



The British
Chamber of Commerce
in Hong Kong
香港英商會

Mr. Ashley Alder, JP
Chief Executive Officer
Securities and Futures Commission
35/F, Cheung Kong Center
2 Queen's Road Central, Hong Kong

26th October 2016

Dear Mr. Alder,

**SFC/HKEX Joint Consultation Paper on Proposed Enhancements to Stock Exchange
Decision-making and Governance Structures for Listing Regulation.**

I attach the response of the British Chamber of Commerce in Hong Kong to the above consultation paper.

Yours sincerely,

Andrew Seaton
Executive Director

Cc: Mr. Charles Li Xiaojia, Executive Director, Chief Executive, The Stock Exchange of Hong Kong Limited



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SFC/HKEX Joint Consultation on Proposed Enhancements to Exchange Listing Regulation: Response by British Chamber of Commerce in Hong Kong

The British Chamber welcomes initiatives to enhance Hong Kong's role as an international financial centre and its ability to support international businesses operating in Hong Kong. The equities market has a central position in this role, and has contributed significantly to Hong Kong's success. Maintaining and enhancing the confidence of investors, both local and international, in the operation of that market is a vital element in Hong Kong's competitiveness in this area. Enhancing the quality of the market is therefore a continuing priority. We also recognize that the policy and market development functions need further strengthening as the market moves ahead.

However the Proposals represent a far-reaching change to the current structure governing the listing of new companies on the Exchange. It is right therefore that they should be subject to a thorough consultation and examination process. The Chamber has the following broad general observations on the proposals and on the consultation process:

- i. The current listing arrangements have been in place for many years. During this period Hong Kong's role as a listing centre has grown significantly. While there have been controversies, the evidence is that the market has broadly operated successfully and continues to command the confidence of investors, including international investors. Given this, and the far-reaching nature of the changes proposed, it is important that full explanation and analysis of the failures or weaknesses seen in the current arrangements is provided, so as to set out a full justification for the proposed changes. We hope the SFC and HKEX will take this opportunity to set out the arguments more fully for the proposed reforms and, in particular, how in practice they will improve the quality of the market and its operations, and promote the interests of investors. We hope further explanation will be provided as to how the proposals would support market development – which we believe should be an important objective of any reform, in respect of its impact on the market's competitiveness.
- ii. The proposed structure appears to blur the distinction between the role of the market and that of the regulator. Under the current arrangements, the SFC is able to consider applications which have been approved by the Listing Committee, provide comments on applications and when necessary refuse them. For the proposed new structure to be successful, openness and transparency of decision making, and clarification of the respective roles and responsibilities of those involved in listing

decisions will be important. These are aspects which are relevant to the interests of investors, especially retail investors. Again we hope the SFC/HKEX will set out their thinking on this aspect more clearly.

- iii. The consultation process has identified a number of concerns across the market. We believe the best way forward is to enter into a dialogue with market participants and other interested parties, to assess if these are concerns that are best addressed by the Proposals, rather than to move ahead with the Proposals without the benefit of such dialogue.
- iv. The proposed changes will effectively integrate the regulator into the heart of the listing process. This would bring the SAR in line with certain other major financial centres (such as the US and UK). We recognize this could be perceived as serving the interests of investors given the SFC's mandate to strengthen and protect the integrity and soundness of the securities and futures markets for the benefit of investors and the industry. We also recognize that the proposed structure could mitigate perceived potential conflicts of interest in the current process arising from the involvement of HKEX, as a listed company with revenue targets, and other market practitioners, in listing decisions. This could give investors additional confidence in the strength of companies listed in Hong Kong.
- v. However concerns have been raised over the potential impact of the proposed changes on the local IPO market. There is an argument that the Hong Kong IPO market is amongst the strongest in the world partly because of the current practitioner-led listing process resulting in a more amenable market environment for offerings. Changes to this structure may initially prompt concern from investors if not handled carefully. And as noted above, we believe the overall justification – including in respect of the interests of investors – for the proposed changes (including perceived deficiencies of the current arrangements) need to be spelt out more explicitly if the proposals are to command support.

Against that background and by way of illustration, we are aware that the following are among concerns that have been raised:

- a) Relating to our point above about explanation of how the proposals would in practice improve the quality of the market, Paragraph 6 of the Consultation Paper observes that "... the market has become increasingly large and complex and carries a greater variety of risks." It concludes that "... it is now the right time to revisit the decision-making structure and adopt enhancements that would better enable the SFC and the Exchange to better coordinate and address future regulatory needs". However, the reason for the current high level of practitioner engagement in the regulatory process is precisely because of the complexity of the markets. Specifically, the Hay Davison Report (the Report of the Securities Review Committee on the Operation and Regulation of the Hong Kong Securities Industry) that resulted in the current structure, concluded that a practitioner-based regulatory system was best suited to Hong Kong as it should, "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". It was also observed 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". As a result it was concluded that there was no better alternative to practitioner-based regulation. In the absence of convincing counter-arguments, the ever more complex markets of today would seem to benefit from maintaining, not reducing, the role in the regulatory process currently performed by practitioners with up-to-the minute hands-on experience of those markets.

- b) Rather than the major structural changes proposed, closer cooperation and coordination between the SFC and HKEx could be achieved by making greater use of existing structures, such as the monthly Listing Matters Liaison Meetings. Also, the SFC could appoint staff to those Listing Committee (LC) meetings (a) at which policy matters are discussed and (b) which will hear listing applications/listed issuer matters involving LRC Matters. Attending LC hearings of applications involving LRC matters would give the SFC the earlier and more direct input it requires on listings involving suitability issues, while the application would benefit from the input of the LC's market practitioners. Non-LRC Matter listing applications would still be determined by the LC as at present - subject to the SFC's right to object to the listing under the Stock Market Listing Rules as under the current regime. Alternatively, in order to preserve the integrity of the SFC's statutory veto right, it could send observers with a right to speak but not vote at such meetings of the LC. This would only require an amendment to the MOU to implement.
- c) Similarly, in respect of the current practice of the Chief Executive of the HKEX sitting on the LC, representation at a less senior level, and in an advisory capacity, is an alternative which could reduce any implication of conflict of interest.
- d) As regards the extent of practitioner involvement under the Proposals, it is puzzling as to why (i) there is no Sponsor representation on the new committees, and (ii) it is to be mandated that one of the deputy chairs, and consequently one of the three representatives of the LC on the Listing Regulatory Committees and on the Listing Policy Committee, must be a representative of investors, given that one of the primary statutory function of the SFC itself is investor protection. Further, it is unclear how this representative, who should presumably have the experience and industry knowledge to assess the various technical, accounting and legal issues that are discussed at committee level, be identified?
- e) If one of the objectives of the proposals is to streamline and simplify, there should be fewer, not more, committees. Further, there is an inherent and significant level of subjective judgement involved in determining whether an issue goes to the "suitability" of an applicant for listing. More committees, where there is more chances of differing views, may lead to uncertainty and a drawn-out process, making the logistics of planning and IPO more challenging, as well as inevitably leading to a longer time "to market" and an increase in costs. Where there is not a clear case

that more committees lead to better decision-making, this is not a helpful development and will disadvantage Hong Kong relative to other markets.

- f) It is proposed that the SFC will cease to provide comments on listing applications. However, given that, in 2015, the SFC had comments on 216 out of the 218 listing applications filed under the dual filing system there would clearly seem to be a demonstrable need from the perspective of market protection for the SFC to continue to provide its input as part of the vetting process. Also, there will be increased uncertainty in the vetting process for a listing applicant if the SFC's issues only get raised once the application reaches the proposed Listing Regulatory Committee.
- g) Following the introduction of the requirements that all listing applications must be "substantially complete" when they are filed and that listing application proofs be published publicly, the obtaining of informal and confidential pre-filing guidance has become of even greater importance to applicants. It is proposed that the ability to obtain this will be continued, which we welcome. However, it is also proposed that it will not be possible to seek a review of the guidance, which would seem to deny due process to unsuccessful applicants.
- h) It is proposed that the Listing Policy Committee will have primary responsibility for appraising senior executives of the Listing Department in the performance of their regulatory responsibilities; and that HKEx's Remuneration Committee will take into account the assessment from the Committee in considering the remuneration of the executives. This seems highly susceptible to criticisms of unduly influencing the way the executives will perform their roles, and accordingly there is a real risk that the individuals involved may find themselves in conflicts of interest.

This is not intended to be an exhaustive list of concerns that have been raised. However, it illustrates the extent of the questions raised and why we urge SFC/HKEX to undertake further consultation and consider the widest range of options for maintaining and improving the quality of listings and choice of listed investments for investors.

If the outcome of the consultation process is to move ahead with the proposed new structures we have the following proposals:

- i. The proposed Listing Policy Committee should be renamed 'Listing Policy and Market Development Committee (LPMDC)' to evidence its key role in initiating new policy and developing our capital markets; and its terms of reference and composition amended accordingly.
- ii. The proposed new LPMDC and Listing Regulatory Committees should include practitioners with real knowledge of the markets, and not be primarily staffed by SFC Regulators and SFC Nominees. This is a 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.

- iii. In the interests of transparency and to reduce the risk of referring all difficult and controversial decisions to the LRC, clear policy guidelines should be established to determine which issues should be so referred. These should be publicly available.

In conclusion we urge SFC and HKEx to ensure that any changes adopted must clearly lead to market development and better efficiencies. Furthermore, we urge that the fullest and widest consultation is undertaken so as to achieve an outcome which receives broad market acceptance prior to adoption, failing which the harmony, efficiency and success of our financial markets will be at risk.

The British Chamber of Commerce in Hong Kong
26 October 2016