

## Comments on Joint Consultation Paper of June 2016 re Listing Regulation

My overall comment is that the proposals, if implemented, would in my view represent a considerable improvement in the Hong Kong Listing Regime. In particular, I welcome:

1. The separation of decision-making on listing policy from decisions on individual applications and post-listing cases, via the establishment of a separate Listing Policy Committee (LPC);
2. The Listing Committee (LC) becoming an advisory (rather than decision-making) body in relation to listing policy;
3. The establishment of a Listing Regulatory Committee (LRC) being charged with handling complex and difficult cases, with direct SFC participation.

I believe the proposed adaptations to the listing regime would considerably improve coordination between the SFC and HKEx and the efficiency of the decision-making process. Overall, therefore, I am supportive of the proposals. I do not feel it necessary to add further comment on the components of the proposals with which I agree.

There are three aspects of the proposals where my views diverge from the suggestions in the CP.

1. I believe the listing regime would be further improved if the Listing Committee were made a wholly advisory body. Hong Kong is unique among significant international financial markets in having a group of market practitioners as the decision-making body in relation to new listings and ongoing listing cases. The reasons for this unusual structure date back to the time when I was at the SFC. Following the scandals uncovered in 1988, involving members of the then Council of the Stock Exchange of Hong Kong (SEHK), the listing function was removed from the exchange. It was returned to the SEHK in 1991 when the exchange was judged to have a sufficiently professional and independent executive team in the Listing Division (LD). However, the Council (which would today be the Board of HKEx) was required to renounce all involvement in listing decisions, primarily in order to prevent any similar scandals. Decision-making power was assigned to the LC, under the supervision of the SFC. The circumstances which led to the creation of this structure are now ancient history and bear no resemblance to those which prevail today.

Back in the early 1990s, it was also widely believed internationally that the self-regulatory model for exchanges was in principle right. In the light of subsequent experience, the prevailing international wisdom in this respect has since then altered substantially.

I am still a strong believer that practitioner input to listing decisions is essential, to mitigate the natural tendency of professional regulators to adopt a process-driven approach to decision-making which takes insufficient account of the commercial context. There is no question that the experience and market "nous" of the members of the LC adds a crucial element to the analysis and judgment required. Nor do I fail to appreciate the very considerable amount of time which LC members contribute freely to this work. In my opinion, however, this valuable contribution could be made just as effectively if the LC was a fully advisory body, as are equivalent bodies in other markets where they exist.

I do not doubt that LC members make very sincere efforts to adopt a public-interest approach when making decisions. However, I believe it is inevitable that their business interests will colour their decisions. This is particularly true of practitioners from the “sell” side of the market and the professional advisers who work with them. It is less true of the “buy-side” members of the LC, but the latter are less numerous and more difficult to recruit to the committee—perhaps because they do not have so much commercial incentive to devote their time to the LC.

I do not at all accept the view that, if the LC were made wholly advisory in nature, it would become difficult to recruit appropriately-qualified people to serve on the committee and to devote as much time to its work as they do now. I believe the incentives (including the altruistic ones) would be just the same. In practice, I believe the deliberations of the committee would not be greatly different from the way they are now.

I am well aware of the sensitivity of some LC members and market participants in relation to the decision-making power of the LC. I nevertheless advocate this change in the listing regime because I believe the interests of Hong Kong as a progressive financial centre call for this anomaly to be corrected. I should clarify that I am not opposed to the Chairman of the LC and his two deputies participating in a decision-making role via their proposed membership of the LRC and LPC.

I also venture to suggest that it is unnecessary to burden the LC with all decisions on cases which do not involve suitability concerns or broader policy implications, and that these could be taken by the professional regulators in the LD, with advisory input from the LC where they consider this necessary. Hopefully this change would reduce the amount of paper which members of the LC have to digest in relation to straightforward cases and permit them to focus more of their available time on their advisory role in relation to policy issues and more important or difficult cases.

2. My second reservation about the proposals concerns the composition of the LPC and the role of the Board of HKEx. As mentioned above, the basic structure of the listing regime has not altered materially since it was established in the early 1990s. In addition to handing over decision-making power to the LC, the Board of the exchange was required to be excluded from all involvement in listing decisions. This was achieved via a MOU between the SFC and SEHK which established a “Chinese Wall” between the Council and the LD/LC. It should be recalled that in those days the exchange was owned by brokers and a majority of the Council were elected by brokers. The reality of the conflicts between the interests of brokers and those of investors and other market users was amply demonstrated by events at the time.

Since then, the exchange has been demutualized and become a listed company. When this happened, the Chinese Wall was retained in substantially the same form. The reason given for this decision was the need to minimize a very different perceived conflict of interest, namely that between the commercial interests of the exchange as a listed company and its regulatory duty.

In my opinion this latter conflict is more theoretical than real in the Hong Kong context. Extensive mechanisms exist to ensure that regulatory priorities are not overruled, including HKEx's statutory duty to give precedence to the public interest over its other interests (which has few parallels in other markets), the fact that half the board are nominated by Government, that all rule amendments, new products, fees or tariffs of HKEx are subject to approval of the SFC and that the SFC has reserve powers to overrule HKEx if it considers the public interest calls for such action. Against that background, I believe the Chinese Wall that keeps the HKEx Board at arm's length from listing policy decisions is (like the decision-making role of the LC) an anachronism. If anything, the CEO (who is proposed to be a member of the LPC), being an employee of the exchange, is potentially more conflicted in relation to HKEx's commercial interests than are the Board members.

The only real conflict in practice today, in my view, is that between the need to ensure that adequate resources are devoted to the exchange's regulatory functions (including the LD) and the desire of the exchange to maximize its bottom line. This does not bear on the involvement of Board members in listing policy decisions. Nor am I aware of any evidence that in practice HKEx has starved its regulatory functions of resources. If the non-involvement of Board members in listing matters has any effect in the context of resource allocation, it is to inhibit the Board's ability to perform its duty to evaluate the adequacy of resources in the listing function.

It is possible that some HKEx Board members, as individuals, may have business or personal interests which might conflict with regulatory objectivity. I believe this is much less of an issue in relation to Board members than it is with LC members. I nevertheless agree that there are valid arguments for excluding HKEx Board members from involvement in decisions on individual listing cases (i.e. in membership of the proposed LRC). However, I consider the exclusion of HKEx Board members from direct participation in listing policy decisions (para 10 of the CP) is unwarranted.

I note that the HKEx Board is invited "to express a view on how a proposed rule amendment or policy may affect the commercial interests of HKEx" and to submit its views via the CEO of the exchange, who is proposed to be a member of the LPC. I find this aspect of the proposals misconceived and somewhat demeaning of the Board. The wording of para 10 implies that the only legitimate interest of the Board is in the way a policy or rule change may affect the commercial interests of HKEx. Many members of the Board have considerable value to add to listing policy discussion and decision-making which goes a long way beyond expressing a view related to the commercial interests of HKEx. Many have extensive and relevant experience and, I believe, are capable of taking an objective view of the best interests of Hong Kong. I therefore suggest that a mechanism should be established which permits more direct participation by HKEx Board members in decisions relating to listing policy.

There are various ways that the Board could be given this direct involvement in listing policy decisions. One possibility is that two or three members of the Board (proposed by the Chairman and subject to SFC agreement) might be members of the LPC with a mandate to opine directly on any aspect of the matters under discussion.

If the perceived conflict between the exchange's commercial interests and its regulatory duties is still considered to be a real issue, an additional check and balance which could be introduced is the establishment of a special committee of the HKEx Board ("Regulatory Oversight Committee") comprising clearly independent Board members, free of commercial conflicts, approved by the SFC, whose role would be to review the efficiency and resourcing (in quality as well as quantity) of the LD and the procedures for managing any commercial versus regulatory conflicts.

3. My third comment on the proposals relates to the continuing lack of clarity concerning the accountability of the LC and the reporting line of the LD. For the reasons cited above, the LC is not accountable to the HKEx Board, despite the fact that the LC is a committee of a subsidiary of HKEx. Nor is the LC accountable to the SFC. In 2008, I undertook a review for HKEx of matters related to the listing regime, which involved extensive consultation with market participants. In that context, I asked many members of the then LC to whom they considered the committee to be accountable. The variety and conflicting nature of the answers revealed a high degree of confusion. I do not believe the LC is presently accountable clearly to anyone. The proposals in the CP do not resolve this issue, although they do render it less important, in as much as the role of the LC would become advisory in relation to listing policy and complex cases. If the LC were made wholly advisory (as suggested above), this problem would disappear.

Clarity concerning the reporting line of the LD is arguably more important. Because of the Chinese Wall, "oversight" of the LD is assigned to the LC (under Chapter 2B of the Listing Rules, the LC has "oversight of the Listing Division and the Chief Executive of the Exchange to ensure that they exercise those powers and carry out their day-to-day functions in a professional and impartial manner...."). I do not consider that the LC, as a very large body of rotating part-timers without a permanent secretariat, is equipped to perform this function effectively.

The proposal in the CP is that the LD should be overseen by the new LPC. This would at least be a body of more manageable size and hopefully more consistent membership than the LC. However, I have reservations as to whether it is appropriate for a body containing staff members of the statutory regulator to be opining on the remuneration of staff of the Exchange (para 28 of the CP). I would suggest that performance appraisal and remuneration decisions should be undertaken by a sub-committee of the Board of HKEx including the Board members who (I suggest above) should be members of the LPC, together with the CEO of HKEx. Alternatively, if a Regulatory Oversight Committee were established (as mooted above) that body should perform the oversight role.

If, in considering the responses to the Consultation Paper, either the SFC or HKEx would like me to elaborate further on the views expressed above, I would be happy to participate in a discussion.

Robert Owen

15 November, 2016.