appointed as the Listing Committee's members of the LRC. Neither the Exchange nor the Listing Committee will have a comparable influence over who are the SFC representatives on the LRC. Moreover, it should be recognised that while the SFC representatives are all employees of the SFC who represent its views, the same is not the true of the Listing Committee Chairman and Deputy Chairmen. These are independent individuals who will vote according to their conscience as they currently do as members of the Listing Committee. They are not bound to follow the Exchange's views on any issue and are not its representatives.

The LPC will also be under the control of the SFC. The SFC will directly control the composition of half its members who will be the CEO of the SFC, two senior executives of the SFC's Corporate Finance Division and the Chairman of the Takeovers Panel, who is appointed Chairman 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 hadn't 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 mentioned above). It is therefore a fallacy to suggest that there will be no increase in the SFC's power 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 open to question. The authors take issue with 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 practicable.⁵⁵ If alignment is the intention, this would arguably be achieved by the proposals. However, if both committees have a core composition of the same individuals, their decisions will not benefit from challenges and opposing viewpoints with the danger that the decision-makers become blinkered to real concerns and arguments.

7.2 SFC to influence the most significant listing decisions

The SFC has insisted that there will be no increase in its powers since the new LRC will only decide the 10% of new listings which involve suitability issues or matters having broader policy implications. These are however the most important new listings since the LRC's decisions on these cases will determine those companies which are considered unfit for listing in Hong Kong notwithstanding that they meet the objective listing criteria. The increase in the SFC's influence will therefore be disproportionate to the number of cases reviewed by the LRC. While the Listing Committee will review all listing applications, including those to be referred to the LRC for decision, and its comments will be conveyed to the LRC, the latter will not be bound to take those comments into account in reaching its decision. Nor will there be any requirement for the LRC to explain why it does not follow the Listing Committee's advice in any particular case, giving it *carte blanche* to ignore the Listing Committee's views.

According to SFC figures,⁵⁶ it commented on or raised concerns with respect to 216 of the 218 listing applications submitted to it under the dual filing process in 2015. Of these, three were returned for not being substantially complete,⁵⁷ while six were rejected by the Listing Committee.⁵⁸ Thus of 216 listing applications only six were rejected for listing. Even assuming that these six were all rejected due to lack of suitability or public interest concerns, they only represented 2.8% of the listing applications reviewed by the SFC. If the numbers are really that small, there surely must be a question as to whether the proposed substantive reforms are justifiable.

7.3 Lack of scrutiny of "routine" listing applications

Of perhaps even greater concern, is that the vast majority of listing applications which do not involve suitability or policy concerns, will no longer be commented on by the SFC under the Consultation's proposals. Given that the SFC last year commented on, or had concerns about, 216 out of 218 listing applications, there must be a concern that these supposedly non-controversial or routine applications will be deprived of the degree of SFC scrutiny to which they have previously been subjected.

⁵⁵ Paragraph 76 of the Consultation Paper.

⁵⁶ SFC. *"Regulation for Quality Markets – Annual Report 2015-16"*.

⁵⁷ HKEX Listing Decision HKEX-LD101-2016. April 2016.

⁵⁸ HKEX Listing Decision HKEX-LD100-2016. April 2016.

Request for Comment

Specific comments under the headings suggested by the Consultation are set out below.

1 Policy development

There is no need for the establishment of a new LPC as the SFC already plays a significant role in policy as summarised in Annex 2. The MOU provides for a High-Level Liaison Group to meet regularly to discuss policy and systemic issues. If this group is not already discussing and reviewing policy issues as envisaged by the MOU, it is perhaps now time that it should start. The addition of market practitioner members of the Listing Committee to this High-Level Group would make it a preferable alternative to the currently proposed LPC.

2 Listing applications by new applicants

Under the proposals, the determination of suitability for listing 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. There is no comparable suitability requirement for listing on other international stock markets – so that a listing applicant will be listed provided it can demonstrate compliance with objectively ascertainable criteria. Suitability defies precise definition. Thus the factors the Exchange (through the Listing Committee) takes into account in determining suitability as stated in its Guidance Letters⁵⁹ are non-exhaustive and are outlined in broad terms only. Factors affecting suitability include, among others, excessive reliance by the listing applicant on a third party (e.g. the parent group, connected persons or a major customer); an unsustainable business model as indicated for example by a deteriorating financial performance after the track record period; or a changing regulatory environment and industry outlook. These are clearly 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 Listing Committee members. Instead, under the proposals, the Listing Committee will be largely reduced to rubber stamping the most straight-forward listing cases.

The Consultation's proposals will mean 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, while there is no requirement for a sponsor representative on either committee. Given that the SFC's statutory functions include securing protection for members of the investing public⁶⁰ 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

⁵⁹ Guidance Letters HKEx-GL68.13 (Guidance on suitability for listing) and HKEx-GL68-13A (Guidance on IPO vetting and suitability for listing).

⁶⁰ Section 5(1)(l) of the SFO.

investor representative to be one of the Listing Committee's members of the LRC. Given the "unique" role in the IPO process ascribed to sponsors by the SFC,⁶¹ it is surprising that there is no provision for sponsor representation on the new committees.

3 Matters involving listed issuers

Comments relating to the LRC's ability to decide listing applications apply equally to its decision-making role on matters involving listed issuers. Again, the presence of market practitioners on the relevant decision-making body is essential to making the difficult, subjective decisions required to be made in the case of listed issuers. Decisions, for example, as to whether a listed issuer complies with Listing Rule 13.24 – that is whether its operations or assets are sufficient to warrant its continued listing, are rarely clear-cut and thus are best made by the existing Listing Committee with its wealth of commercial expertise.

4 Reviews of Listing Decisions

The Consultation proposes that the LRC (whose composition, as discussed above, will be effectively under the SFC's control) will replace the Listing (Review) Committee as the body to review the decisions of the Listing Committee on non-LRC listing applications. A decision of the LRC to reject a listing application will be subject to review by a newly formed Listing Regulatory (Review) Committee (the LRRC). It is proposed that the new LRRC will be made up of the Chairman and CEO of the SFC (as ex officio members) and a non-executive director of the SFC nominated by the SFC board and three individuals who have formerly served on the Listing Committee, one of whom must be an investor representative. The former Listing Committee members will be nominated by the Listing Nominating Committee, thus raising the same issue that the committee's composition is under the control of the SFC as discussed in relation to the LRC and LPC above. Again, the interests of investors are already sufficiently protected by the three SFC representatives on the LRRC without one of the Listing Committee representatives needing to be an investor representative. This would tilt the balance on the LPC towards investor protection.

As mentioned above, the level of review of LRC decisions will be considerably below the rights of review of SFC decisions to object to a listing application under section 6(2) of the Stock Market Listing Rules. Under the current regime a listing applicant can apply for a review of an SFC decision under the Stock Market Listing Rules by the SFAT, which is chaired by a judge, and has a further right of appeal on a matter of law to the Court of Appeal. The level of review of SFC decisions under the proposed regime will be lower than under the current regime which raises concerns for the protection of investors. This proposal also arguably reduces SFC accountability.

5 Disciplinary Matters

⁶¹ Paragraph 5 of the SFC's "Consultation Paper on the regulation of sponsors" (May 2012) states "*The role of sponsors is unique ... only sponsors have a function that begins and ends with the IPO itself and are specifically licensed by the SFC*".

Under the Consultation's proposals, the disciplinary powers of the Listing Committee under Chapter 2A of the Listing Rules will be removed. Disciplinary powers will instead be vested in the Listing (Disciplinary) Committee and the Listing (Disciplinary Review) Committee which will comprise Listing Committee members but will be chaired by a practising or retired senior counsel (or another individual of equivalent qualification) who is a member of the proposed new Listing Disciplinary Chairperson Group.

Currently, disciplinary hearings are conducted in accordance with the Exchange's statement on its approach to the enforcement of the Listing Rules⁶² (the **Enforcement Statement**) and its procedures for disciplinary matters involving breaches of the Listing Rules⁶³ (the **Procedures**). When these were last updated in September 2013, the Exchange noted that the disciplinary process remains informal and is designed to be flexible.⁶⁴ There is a concern that the proposal that disciplinary hearings are chaired by a senior counsel will fundamentally alter the nature of these proceedings, resulting in a far more formalised and legalistic forum than is presently the case. Under the existing Listing Rules,⁶⁵ while the party the subject of disciplinary proceedings is entitled to make submissions and may be accompanied by professional advisers, the professional adviser has no right to address the Listing Committee or Listing Appeals Committee, as the case may be. Under the principles of natural justice, the chairing of the new committees by senior counsel might suggest that issuers' counsel should be given rights of audience at relevant hearings which is likely to increase the formality and length of hearings as well as the legal costs incurred by issuers or their directors.

While the Listing Rules provide for the suspension or cancellation of a listing in the case of a breach of the Listing Rules, in the vast majority of cases the sanctions imposed are reputational public sanctions, remedial actions, or denial of the market's facilities in the case of wilful or persistent failure by an issuer to discharge its Listing Rule responsibilities. Given the nature of these lesser sanctions, which constitute the vast majority, it is questionable whether it is appropriate to risk rendering the disciplinary hearings more legalistic and formal.

During 2015, there were eight disciplinary hearings – six at first instance and two review hearings involving six cases.⁶⁶ The disciplinary committees will be comprised of Listing Committee members and chaired by senior counsel. The risk in making disciplinary proceedings more formalised is that this will impact the length of such proceedings making them less efficient than is currently the case. The revisions to the procedures made in September 2013 were intended to expedite disciplinary

⁶² HKEX. "Statement on the enforcement of the Listing Rules by the Exchange". http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/documents/enfs_0913.pdf

⁶³ HKEX. "Disciplinary Hearings Procedures".

⁶⁴ HKEX. "Stock Exchange Publishes New Statement on Enforcement of Listing Rules and Implements New Procedures for Disciplinary Action Involving Listing Rules". <http://www.hkex.com.hk/eng/newsconsul/hkexnews/2013/130913news.htm>

⁶⁵ Listing Rule 2A.16.

⁶⁶ HKEX. "Listing Committee Report 2015". Paragraph 68.

proceedings and ensure that regulatory outcomes are “*delivered in a timely and efficient manner*”.⁶⁷

6 Oversight of the listing function

It is proposed that the LPC will replace the Listing Committee as the body responsible for oversight of the listing function and, generally, the performance of the Listing Department’s regulatory responsibilities.⁶⁸ The LPC is also to 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*”.⁶⁹ This latter proposal is completely unacceptable given the obvious need for the Listing Department to be independent of, and to be seen to be independent of, the LPC, and indirectly, of the SFC.

The Listing Committee was originally made responsible for oversight of the listing function and the Listing Department’s performance precisely because it is independent of the Exchange. While the Listing Committee has a right of oversight, it is not responsible for Listing Department remuneration, as is proposed for the LPC.

7 Publication of Decisions

It is proposed that decisions of the LRC, the LRRC, the Listing (Disciplinary) Committee (the LDC) and Listing (Disciplinary Review) Committee (the LDRC) will be routinely published on the HKEx website together with reasons for those decisions. Whilst not an objection in itself, any such new protocol would change the timetable for the decisions as currently made, in terms of increasing the legalistic and formalistic nature of the decisions and hence the decision making process.

8 Composition and Procedures of the LPC, LRC, LDC and LDRC

8.1 Composition

As commented above, it is undesirable for the composition of the new committees to be under the effective control of the SFC and the lack of market practitioners on the new committees is contrary to the Hay Davison conclusion that practitioner-based regulation is the best option for Hong Kong. Despite that decision having been made more than 20 years ago, it is considered it still holds true today.

A number of parties have suggested that instead of the new committees, the same objective of giving the SFC greater and earlier input on policy and listing decisions could be achieved by adding three SFC representatives to the Listing Committee. This suggestion definitely appears

⁶⁷ Enforcement Statement at page 3.

⁶⁸ Paragraphs 28 and 129 of the Consultation Paper

⁶⁹ Ibid.

worth consideration, although it is suggested that the Consultation's proposal that the Listing Department should classify appropriate listing applications as ones involving suitability issues (which in any event may already have been indicated by the applicant's sponsor(s) as required by Paragraph 17 of the Code of Conduct) or other novel matters should be adopted. It is suggested that the SFC members of the Listing Committee would then only be required to attend Listing Committee meetings deciding on listing applications involving these issues. Where the Listing Committee considers that a listing application not flagged by the Listing Department as involving suitability issues etc. in fact raises such issues, the consideration of the relevant application would be postponed until the next meeting, which the SFC's representatives would then be bound to attend. Likewise, instead of a new LPC, SFC representatives would attend all listing committee meetings at which policy issues are discussed. This could be supplemented by meetings of the High-Level Liaison Group which could discuss and guide the Listing Committee on policy-setting. The further advantage of this proposal is that it will reduce the burden on those proposed to be members of the LRC and LPC, while giving matters the undoubted benefit of the views of the 28 Listing Committee members.

It is recognised that there have been some calls for wider representation on the Listing Committee as its current make-up is considered to represent the "vested interests" of those who earn their living from listings. It needs to be recognised however that the Listing Rules and related guidance are highly complex. The great strength of the Listing Committee is that it is composed of corporate finance advisers, lawyers and accountants with years of experience in the Hong Kong IPO market and detailed knowledge of its regulatory regime which others may lack. Members of the Listing Committee are undoubtedly best placed to determine the extremely difficult issues arising under the listing regime. Moreover, the rules governing Listing Committee proceedings adopt a robust approach to the handling of conflicts of interest, as set out in the Listing Committee's Terms of Reference in order to ensure the impartiality of its decisions.⁷⁰

8.2 Procedures

As regards the procedures of the new committees, it is noted that each committee will have an even number of members with no provision for a casting vote in the event of a deadlock. The Consultation fails to specify how issues such as suitability for listing will be determined in the event of a tied vote causing unnecessary uncertainty. The Listing Rules require that listing applicants must be considered to be suitable for listing. In the event of a tied vote, it is not clear whether the application will be disapproved because there is no majority in favour, or whether it would be approved, as a majority failed to find the applicant unsuitable for listing. The same issue would apply to post listing matters. Assuming that a tied vote on a listing application would mean that it will be rejected, then a tie on a post-listing matter, such as whether an issuer should be suspended for failure to comply with Listing Rule 13.24 due to

⁷⁰ Listing Committee Terms of Reference at paragraph 14 "Handling Conflicts of Interest".

insufficient operations or assets, would mean that the suspension would not go ahead – as there would not be a majority vote that the issuer was in breach of Rule 13.24. With such a small number of individuals on the LRC, in particular, it seems unfair to give any one person a casting vote. Yet without a casting vote dead lock cannot be avoided, unless SFC and Exchange representatives are given the casting vote on alternate decisions.

The LRC and LPC are proposed to be committees of the Exchange. It should be noted that the Articles of Association of the Exchange (and the HKEC) stipulate in the article relating to “Procedures at Committee meetings”⁷¹ 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 Exchange’s 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.

9 Other Matters

9.1 Reduced Efficiency

One of the Consultation’s stated objectives is the improvement of efficiency in the listing approval process. For those listing applications involving LRC matters, the proposed approval procedure has the potential to become less efficient. Instead of one hearing by the Listing Committee, the new proposals envisage initial consideration of the application by the Listing Committee whose views are then relayed by the Listing Department to the LRC (as well as the listing applicant and its sponsor). The decision on the listing will then be made by the LRC which will have the benefit of, but will not be bound by, the Listing Committee’s views. Quite apart from a second layer of regulatory hearings, a further inefficiency lies in the requirement for the Listing Committee’s views to be relayed to the LRC by the Listing Department which creates the additional problem of ensuring that the Listing Committee’s views are fully and accurately conveyed. This inefficiency could easily be cured by the suggestion above that instead of having a separate LRC, members of the SFC would instead be obliged to attend listing committee meetings hearing applications flagged by the Listing Department as involving suitability or other novel issues.

9.2 Removal of checks and balances

The proposed removal of the vitally important checks and balances built into the current regime is extremely concerning. The Listing Committee currently acts as an independent

⁷¹ 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.

reviewer of the Listing Department's decisions while the SFC's ability to object to a listing application, and to order the suspension of a listed issuer, operates as an important check on the Listing Committee's exercise of its powers. A vital element of the system of checks and balances is the review process for decisions of the SFC. The exercise of the SFC's statutory powers are subject to judicial review and, in the case of "specified decisions" (which include an SFC decision to object to a listing application under section 6 of the Stock Market Listing Rules), to a review of the decision by the Securities and Futures Appeal Tribunal. A major concern in relation to the proposals is that they will effectively allow the SFC to regulate via the backdoor (i.e. through its participation in the LRC) but since those decisions will be decisions of the Exchange, theoretically at least, they will not be subject to the checks on the SFC's exercise of its powers which currently exist.

9.3 Misguided emphasis on consensus as a good in itself

The Consultation places 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 and resultant group-think is antithetical to proper and full scrutiny and oversight. Excessive emphasis on the desirability of consensus (with its virtue-signaling tone) may discourage the expression of dissenting opinions which need to be heard and properly considered. The concentration of policy-making and regulatory decision making in the hands of such a small group of people, who are then deprived of the benefit of alternative viewpoints and challenge, could be highly detrimental. 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. This advantage will be lost if the proposal for listing decisions to be made by the same six individuals is adopted.

9.4 Problems inherent in 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. designating cases as "routine" at the Listing Department assessment stage could lead to decisions being made too quickly;
- ii. those tasked with deciding "routine" cases 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 the ones to be decided by the

LRC), a review and commenting process is different in key respects from the decision making process;

- iii. the cases presented to the Listing Committee for decision will come with the presumption that they are straightforward and are thus likely to be waved through with a lighter-touch than those subjected to the heavier scrutiny of the LRC;
- iv. since the SFC will cease to comment on listing applications as it does currently under the dual filing process, routine listing applications will not benefit from the scrutiny of the SFC; and
- v. the Listing Committee, being largely relegated to the role of rubber-stamping routine listing applications, will cease to attract the high quality, experienced professionals it has attracted to date.

9.5 Lack of Certainty

The proposed changes will cause considerable uncertainty which may adversely affect the attractiveness of the Exchange as a listing venue.

In addition, it could make it increasingly difficult for sponsors and financial advisers to advise their clients. Fundamental changes to how the IPO process works are the last thing the market needs and they will do nothing to encourage access to the capital markets. The new regime implemented in October 2013 already caused substantial disruption and additional costs, further disruption and costs should not be triggered without very good reason, which has not been established by the proposals made under the present Consultation.

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

The Consultation contains the very sensible proposal 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.⁷² 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 is clearly in listing applicants' interest if they 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 SFC at an early stage, i.e. before listing application submission. This would enable listing applicants to make a more informed

⁷² Paragraph 11 of the Consultation Paper.

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.

Otherwise, the danger is that only companies who most obviously meet the suitability criteria will apply to list in Hong Kong. This could restrict listing applicants to the very largest financial and property companies. Not only would this limit investor choice to only the most obvious investments, but it would also deprive SMEs of the funding they require for growth and expansion, potentially depriving investors of the opportunity to invest in the stars of the future. It is noted that the three candidates for the financial services industry's representative at the recent Legco election all expressed their opposition to the Consultation's proposals.⁷³ Moreover they are calling 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.

9.7 Conflict in SFC's role in consulting on market reforms as the statutory regulator of IPO sponsors

The implications of the Consultation's proposals are far-reaching, but are of particular relevance to the investment banks and corporate finance advisers who act as sponsors to listing applicants. It seems inherently unfair, that these parties should have to respond on issues which go to the heart of their business to the entity which is their statutory regulator, the SFC. If the aim of the Consultation is to elicit full and frank views on its proposals, it is considered that the consultation process should be conducted by an independent body, such as the Financial Services and Treasury Bureau, particularly in view of the increase in SFC powers proposed and the possible requirement for amendments to the Stock Market Listing Rules.

Conclusion

In conclusion, we would urge the SFC to reconsider the proposed reform changes. As stated above, it is thought that the regulators will be far more successful in discouraging practices such as shell listings if enhanced resources are allocated for active surveillance and monitoring of listed issuers' post-listing activities and parties engaged in any suspected price rigging of "shell companies" and reverse takeovers. The few areas with the potential to damage the market's reputation, such as backdoor listings, are best dealt with through the existing post-listing enforcement regime. 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

⁷³ South China Morning Post. "Hong Kong should change listing rules to attract tech companies to raise funds, candidates say". 28 August 2016.

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 the regulators still feel that SFC representatives need more direct involvement in the listing application approval process, we would urge them to give consideration to the suggestion that SFC representatives should attend all Listing Committee hearings involving LRC Matters. Listing applicants would then benefit from the input of a committee representing all relevant interests, investors, regulators and market practitioners and the committee would facilitate the coordinated listing approval process sought by the regulators. Likewise, to give the SFC greater input on policy matters, SFC representatives could also attend all listing committee meetings at which policy is discussed.

ANNEX 1

Role of the SFC in respect of Listing Applications and Regulation of Listed Issuers

1. Right to object to a listing application under the dual filing process

Under sections 6(2) and 6(6) of the Securities and Futures (Stock Market Listing) Rules (Cap. 571V) the SFC has the right to object to a listing application within 10 business days of its submission (or within 10 business days from when further information is provided to the SFC in the case of (c) below) if it appears to the SFC that:

- i. the application does not comply with the Listing Rules or any provision of applicable law or does not contain the information necessary to enable an investor to make an informed assessment of the applicant's activities, assets and liabilities, financial position and profits and losses;
- ii. the application is false or misleading as to a material fact or is false or misleading through the omission of a material fact;
- iii. the applicant has failed to comply with a requirement for further information made by the SFC within 10 business days of submission of the listing application, or has provided the SFC with materially false or misleading information in purported compliance with such a requirement for further information; or
- iv. it would not be in the interest of the investing public, or in the public interest for the securities to be listed.

2. Right to direct the Exchange to suspend dealings in a listed issuer's securities

Section 8 of the Stock Market Listing Rules entitles the SFC to direct the Exchange to suspend dealings in the securities of a listed issuer if it appears to the SFC that:

- i. any materially false, incomplete or misleading information has been included in any (i) document issued in connection with a listing of securities on the Exchange; or (ii) announcement, statement, circular or other document made or issued by or on behalf of an issuer in connection with its affairs;
- ii. it is necessary or expedient in the interest of maintaining an orderly and fair market in securities traded through the facilities of the Exchange;
- iii. it is in the interest of the investing public or in the public interest, or it is appropriate for the protection of investors generally or for the protection of investors in any securities listed on the Exchange; or
- iv. an issuer has failed to comply with a condition imposed by the SFC in permitting dealings to recommence.

3. The right to require the Listing Committee and the Listing Appeals Committee to review its own decision

Paragraph 10(6) of the Memorandum of Understanding Governing Listing Matters (**MOU**) entered into between the SFC and the Exchange gives the SFC the right to require the Listing Committee and the Listing Appeals Committee to consider or review any matter, including a decision of the respective committee itself.

4. The right to be informed of novel or potentially controversial issues

Paragraph 6.6 of the MOU requires the Exchange to 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 in connection with a listing application, a transaction involving a listed issuer or otherwise.

Annex 2

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 Rule Changes

The SFC and Exchange hold "Listing Matters Liaison Meetings" monthly to discuss, among others, policy or other matters including potential changes to the Listing Rules.

6 Review of Systemic and Policy Issues

The MOU envisages a "High-Level Group" of Exchange and SFC representatives that meets from time to time to review systemic and policy issues concerning listing-related matters,⁷⁴ the membership of which 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.⁷⁵

⁷⁴ Paragraph 5.1 of the MOU.

⁷⁵ Ibid. at Appendix II.