16 November 2016

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

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Response from Davis Polk & Wardwell

Davis Polk

Introduction

This submission is made in response to the captioned paper ("Consultation Paper") by Davis Polk & Wardwell, after consultation with a number of global investment banks which are active players in the Hong Kong IPO market.

We are pleased to see the continued efforts of the SFC and the Exchange to improve and modernise the listing application regime. We consider that the stated objectives in the Consultation Paper, namely, closer coordination between the regulators, simplification of processes and accountability, to be beneficial to the markets. We have set out in this paper some observations and suggestions which we hope will help the regulators refine the new structure and, hopefully, pre-empt some problems that may arise.

Terms used in this letter have the same meanings as used in the Consultation Paper. The first-level headings used in this paper reflect the consultation topics (in Para.141 of the Consultation Paper) on which we would like to express a view.

Executive summary

For ease of reference, our suggestions are summarised in the table below, and further elaborated in the rest of this paper.

Issue	**Suggestions**	**Page(s)**
LRC Matters	The market would welcome considerably more guidance on the definition and substance of LRC Matters, potentially in a new Chapter of the Listing Rules or another mode of formal guidance.	6
Referral / escalation of LRC IPO cases	The market will benefit from a more detailed explanation as to how the Listing Regulatory Committee would conduct its meetings to achieve the intended efficiency. Measures should be taken to minimise the time-cost for the listing applicant in engaging the Listing Regulatory Committee. In the interests of certainty and efficiency, the sponsors and listing applicant should be notified without delay of the formal designation (whether at the initiation of the sponsor, the Listing Department, the Listing Committee or the Listing Regulatory Committee) of a case as an LRC IPO case – preferably, no later than the issue of the first comments on the draft prospectus. The system	7-9

	should be designed so that the final decision on such designation should be taken within a specified time-frame. In respect of referrals of LRC cases by the Listing Committee to the Listing Regulatory Committee, where the Listing Department has already expressed its view that an LRC Matter did not exist, "checkpoints" should be built into the system to prevent this kind of referral from being necessary – e.g. a "short-circulated" consultation between the Listing Department, the Listing Committee and the SFC. Sponsors should have the right to escalate the matter directly to the Listing Regulatory Committee instead of waiting for escalation by the Listing Department or the Listing Committee. During the vetting process, the market will benefit greatly from better transparency and closer contact – for example by way of contact persons at the SFC's Dual Filing team being readily available for discussion with the sponsors and the listing applicant. Alternatively, it is worth considering augmenting the Listing Committee with SFC delegates, in place of setting up a separate Listing Regulatory Committee.	
Review powers of LRC IPO cases	The efficacy of pre-IPO enquiries in respect of LRC IPO cases could be undermined if a relevant decision cannot be reviewed. It would be conducive to market efficiency and user-friendliness to provide an avenue for review of preliminary guidance given on an LRC Matter.	11
Role of Listing Committee	The actual number of LRC IPO cases may exceed anticipation, and further thoughts could be given as to whether it is best for LRC IPO cases and Post-IPO LRC Matters to be almost exclusively resolved by the delegates of the Listing Committee and the SFC sitting on the Listing Regulatory Committee. The composition of the Listing Committee may be revisited, as a possible alternative to setting up the Listing Regulatory Committee. The stated objectives of closer coordination and cooperation between the SFC and the Exchange could be enhanced simply by	11-12

	introducing SFC delegates into the Listing Committee, instead of setting up a new committee.	
SFC comments	SFC comments during the listing process are helpful to the market and should be retained. Efficiency can be improved by involving the SFC earlier and more closely in the vetting process (as part of the Dual Filing structure), and by the SFC and Exchange staff closely coordinating their comments	12
Listing Policy Committee and policy development	The Listing Policy Committee should have a steering role only, and the creation and implementation of such policies should continue, primarily, to be in the hands of the Listing Department staff under the supervision of the Listing Committee. Alternatively, the regulators may consider introducing suitable SFC representation into the Listing Committee rather than setting up a new committee.	14
Review of listing decisions	In the interests of market protection, we suggest maintaining the current dual-review (by the Listing (Review) Committee and the Listing Appeals Committee) framework, instead of replacing it by a one-stage review (by the Listing Regulatory (Review) Committee) for LRC Matters, as proposed in the Consultation Paper.	14
Publication of decisions	We have no objections to publishing disciplinary decisions in the interests of transparency, but would advise cautiousness, in view of the heavy volume of written guidance already available to the market. We invite the Exchange and the SFC to revisit the current system of publishing guidance, and focus more on issues for which non-rule guidance is essential.	15
GEM listings	As the approval process for GEM listings is not identical to the Main Board process, we await further elaborations from the regulators as to how the proposals will apply to GEM.	16

Our detailed submissions

Listing applications by new applicants

1. LRC Matters – challenges of demarcation

We read in para. 73 of the Consultation Paper an exposition of the term "LRC Matters", which is in very broad terms. We consider that the market needs clearer definition to enable them to effectively advise new applicants:

- **What makes a company "unsuitable for listing"** – Although the Exchange continues to issue guidance on listing suitability, a quick look at the recent examples reveals how varied and fluid these issues are, especially when applied to real cases. Over the years, a myriad of factors have featured in the evaluation of listing suitability or have resulted in a company being considered not suitable for listing. In Appendix 1 to this letter we have set out some examples of these guidance materials to provide an overview.

- **Novel, controversial, etc.** – Novelty issues are, by definition, new and probably impossible to demarcate precisely. The expression "potentially controversial or sensitive" appears opaque as a guiding concept. In order for professional advisers to be able to advise new applicants with reasonable certainty, the boundaries must be easy to articulate and comprehend. Ultimately, it is important that prospective new applicants, comparing Hong Kong with other potential markets, are generally comfortable with the predictability of Hong Kong's listing process. This is particularly important as Hong Kong prepares itself for the next wave of new applicants, including many "new economy" issuers such as fintech, TMT, etc., which may operate with business models quite different from the traditional companies which our Listing Rules were designed for.

- **Better transparency on previous cases** – Ideally, professional advisers should be able to explain the concept of LRC Matters as outlined in the Consultation Paper by pointing to the treatment in previous cases. This would, however, require a disciplined practice on the part of the regulators to publish guidance on cases which were subject to their deliberation. Applying the concepts in the Consultation Paper, for example, to the recent controversial case of Alibaba, the market finds itself no wiser than a year ago as to what the likely treatment would be under the new regime. In the absence of a formal "post-mortem" on that case, it is difficult for the market to understand how the unique features of that company clashed with the regulatory philosophy underpinning our market so materially as to result in the final outcome we have seen. In the event, the market resorted mostly to unofficial media reports for an understanding of that case. Going forward, we believe the market would benefit from more transparency on similar cases.

- **Potential mismatch of views** – In the past, there have been instances where the regulators themselves did not hold the same views (e.g. the SFC and the Listing Committee taking different approaches) over the meaning of a term, or the correct classification of an issue. While this is understandable with fluid concepts like the ones we are examining here, it serves only to highlight the practical difficulty the market may encounter.

Suggestion: We believe the market needs considerably more guidance on the definition and substance of LRC Matters, potentially in a new Chapter of the Listing Rules or at least in another mode of formal guidance, preferably with pre-engagement of the market. In addition, the more the SFC and the Exchange spell out the underlying regulatory philosophy on matters with suitability implications, such as competition, business delineation, shareholding structure, etc. (as opposed to a Listing Decision that pertains to a particular fact pattern and may or may not have reference value for another case), the easier it would be for applicants and their advisers to form a realistic judgment of the key hurdles to a listing, the likely timetable implication, and ultimately, whether Hong Kong is a feasible option for a particular issuer.

2. Escalation / referral of LRC Matters – transaction certainty

The continued jurisdiction of the Listing Department to reject cases (including those involving LRC Matters) should be fairly uncontroversial. However, further clarifications on the following aspects would be helpful:

- **Referrals by the Listing Department** – When the Listing Department sees an LRC Matter which it decides to escalate to the Listing Regulatory Committee, the proposals envisage that it should first take the case to the Listing Committee to canvass its comments, although those comments would be non-binding on the LRC. It seems that this two-step referral process can be more streamlined to prevent delay in the listing timetable. The Consultation Paper promises that the Listing Department will notify the listing applicant "as soon as reasonably practicable" of the referral, without giving an estimation of timing. We believe more can be done to enhance transaction certainty. In this regard, our suggestions as to having a time-frame for formal designation of LRC IPO Cases, built-in checkpoints and other ways to maximise efficiency are set out under "Suggestions" below.

  The Listing Committee has a regular system of meeting dates – basically every Thursday with allowance for extra meetings where the need arises – and caseloads, and so (conceivably) will the Listing Regulatory Committee. It would be helpful for the regulators to give an indication of the frequency and mode of Listing Regulatory Committee meetings, so that the market can form a view as to the likely timing impact of an escalation to the Committee.

- **Referrals by the Listing Committee** – Where the Listing Department does not, but the Listing Committee does, detect the presence of an LRC Matter, the latter has discretion to refer the matter to the Listing Regulatory Committee. Conceivably, relevant arrangements will be made by the Listing Department to re-direct the case from one committee to the other. This does not appear to be an optimal solution as, up to this stage, the listing applicant and its advisers have been proceeding (with all good faith) on the basis that their case involves no LRC Matter. That this would have been a reasonable assumption to make is highlighted in the fact that the Listing Department did not see an LRC Matter either. Again, the Consultation Paper states that the Listing Department will notify the listing applicant "as soon as reasonably practicable", which we believe can be improved upon. Our market is probably not performing at its best if an issuer can expect so little transaction certainty, even as late in the day as when the case is already before the Listing Committee – in practice, at least a number of weeks after A1 application and many months after commencement of listing preparation. With the case diverted to the Listing Regulatory Committee at this point, a new applicant may feel that its listing plans have been thrown back to "square one", possibly even derailed.

We appreciate the regulators' goal of enhancing efficiency and streamlining of transactions. We are also aware of the unique challenges posed by potential LRC Matters. However, the solutions proposed in the Consultation Paper need to be balanced against the fact that market windows for launching IPOs are often narrow, and a delay in the timetable could have significant implications such as the need to conduct further audits of the financial statements, updates of material information (which has to be due diligenced), renewing approvals, etc.

Suggestions:

(a) Escalation – In respect of the escalation process, we hope to see measures taken to minimise the time-cost for the listing applicant of engaging the Listing Regulatory Committee:

Firstly, we would be grateful to know how often the Listing Regulatory Committee will meet, and specifically whether the market can expect the same "performance" (in terms of timing) as that of the Listing Committee currently. Perhaps the regulators would be willing to consider some administrative streamlining – for example, instead of adding steps (and paperwork) to the referral system, some of them may be integrated; where appropriate the Listing Committee meetings and the Listing Regulatory Committee meetings may take place simultaneously or within a short space of each other; and where the Listing Department escalates a case, the Listing Committee's non-binding opinion can be sought concurrently (e.g. by circulation of papers rather than a full committee hearing), or even informally.

Secondly, in the interests of certainty and efficiency, it is important that the sponsors and listing applicant should be notified without delay of the formal designation of a case as an LRC IPO case – preferably, no later than the issue of the first comments on the draft prospectus. This should apply whether the designation of the LRC IPO case is at the initiation of the sponsor or one of the relevant regulatory bodies. The system should be designed so that the final decision on such designation should be taken within a specified time-frame and with the views of the Listing Division, Listing Committee, the Listing Regulatory Committee and the SFC fully aligned.

Thirdly, we have set out our concerns in respect of referrals of LRC IPO cases by the Listing Committee to the Listing Regulatory Committee, where the Listing Department has already expressed its view that an LRC Matter did not exist. We strongly suggest that "checkpoints" should be built into the system to prevent this kind of referral from being necessary: possibly a "short-circulated" consultation between the Listing Department, the Listing Committee and the SFC so as to align their views as to the existence of an LRC Matter and minimising the prospects of a case being referred by the Listing Committee.

We have included in Appendix 2 to this paper some performance pledges on IPO processing time made by some of the world's leading stock markets, which may be of reference value. We believe that as an international IPO market, Hong Kong should have similar performance pledges. We would appreciate further elaboration as to the expected process time by the Listing Regulatory Committees for the matters reserved for them under the proposals.

(b) Sponsors' / issuer's direct access to the Listing Regulatory Committee – Another important way to enhance deal certainty and lessen the time-cost is providing sponsors and issuers with direct access to the Listing Regulatory Committee at the time of Form A1 submission. The Consultation Paper makes it clear that the sponsors should be on the lookout for potential suitability issues. We suggest that, where the sponsor expects such issues to arise (with or without the benefit of a pre-IPO consultation), it should have the right to escalate the matter directly to the Listing Regulatory Committee instead of waiting for escalation by the Listing Department or the Listing Committee. Conceivably, a procedure can be worked out (e.g. through Form M104 or some other appropriate form of disclosure) whereby the Listing Department may be notified of the sponsor's views on suitability issues.

(c) Contact points at the SFC – A way in which efficiency and transparency can be substantially improved is by providing more channels of personal contact and cooperation between the regulators and the IPO working team. We believe that, during the vetting process, the market will benefit significantly from contact persons for the relevant matter at the SFC's Dual Filing team being readily available for discussion with the sponsors and the listing applicant.

(d) Alternative to Listing Regulatory Committee approach – Alternatively, we believe it is worth considering that, in lieu of setting up a separate Listing Regulatory Committee, the three SFC delegates should sit instead on the Listing Committee. This

would eliminate the extra step of delegation envisaged by the proposals, yet address the need to have more input from the SFC.

3. LRC Matters – small number of cases

The regulators emphasise in the Consultation Paper (para. 74) that LRC Matters are expected to be small in number. We believe that as a result of how some of the proposals are designed, the actual number may well exceed the expectation stated in the Consultation Paper:

- **Are LRC Matters really that unusual?** We have set out in Appendix 1 previously published guidance that could, under the proposed structure, potentially involved LRC Matters. It appears to us that LRC Matters will turn out to be fairly substantial in number. Turning around the argument, if LRC Matters are expected to be unusual, there would scarcely have been a need to create a new dedicated committee at all.

- **Who decides?** – Under the proposals, the Listing Department remains the first "gatekeeper" of LRC IPO Cases. The actual number of such cases ending up before the Listing Regulatory Committee will depend largely on how the Department makes its decisions. The question arises whether the Listing Department would be incentivised to pass every suspicious case to the Listing Regulatory Committee, just to be on the safe side. Under the proposals, the Listing Policy Committee (with a substantial personnel overlap with the Listing Regulatory Committee) will have primary responsibility for appraising senior executives of the Listing Department (paras. 28 and 130). This framework may unwittingly foster a degree of tendency to escalate LRC IPO Matters, as the Listing Department staff may be pressured to pre-empt the views of the Listing Regulatory Committee. This would give rise to the risk of overwhelming the designed capacity of the Listing Regulatory Committee.

- **A more forward-looking mindset** – Taking this from another perspective, it seems to us that, as Hong Kong is at the forefront of international market development, it should aspire to being one of the world's most forward-looking, most robust markets. It seems that a "leading" IPO market could not rightly live up to that claim, if it gives itself a system that only works smoothly if it deals with a ***small number*** of cases with novel, controversial or sensitive aspects. A healthy market, in our view, should be structured so that we are both equipped and poised to deal with more, rather than fewer, novel cases. We would encourage our market regulators to provide more certainty, rather than less, to enterprises that may be in some ways "unproven" but may very well be the upcoming stars. Some well-known companies in the tech space listed overseas, such as Amazon, Netflix, Sina Weibo and JD.com, were not necessarily profit-making at the time of IPO and may even continue to be loss-making for some time after listing.

- **Focus on SFC delegates to Listing Regulatory Committee** – It is worth considering in more depth whether it is best for LRC Matters to be almost exclusively resolved by the delegates of the Listing Committee and the SFC sitting on the Listing Regulatory Committee. As we will discuss in more detail below, the Listing Committee was carefully designed to achieve a good balance between the regulators and the market (including different sections of the market). Whilst it is right that the SFC should retain its current overall regulatory powers (including veto powers over listing applications), the composition of the Listing Regulatory Committee, as set out in the Consultation Paper, may result in an excessive leaning towards the regulatory side, thus depriving the market of the benefits of having different stakeholding groups take part in decision-making, as we currently see in the Listing Committee.

4. Pre-IPO consultations – powers of review

Under the proposals, the designation (either by the Listing Department or the Listing Committee) of an LRC Matter and the decision to refer it to the Listing Regulatory Committee are not subject to Chapter 2B review powers – in other words, this decision is final. By contrast, where the Listing Department detects an LRC Matter and exercises its usual jurisdiction to ***reject*** the listing application, the listing applicant is fully empowered to apply for a review before the Listing Regulatory Committee, with a second review available before the Listing Regulatory (Review) Committee.

We also note the position set out in para. 96 of the Consultation Paper that all preliminary indications or guidance (we read this to include potentially all pre-IPO enquiries – including both LRC and non-LRC Matters) are non-reviewable. We see some conceptual difficulties with an unreviewable (i.e. final) "preliminary" piece of guidance, and are concerned that potential problems of due process may arise in future and expose the regulators to judicial challenge.

Turning now to consider a hypothetical case where the listing applicant pre-consults the Listing Department (or even the Listing Committee), and receives the preliminary guidance that an LRC Matter exists and that the company is potentially not suitable for listing. Even if the applicant, after taking professional advice, takes strong exception to this, the issue is not reviewable. There are now two routes open to this applicant:

- Submit the Form A1 and wait for either:
    - a rejection by the Listing Department – in which case the applicant will be able to apply to the Listing Regulatory Committee for a review of that decision, with the attendant uncertainty and possibility of delay; or
    - an escalation to the Listing Regulatory Committee – in which case there is the same level of uncertainty and possibility of delay

(Note: This situation is precisely the same for the applicant as if the Listing Department had ***not*** been consulted.)

- Revise its listing plans – probably in favor of another stock market.

Suggestion: In such circumstances, a prospective applicant is put in a dilemma as to whether it should seek preliminary guidance. Our concern is, therefore, that the regulators may be undermining the efficacy of pre-IPO enquiries, whilst purporting to encourage the public to use them, as stated in numerous listing decisions and guidance letters. To increase public confidence in our market, both in terms of its efficiency and its user-friendliness, we would hope to see an avenue for review of preliminary guidance given on an LRC Matter.

5. The role of the Listing Committee

Under the proposals, the Listing Regulatory Committee will comprise three representatives from each of the SFC and the Listing Committee. This gives the initial impression of equal representation of the two bodies. We agree with the Consultation Paper that the Listing Committee in its entirety represent the diverse views of the market and brings valuable expertise in specialised areas. We believe therefore it would be in the market's interest that the proposals in the Consultation Paper do not erode the role that the Listing Committee plays and diminish the value that it is designed to bring under the current regime:

- **Balanced representation** – Historically, the Listing Committee sits as an "expert panel" attached to but independent from the Exchange. Its independence from both the SFC and the Exchange is key to its unique position and the high regard with which it is held by the market. Its composition is carefully designed, and has been refined over the years, to achieve an optimal mix of representatives from key stakeholding groups. Its nomination, appointment and retirement systems are all finely-honed to give it its current position of esteem and trust in the eyes of the public. The proposals seem to relegate the Listing Committee to a body which provides "non-binding" views for LRC matters, potentially undermining the current balance.

- **Dampen interest to serve as Listing Committee members** – The proposals may significantly disempower the current Listing Committee, which may not be conducive to attracting quality professionals to serve as Listing Committee members.

Suggestion: We invite the SFC and the Exchange to revisit the proposed composition of the Listing Regulatory Committee and the modified role of the Listing Committee. It appears debatable to us whether the new committee option is the best solution, and even if so, whether it should be done at the expense of undermining the Listing Committee. If the objective is to forge closer coordination and cooperation between the SFC and the Exchange, a possibly better solution may be to include the three

SFC delegates into the Listing Committee, instead of setting up a separate six-strong Listing Regulatory Committee. By doing so, the SFC would have a direct interface and communication with Listing Committee members on the full array of listing related regulatory matters.

6. SFC Comments

The consultation paper proposes that the SFC should stop issuing comments going forward on the basis that this would improve efficiency. However, from past experience, SFC comments have been useful in allowing market practitioners to understand better the SFC's stance on policy issues. Under the current structure of frontline regulation by the Exchange, a "glimpse into the mind of the SFC" afforded by the Dual Filing process and SFC comments from a relatively early stage of a listing application is essential in providing certainty, so that market participants can plan their affairs accordingly.

Going a little further down this line of reasoning, because of the proposed changes to oversight over the Listing Department, the cessation of SFC comments may possibly, in practice, be "over-compensated" by the Listing Department staff trying to pre-empt SFC views and asking more questions. This may counteract the streamlining and simplification that the regulators have in mind as a goal.

From a governance perspective, for any LRC cases and cases which may have to go before the Listing Regulatory Committee, the SFC delegates to the Listing Regulatory Committee would justifiably wish to be guided by the views and input of SFC staff who have been involved in the reviewing process since a relatively early stage. The advantages of this consultation will be lost if the SFC withdraws from the commenting process.

Paragraph 69 of the Consultation Conclusions on the Regulation of IPO Sponsors of 12 December 2012 states that "the SFC and the Stock Exchange will work together on measures to streamline and shorten the commenting process, allowing regulatory effort to be devoted to more important issues or involve public interest concerns". Apparently, the thinking behind this statement was refining the SFC's comments, rather than removing them. We agree that refinement, not removal, is the right way forward.

Suggestion: We believe that, instead of the SFC refraining from issuing comments, efficiency can be improved by involving the SFC earlier and more closely in the vetting process (as part of the Dual Filing structure), and by the SFC and Exchange staff closely coordinating their comments.

Matters involving listed issuers

Our key comments in respect of post-listing matters mirror the ones set out under "Listing applications by new applicants" above, where applicable, to the post-listing situation. To recap:

- **Guidance on LRC Matters** – We suggest strongly a more proactive approach and more elaborate guidance on the concept of LRC Matters (in both a pre- and post-IPO context).

- **Efficiency and certainty** – We would like to see less administrative delay and more transaction certainty where an LRC Matter is escalated. In the post-IPO context, we note the additional responsibility for the Exchange to ensure minimum disruption to the market, as well as maximum certainty for public investors.

- **Composition** – We reiterate the points we have raised above on the composition of the Listing Regulatory Committee and the modified role of the Listing Committee.

Policy development

We have, in principle, no objections to the establishment of the Listing Policy Committee. We would like, however, to offer some words of caution and suggestions on its designed role and policy formulation:

- Concrete steps to move things forward

We note that the aims of the Listing Policy Committee include "initiat[ing], steer[ing] and decid[ing] listing policy" (paragraph 56 of the Consultation Paper). However, setting up a new committee charged with formulating policies is not the same as creating such policies, still less seeing them implemented successfully.

- We need a fresh mindset

Hong Kong is at a crossroads. The certainties that our market has enjoyed of a practically constant stream of high quality, "old economy" listed companies are, after more than two decades, showing some signs of waning. This is completely natural and no cause for alarm. The world today is unrecognisable from the one for which the original version of the Listing Rules was designed; this market is very different even from the one that witnessed the launch of the 2004 major revamp of the Rules.

Hong Kong has kept itself prosperous and vibrant by choosing the road to innovation rather than stagnation, opening itself up to new things rather than staying within a comfort zone. Over the years, we have had ambitions to become one of the regional centres, if not the regional centre, for a number of products and services including RMB clearing, Islamic finance, green finance, retail fund distribution, Exchange Traded Fund formation, among other things.

If, at the finalisation of the consultation process, the regulators decide to set up the Listing Policy Committee as proposed, we respectfully urge the committee to be mindful of the changes that need to take place not only in the "hardware" – systems, personnel, processes – but also in the "software", namely, the mindset. Having the correct mental

framework and a requisite open-mindedness is indispensable if Hong Kong is to capture the many opportunities that arise from the disturbance, uncertainty, sometimes even chaos, that epitomise the dynamics of today's global economic and political realities.

Problems of listing suitability and other LRC Matters are perfectly valid concerns, and we are very much in favour of safeguarding the market against low quality companies that do not have real business prospects to merit a listing. We must, however, juggle the traditional ways of evaluating a business – concepts such as proven track record, sustainable business model, sunset business, etc. – with the utmost care. While these are, and will continue to be, important considerations in our evaluation process, care must be taken that Hong Kong does not stick to the traditional values too inflexibly so that we miss out on the next generation of winners which are increasingly unlikely to have features of old economy businesses, nor traditional ownership and control structures.

Suggestions:

(i) We consider that the Listing Policy Committee should have a steering role only, and that the creation and implementation of such policies should continue to be the Listing Department staff under the supervision of the Listing Committee, and working closely with the SFC executives. As the Consultation Paper correctly points out, the market has become increasingly complex. Instead of putting on a committee of eight persons the burden of policy decision, we believe that the formulation and in particular, the decision, of listing policies would be best achieved by active participation of the Listing Committee with representation from all the key stakeholding groups.

(ii) As an alternative, largely the same results may be achieved simply by adding suitable SFC representation into the Listing Committee, as we have discussed in respect of the Listing Regulatory Committee in the section above titled "Listing Applications by new applicants – The role of the Listing Committee".

(iii) We hope to see that setting up the new Listing Policy Committee is not an end in itself, and look forward to seeing the Committee take leadership and engage the market actively in giving us a blueprint for the future.

Reviews of listing decisions

In principle, we have no objections to the proposed reforms regarding the review powers and processes. However, it seems to us unnecessary to remove the current dual-review (by the Listing (Review) Committee and the Listing Appeals Committee) framework and to replace it by a one-stage review (by the Listing Regulatory (Review) Committee), as far as LRC Matters are involved. We believe that, in the interests of market protection, the two-level review process should be retained.

Publication of decisions

We have no objections to the proposal in the Consultation Paper to publish disciplinary decisions in the interests of transparency, but we take this opportunity to

encourage our regulators to exercise caution, in view of the volume of published guidance, decisions, FAQs, letters, etc., except where absolutely essential (guidance on LRC Matters being one such example).

Despite the relatively simple dual-platform structure of the Exchange, Hong Kong appears to be a very "wordy" listing jurisdiction. A cursory glance reveals that market practitioners have, in a ***most basic*** Exchange toolkit:

- the Main Board Listing Rules (1,061 pages) and the GEM Listing Rules (684 pages)
- Frequently Asked Questions (375 pages)
- Listing Decisions (approximately 825 pages of 275 "live" decisions, on an average of 3 pages per decision)
- Guidance Letters (approximately 450 pages of 75 "live" letters, on an average of 6 pages per letter)
- Interpretive Letters (approximately 200 pages of 25 "live" decisions, on an average of 8 pages per decision)

The above, which omits the entire company law regime, disciplinary regime as well as trading regime, adds up to almost 3,000 pages (and the figure continues to grow). The volume of non-rule guidance considerably exceeds the 1,000-page Listing Rules. This leads to, in practice, a disproportionate amount of research time spent by practitioners for the purpose of advising listing applicants, as well as an equally heavy burden of audit and maintenance by the Exchange.

Between 2010 and 2013, we had seen an exponential increase in the number of Listing Decisions (35 in 2010 and 37 in 2013, with a total of 150 between 2008-2013) and Guidance Letters (19 in 2012 and 17 in 2013). Although matters appeared to have calmed down in more recent years, we have seen eight Listing Decisions in each of 2014 and 2015 and nine in the first half of 2016, plus a total of 19 Guidance Letters from 2014 to the first half of 2016. If the consultation conclusion is to establish a Listing Regulatory Committee, we are potentially going to see an additional source of guidance in the form of LRC decisions.

We note in passing that the SFC has commented on Exchange guidance materials in paragraphs 40 to 55 of its June 2016 Report on the SFC's Annual Review of the Exchange's Performance in its Regulation of Listing Matters.

Suggestion: In view of the proliferation of written materials, we invite the Exchange and the SFC to revisit the current system of publishing guidance – including the current ways of giving guidance and how best to disseminate and organise such guidance. We invite the Exchange to focus more on issues for which non-rule guidance is essential. If appropriate, the Exchange may consider working with the knowledge

management executives at major IPO law firms with an aim to streamlining the current arrangement.

We believe that a revisit of guidance materials (with a view to a reduction in their volume) is of some urgency, in particular given that the Exchange will likely be issuing further guidance on such essential issues as the meaning of LRC Matters, as we have suggested on page 6 above.

Other matters

Para. 35 of the Consultation Paper states that the proposals will apply to both Main Board and GEM matters. The approval process for GEM listings, however, is not identical to the Main Board process.

In particular, the GEM Listing Committee has delegated most of its powers and functions to the Listing Department and the Chief Executive of the Exchange subject to certain reservations and review procedures (see GEM Rule 3.02). The model of referral and decision-making specified in the Consultation Paper for Main Board listings cannot be replicated for GEM listing applications and a "mutatis mutandis" principle does not help make the position sufficiently clear. We await further elaborations from the Exchange on the administration of GEM listings and listed companies involving LRC Matters.

Conclusion and next steps

We hope that our comments and suggestions will be taken into consideration by the regulators in formulating the next steps. In addition, as some of the reforms outlined in the Consultation Paper are of a fundamental nature, we believe many disruptions and confusions could be avoided if the regulators were to organise the implementation gradually, for example with a phased approach or with a trial / pilot period, giving market practitioners time to acclimatise to the new regime. In particular, we would suggest that the market should be given a continued dialogue with the regulators during the trial phase, with opportunities to give feedback, and to cooperate with the regulators generally on ways to resolve any practical issues that may arise and to refine the process.

Contacts

Please contact

of this office if you have any questions in relation to this paper.

Yours faithfully

Davis Polk & Wardwell

Appendix 1

Examples of past Stock Exchange guidance illustrating factors related to listing suitability concerns

Part A: HKEx Listing Decisions relevant to suitability issues

DECISION	SUITABILITY FACTOR ENGAGED	REMARKS
HKEX- LD100-2016 (Company A)	Corruption	- Company A was a mining company whose principal operations and assets were in a high risk jurisdiction. - It is stated in the report that since the country had a high Corruption Perception Index, legal and political uncertainties are prevalent and, this business is not suitable for listing.
HKEX- LD100-2016 (Company E)	Extreme Reliance on fair value gains	- Reliance on fair value gains should not per se render an applicant engaged in a property business not suitable for listing (see paragraph 3.2(7) of HKEX-GL68-13) - However, the Exchange deviates from this rule and suggests that Company E's reliance on the fair value gains was extreme and thereafter render the company not suitable for listing.
HKEx-LD92-2015 (Company C)	Director's suitability	- Company C was engaged in wholesaling and retailing of goods. - The application was rejected due to concerns on director's suitability under Main Board Rules 3.08 and 3.09 - a director who was also a controlling shareholder had made payments to an ex-government official who was then convicted of receiving bribes by a PRC court. - No charges had been laid against the director, he was considered unsuitable to be a director of a listed company given that the sponsor had not demonstrated to the Exchange's satisfaction that the director was able to meet the character and integrity standard requirements under the Main Board Rules based on the submitted facts and circumstances.
HKEx-LD92-2015 (Company F)	Heavy reliance on major customer	- Company F was engaged in the trading of commodities. - The credit period granted to the single largest customer was substantially longer than other customers and therefore it was not demonstrated to be on normal commercial terms, and this had an adverse impact on Company F's working capital sufficiency - There was no proven record on Company F's ability to find new customers to reduce reliance on the single largest customer.

HKEx-LD92-2015 (Company G)	Not qualified for a waiver and had only one mine	- Company G was a mining company in the PRC. Company G had only one mine. - The application was rejected because Company G was not qualified for a waiver under Main Board Rule 18.04 (i.e. a mineral company may still apply to be listed even if it is unable to satisfy the eligibility requirement under Main Board Rule 8.05) as it had not demonstrated a path to profitability given that the mine was already in commercial production. Accordingly, Company G failed to satisfy the eligibility requirement of Main Board Rule 8.05 - Also, as Company G had only one mine, any mandatory suspension because of accidents in its mine or other mines in the region would adversely affect its operations and financial position.
HKEx-LD92-2015 (Company H)	Lack of continuous control over the company	- Company H's application involved a very substantial acquisition of two companies ("Target Groups") which would make up Company H's business upon listing. - The Target Groups had been held by different controlling shareholders and managed by different individuals during the track record period. - There was no conclusive evidence that Company H's controlling shareholder had been exercising control over the Target Groups during the relevant period through cooperation with the controlling shareholders of the Target Groups
HKEX-LD76-2013	Conducting trade in countries with Trade Sanctions	- Company A, incorporated and based in the PRC, entered into several engineering or construction contracts with certain companies in a Sanctioned Country during the track record period. Company B, incorporated and based in the PRC, entered into several engineering contracts with companies in the Sanctioned Countries. - The Exchange questioned whether an applicant that traded with companies of a Sanctioned Country would thus be "unsuitable". - The Exchange determined that given the applicants had undertaken measures to minimise sanctions risk, including terminating the relevant sanctionable activities or transferring the contracts in the Sanctioned Countries before listing, the Applicants' past business in the Sanctioned Countries would not render them unsuitable for listing, and the issue could be addressed by disclosure.

HKEx-LD73-2013	Non-compliance with building laws	- Company A was a retailer and had three principal retail stores (Stores A, B and C), all of which were leased properties. - Store A contributed over 30% of Company A's revenue during the Track Record Period. The use of five out of six of the floors in Store A was not permitted under the permit of the building, and there were also unauthorised building works in Store A. - Company A submitted an alteration work proposal (the "Proposal) to the relevant authority for the rectification of the unauthorised building works. This was pending approval, but it was estimated that profits would fall during the renovation period. Further, if rejected, Store A will need to move. - Although the profit tests were met on paper, the Exchange expressed concerns over listing applicants with serious non-compliances. The Exchange found the breaches on three of the floors to be "material". - Importantly, the Exchange came to this conclusion even though they noted that Company A would still meet the profit test under Rule 8.05(1)(a) after adjusting the track record period's results, or after assuming that Store A had been operating without the three "material breaching" floors. The Exchange said that this was because the Proposal pending approval raised issues of uncertainty as well.
HKEx-LD37-2012	Uncertainty over a company's future financial performance	- The company satisfied the minimum cash flow requirement under GEM Rule 11.12A(1) and submitted that it would have sufficient working capital for at least 12 months after the date of prospectus. - While no profit requirement is imposed on companies seeking to list on GEM, it is decided that uncertainty over a company's future financial performance may cast doubt on its sustainability. - The Exchange considered the issues could not be appropriately addressed by disclosure and rejected the application.
HKEx-LD30-2012	Excessive reliance on parent company	- Company A was a "*Product X*" manufacturer in China. It was a subsidiary of Parent Company, a "*Product Y*" manufacturer. - Since the Group's first sales of Product X in Year 2, it had generated substantial revenue from sales to Parent Company and Parent Company had been the Group's largest customer, representing over 75% of the Group's total sales in Year 2, Year 3 and the first six months of Year 4. The Group expected future sales to Parent Company to account for more than 50% of the Group's total sales volume in each of Year 4, Year 5 and Year 6. - The Exchange concluded that Company A had not yet demonstrated its operational and financial independence from Parent Company and that Company A's significant financial reliance on Parent Company also raised the issue of sustainability of business and Company A's suitability for listing under Rule 8.04. - Importantly, the Exchange came to the conclusion even though they conceded that the reliance was expected to decline.

HKEx-LD19-2011	Non-compliance of Financial Arrangements	- Company A's Non-compliant Bill Financing Arrangements were significant during the track record period compared with its cash, bank borrowings and operating cash flow. - Prior to filing the listing, Company A had already ceased its non-compliant Bill Financing Arrangements and repaid the non-compliant loans already. It also enhanced internal controls to avoid future non-compliance. There were also confirmations from governmental authorities that the breaches were not punitive or legal, which were then confirmed by the sponsors. - After ceasing the Non-compliant Bill Financing Arrangements, Company A experienced declining liquidity. It recorded negative operating cash flow compared to positive operating cash flow throughout the track record period. - The Exchange decided to delay Company A's application for 12 months to allow the company to demonstrate that it would be financially and operationally sound without the non-compliance financing.
HKEx-LD107-1-2010	Heavy reliance on major customer	- Company A was mainly engaged in manufacturing products using the technology provided by Customer X. The products sold to Customer X would be assembled into electronic products. Company A had had a long-term business relationship with Customer X for over 10 years. - The Exchange pointed out that Company A's reliance issue could be dealt with by way of disclosure. In coming to this conclusion, the Exchange drew on a few principles, including the fact that there was a decreasing trend in Company A's reliance on its single largest customer, Company A had made considerable effort to reduce its reliance on Customer X by adopting a diversification strategy and expanding its sales and marketing network, and sufficient reliance would be made in the summary, risk factors, business and financial information sections of the prospectus.
HKEx-LD97-1-2010	Non-compliance of relevant industrial regulations	- Company A was mainly engaged in mining, processing and producing minerals. It breached certain laws and regulations of the place of its operation during the track record period. - The Exchange questioned whether Company A's regulatory non-compliance record made it unsuitable for listing. - The Exchange noted that Company A was unable to rectify all the regulatory noncompliance before listing. However, having considered that the remaining non-compliance incidents could be rectified within a reasonable time frame and they were not so serious as to affect Company A's business viability, the Exchange considered that they would not render Company A unsuitable for listing and the issue could be dealt with by disclosure.

HKEx-LD92-1-2010	Connected transactions with directors and employees after listing	- During the track record period (Year 1 to Year 3), a significant portion of turnover and net profit were derived from transactions with the group's directors and employees. Transactions with these directors would constitute connected transactions after listing. - The Exchange doubted Company A's suitability for listing because of its heavy reliance on transactions with closely related persons during the track record period and after listing. - Although there is no rule that profits from related parties must be disregarded for the purpose of the profit requirements, and the Exchange normally considers that this issue can be addressed by disclosure, it determined that this issue could not be addressed by corporate governance measures and disclosure alone. - It seems this was because the Exchange deemed the reliance to be serious, given that if profits from transactions with directors were excluded, Company A would barely meet the profit requirement. If profits from transactions with directors and employees were excluded, it would not meet the minimum profit threshold of HK$20 million for the latest financial year.

Part B: Stock Exchange Guidance Letters and Rejection Letters on listing suitability or raising relevant issues

GUIDANCE LETTER NO.	THEMES	REMARKS
HKEx-GL68-13A (June 2016)	IPO vetting and suitability for listing	- In this Guidance Letter, the Exchange describes key characteristics of "Target Companies" as follows: • Small market capitalisation; • Only marginally meet the listing eligibility requirements; • Involve fund raising disproportionate to listing expenses (i.e. a high proportion of the listing proceeds were used to pay listing expenses); • Involve a pure trading business with a high concentration of customers; • Are asset-light businesses where a majority of the assets are liquid and/or current assets; • Involve a superficial delineation of business from the parent whereby the applicant's business is artificially delineated from the parent by geographical area, product mix or different stages of development; and/or • Have little or no external funding at the pre-listing stage - The Exchange points out that applicants should note that there is no prescribed bright-line test in identifying the characteristics in "Target Companies" and the Exchange will take into account facts and circumstances of each case. The aforementioned list is non-exhaustive and the relative weighting of the characteristics is likely to differ from applicant to applicant and from industry to industry. These characteristics may also change over time. - The Exchange has also listed out a number of characteristics that are expected to be exhibited in order to substantiate the company's listing suitability: • Use of proceeds • Future objectives and strategies • Profit and revenue growth • Potential sunset industries: the applicant must be able to demonstrate that it is feasible and it has both the ability and resources to modify its business to respond to the changing demands of the market.

HKEx-GL68-13 (December 2013; updated in June 2015)	Suitability for listing	Applicants for listing should appreciate that compliance with Listing Rules may not itself ensure an applicant's suitability for listing. There is no hard and fast rule in determining what would render an applicant and its business not suitable for listing. Each case is determined on its own individual factual circumstances: • Suitability of director and controlling shareholders (e.g. Individual's integrity) • Non-compliance • Deteriorating financial performance • Reliance on parent group/ connected persons/ major customer • Gambling • Contractual arrangements (VIEs) • Reliance on unrealised fair value gains to meet profit requirement • Unsustainable business model
HKEx-GL71-14 (January 2014)	Gambling activities	Where a listing applicant invests in gambling activities, it would be a condition to listing that the issuer must use its best endeavours to ensure that the operation of the gambling activities, throughout its listing, • comply with the applicable laws in the areas where such activities operate; and/or • not contravene the Gambling Ordinance.
HKEx-GL26-12 (January 2012)	Business models with significant forfeited income from prepayments	- An exceptionally high level of forfeited income in the applicant's income portfolio compared to its industry peers could indicate that it should not be considered as generated in the usual and ordinary course of business for the purpose of Rule 8.05(1)(a). - If an applicant has a short history of operating a business with forfeited income, its reliance on forfeited income is significantly above the industry norm, and/or if the operation is associated with a high level of complaints or legal claims, these factors taken together may warrant significant concern. Accordingly, a heightened standard of review will be adopted.

REJECTION LETTER NO.	THEMES	REMARKS
HKEx-RL7-05 (March 2005)	A business of substance and potential for the purposes of GEM Listing Rule 11.12	The Group has not adequately demonstrated that it has a business of substance and potential for the purposes of GEM Listing Rule 11.12 for the following reasons:- • limited Sales and Marketing Activities • limited Production Capacity • limited Human Resources • limited Ability to Collect Money from Customers and the Controlling Shareholders
HKEx-RL1-04 (December 2004)	One focused line of business	The Exchange formed the view that the Group has not adequately demonstrated that it has actively pursued one focused line of business throughout its 24 months of active business pursuit period as required by GEM Rule 11.12 based on the specific facts of the case, namely: • The three segments of the Group's business are distinct operations: 1) nurturing and breeding of [XX] livestock for food products; 2) purchasing and processing of [XX] livestock products principally for exports; and 3) provision of management service to a local [XX] livestock market in [WW] District in the PRC. • In particular, [XX] livestock products used for the processing business were primarily sourced from local suppliers/farmers, while the [XX] livestock products cultivated by the Group were primarily sold to third parties. The management of the local [XX] livestock market is a standalone activity.

Appendix 2

Performance pledges / timing commitments by selected market regulators

Country / Regulator	Statement	Source
US / SEC	"If a filing or confidential submission appears incomplete or if the staff has questions regarding the registration statement or the offering, they usually inform the company with an initial "comment letter," typically within 30 days after filing or confidential submission. The company may file correcting or clarifying amendments to respond to the comments. The initial comment letter may be followed by additional comment letters. The review process is not subject to time limits…"	SEC website – small business and the SEC
United Kingdom / FCA (UKLA) and LSE	"The sponsor is responsible for submitting drafts of the prospectus to the UKLA. The UKLA is allowed 10 business days after the first submission to respond to the sponsor with a comment sheet. The company and its advisers will then revise the prospectus so that the sponsor can submit an updated draft with the UKLA for a further review. For the second and subsequent drafts, the UKLA responds via its comment sheet within five business days. As every transaction is unique, it is impossible to predict exactly how long this process will take. However, as a rule, the timeframe is approximately six to eight weeks from initial submission of the prospectus to the UKLA (approximately three to four submissions) to preliminary approval ahead of launching the transaction, often with a Pathfinder prospectus…"	A guide to listing on LSE (Main Market) – (See p. 24-25 for IPO timetable and p. 27 for UKLA process); see also FCA Service Standards June 2016
Australia / ASIC/ASX	"An 'exposure period' of seven days starts from the date of lodgment. During this time the prospectus is made available for public review and comment, and during this period the company cannot accept any applications under the offer. ASIC can extend the exposure period to up to fourteen days after lodgment if it needs time to review the prospectus in detail… The formal listing application is lodged with ASX within seven days of lodgment of the prospectus with ASIC. Typically the review and approval of the application by ASX is completed within six weeks."… "ASX Listings Compliance aims to process applications for listing as quickly as it reasonably can, given its workloads at the time. Typically, an application for ASX Listing will take ASX four to six weeks to process, from the time a completed application for listing and all other required documents are lodged with ASX, until a decision is made on whether or not to admit the applicant to the official list and quote its securities."…	ASX Listings – Lighting the way forward for business growth (See p. 13-14 for listing timeline and indicative schedule) ASX Listing Rules Guidance Note 1 (See p. 4 for processing time)

Singapore / MAS and SGX	"SGX is committed to provide an iterative response within four weeks from the commencement of Stage 2. This is subject to the receipt of a complete application and the Issue Manager replying to SGX's comments within a specified period. However, the four-week timeline may not apply if there are new key issues identified which (i) have not been adequately resolved or (ii) adequately resolved but meet the LAC referral criteria."	How to get listed on SGX Mainboard; see also SGX website – Company listing process