

17 October 2016

Corporate Finance Division  
Securities and Futures Commission  
35/F, Cheung Kong Center  
2 Queen's Road Central  
Hong Kong

Dear Sirs

**RE: Consultation Paper on Proposed Enhancements to the Exchange's Decision-Making and Governance Structure for Listing Regulation (the "Joint Consultation Paper")**

---

I am writing to express my comments on the Joint Consultation Paper. In summary, I am, in principle, in support of the creation of a new Listing Policy Committee but an enhanced Listing Committee in lieu of the creation of a separate Listing Regulatory Committee.

**Policy Development**

In general, any effort made by the Securities and Futures Commission (SFC), Hong Kong Exchanges and Clearing Limited (HKEx) and market participants to streamline processes and to make the market operations becoming more effective and efficient will always be welcomed.

While any further collaboration between the SFC, the HKEx and market participants can be viewed as a positive step forward, one needs to examine whether the proposed structural reform can serve the "why". It would appear that more would need to be done in order to achieve the desired outcome and to solve the real "why" or the real motive, whatever it is, in its entirety.

**Listing Policy Committee**

The HKEx has been criticized of having a conflict of interest as being both a regulator and a profit-making bourse at the same time. To this effect, I am in support of the creation of a separate Listing Policy Committee that will oversee all regulation matters.

While on this subject, currently, listed companies have to comply with both the Listing Rules as well as rules that are governed by the SFC, such as the Securities and Futures Ordinance (SFO) (s 169) and the Codes on Takeovers and Mergers and Share Buy-backs (the "Takeovers Code"), at the same time.

To be more effective in terms of reporting lines and given the nature of its composition, ideally the Listing Policy Committee would oversee both the Listing Rules as well as any other rules and regulations that the SFC is currently overseeing that would affect listed companies. With all the regulations under one roof and one regulatory body, that would make the job of market practitioners and listed issuers easier, and reduce the chance of making errors.

#### Listing Regulatory Committee

I do not see the value in having a Listing Regulatory Committee that is separate from the Listing Committee itself to oversee the vetting and approval of certain listing applications for the following reasons:

1. There has already been a set of suitability criteria for listing published by the HKEx in June 2016. As long as this set of criteria is effective in itself as well as being strictly followed by the Listing Committee, there should not be any need for a separate committee to examine certain cases that would be categorized as "special". If that was not the case, the criteria could be further enhanced to avoid any grey area as much as possible.
2. Having two separate committees to handle different cases may result in inconsistent rulings. Under the proposal, (i) it is unsure whether or not the same case would result in two different rulings had the case been examined separately by each committee (and this appears to be subjective in nature to a certain extent) and (ii) the Listing Committee would need to make the right judgment in passing the right case to the right committee. To ensure consistency, having the right personnel to perform the vetting instead of having two separate committees for that purpose would be the right call. In addition, reason(s) for rejections has/have to be stated explicitly.
3. No one can be certain that only 10% of the applications will be going to the Listing Regulatory Committee and not more. It is possible that, in the absence of a clear set of criteria, the Listing Committee be "overly cautious" and hence pass the majority of the applications to the Listing Regulatory Committee. Furthermore, the nature of the majority of applicants would by default need to be examined further by the Listing Regulatory Committee. There can be a resource issue that the Listing Regulatory Committee will be facing when any of those situations happens.
4. Although all information is required to be kept confidential, we see that time to time, certain information with regard to new listings has been reported by the media. From experience, no party involved in the working groups would claim responsibility for such information leak. If an application has been passed to the Listing Regulatory Committee, one cannot rule out that similar things would happen, which may affect the investment public's sentiment on the applicant company, as well as the company's

reputation. This would present either an unfair advantage or disadvantage to the company itself when compared to the other applicants.

5. The SFC currently has a veto power on any listing application. This can be regarded as a check and balance on the whole listing application process. The SFC should be cautious in having this unique right removed and injecting itself into the new Listing Regulatory Committee. In such case, its symbol of independence and its authority to monitor the entire process can be at stake.

#### Composition and Procedures of the Listing Regulatory Committee

I am more in favour of a centralized Listing Committee instead of the creation of a separate committee. The composition of membership of the existing Listing Committee can be reviewed, and it can be expanded.

Under an expanded and centralized Listing Committee, the composition of the membership may consist of members from the HKEx, members from the SFC (optional as long as the SFC continues to hold a veto power), and the market practitioners who are legal and finance professionals.

The composition of the Listing Committee should have a balance of power such that (1) there would not be any bias towards any one "side", and that the fate of any application would not fall solely into the hands of the regulators, without the participation and input from other market practitioners, or vice versa, and (2) assuming that in the end the Listing Regulatory Committee is being created, there would not be a significant difference in the number of members in the two committees which would create an unfair bias, either in favour or against, the applicants.

#### Quality of Listing Applicants

There have been media reports that one of the purposes of conducting this consultation is to crack down on shell companies and to ensure the quality of companies listing in Hong Kong after a number of cases concerning the volatile stock prices of newly listed companies.

In an interview with market participants, one representative from a share registrar in Hong Kong, who was in support of the proposal initially (she "became" neutral to the proposal in another interview three months later), shared a concern from her clients in PRC that there was a "significant" number of "fraudulent stocks" listed on the SEHK, and hence those clients were hesitant in applying for a listing in Hong Kong and would consider listing somewhere else.

First of all, I believe that Hong Kong has a stringent regulatory structure in place to ensure that the quality of companies would meet an acceptable standard, and perhaps even

more so than the other markets around the world. The Hong Kong Stock Exchange is still a popular place to list over other exchanges despite these "concerns". We have also seen in recent years that the Listing Rules have been slowly reforming to further improve the corporate governance of listed companies.

Despite that, however, I do not believe that a reform in the regulatory structure is the solution to the "problem". The current proposal merely involves the reform of the regulatory structure and the functions of each committee, which can be viewed as nothing more than a corporate restructure or re-organization.

The present problems associated with the shell companies (and price manipulation for that matter) would still exist even if this regulatory reform is to go ahead. It is (i) the vetting procedures, (ii) the quality of the personnel involved in the vetting process and, in particular, (iii) the vetting criteria, that are critical to the outcome of the determination of the suitability of a company applying for a listing on the Hong Kong Stock Exchange.

If there is an issue with the quality of the companies that are applying for a listing in Hong Kong, the criteria of listing should be reviewed and adjusted as appropriate.

#### New "Third Board"/"New Board"

During the consultation period, there have been talks about the establishment of a new "Third Board", the participation of which will only be restricted to professional investors. This will be similar to the "Professional Investors Board" where the majority of the debt securities are listed, including the Preference Shares issued by the Chinese banks.

While the creation of a new board may allow certain companies "in question" to be listed, and those who are investing in the shares would be deemed to be the more sophisticated investors, it would appear that the purpose for the creation of this new board is to mitigate certain risks that the investors are facing. If that is the case, this new board would be very similar in nature to the GEM Board, with the only difference being that the retail investors will not be able to participate in the investment of those companies that are listed on this new board.

The HKEx needs to be very cautious with this approach. The GEM Board itself is created to allow growth enterprises to raise capital under slightly less stringent rules, and it is designed for professional and informed investors. The latter aspect seems to be forgotten by the general masses. On the other hand, the volume of trading on the GEM Board is typically lower than the Main Board. The creation of a new "Third Board" may not be able to add significant value to the marketplace; neither will it enhance Hong Kong's standing as an international financial centre, as bad companies will continue to be bad companies and poor quality companies will continue to be companies of poor quality, no matter where they are listed. To this effect, there would not be a greater protection to the investor community and it remains to be seen whether or not such companies would be able to raise funds by listing on this new board.

## **Conclusion**

Having considered the above, I would urge both the SFC and the HKEx to take a more progressive approach if the regulatory reform was to take place. Rather than the current proposal, especially in regard to the creation of the controversial Listing Regulatory Committee, a centralized regulatory body would be the ideal solution toward an efficient and effective system.

Yours Sincerely,

Edrick Yu