



香港董事學會
The Hong Kong Institute of Directors

18 November 2016

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

Dear Sirs

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

The Hong Kong Institute of Directors ("HKIoD") is pleased to forward our response to the captioned paper.

HKIoD is Hong Kong's premier body representing directors to foster the long-term success of companies through advocacy and standards-setting in corporate governance and professional development for directors. We are committed to contributing towards the formulation of public policies that are conducive to the advancement of Hong Kong's international status.

In developing the response, we have consulted our members and organised focused discussions.

With best regards

Yours sincerely
The Hong Kong Institute of Directors

Dr Carlye Tsui
Chief Executive Officer

Issued on: 18 November 2016

**The SFC and Exchange Joint Consultation Paper on
Proposed Enhancements to the Stock Exchange of Hong Kong Limited's
Decision-making and Governance Structure for Listing Regulation (June 2016)**

In relation to the captioned Consultation Paper, The Hong Kong Institute of Directors is pleased to present its views and comments.

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What is the purpose? Is it necessary?

As the saying goes, “If it ain’t broke, why fix it?” Whenever there is a suggestion to change an existing structure or process, the usual questions asked would include: “what is the purpose?” and “is it necessary?”

If the change is considered necessary, people will tend to ask: “is the change an improvement over the current situation?” and “what will be the end effect, intended or unintended?” And if there is some purpose to be served, people will also tend to ask: “are there alternatives?”

If it is felt that some problems or issues exist in the regulation of public offerings and listed companies, the community will want an account of what is deficient or missing to be convinced that some changes may be called for. And for changes that could be made, could it be that the more needed changes should be made elsewhere than on those aspects covered by the Proposals?

A more efficient decision-making structure?

One of the proposed new committees, the Listing Regulatory Committee (or LRC), will have a 3:3 representation. And since the chair is not going to have a casting vote, when there is a tie, matters are disposed of as not approved. Consultation Paper para 16-17. The implication – though of course it does not mean it must always happen that way – is that if and when the 3 SFC reps are to act in concert, the SFC can have effective control over the outcome of matters that the LRC may have occasion to deal with.

Another proposed new committee, the Listing Policy Committee (or LPC), will have an eight-person membership (an even number). Like the LRC, the chairperson is also not going to have a casting vote. Like the LRC, in case of a tie, matters are disposed of as not approved. Consultation Paper Para 10-12. More significantly, perhaps, is the proposal to have the LPC replace the current LC as the oversight body for the works of the Listing Department. Consultation Paper para 129. The LPC will have primary responsibility for appraising the performance of senior executives of the Listing Department. Although the ultimate decision on remuneration of those senior executives will remain vested with the Remuneration Committee (and the full board) of HKEx, the HKEx Remuneration Committee will have to take into account the assessment of the Listing Policy Committee when determining a suitable recommendation as to compensation. Consultation Paper para 130. There is the

sentiment that such would be enough to sway some Listing Department executives to want to play and win the heart of those who have much say on their pay.

Although the Proposals reiterate the notion of the Exchange remains being the front line regulator, the cumulative effect of the changes in structure and dynamics could result in a shift in actual influence over listing policy, and which amounts to a de facto change in the division of work and responsibilities between the Exchange and the SFC. If the intent is to make those sort of changes, we surmise such should only be done after a full, explicit deliberation on the subject matter. HKIoD holds the principle that there should always be a clear division of responsibility between the SFC and the Exchange.

If there will remain a Listing Committee, what purpose?

Under the Proposals, there will remain a Listing Committee (or LC). The LC, however, is to only deal with applications that “do not involve suitability concerns or broader policy implications”. The Listing Department (not the LC) will determine if an application or a post-listing matter has suitability concerns or broader policy implications and, if so, will refer the application or matter to the LRC. Consultation Paper para 7. With this proposed arrangement, it could be said that the LC will be rendered perfunctory, because the Listing Department alone will be sufficient to assess if an application or matter needs to go to the LRC, and if there is no such need, actually dispose of it in accordance with prevailing rules. There is the sentiment that, as a result, only those who are after personal honorifics, not substantive work contribution, would really want to be on such a committee.

But the opposite could also be true. If the Proposals are implemented, the LC and the Listing Department may in fact operate with a view to show their worth. Just as a diligent and self-conscious trial judge might try not to get case decisions over-turned on appeal, the LC together with the Listing Department may work together to dispose of applications strictly by the book (or rather, the perceived likings of the LRC). There may be no occasion for the LRC to deal with “difficult decisions”.

Under the current set up, the Listing Committee is not to administer the Listing Rules on a day-to-day basis but it does have one important “reserved matter” in its mandate, which is to approve the application for equity listing by new applicants. The decision as to who can or should get listed, though to a large extent confined by the text of the Listing Rules, pertains to listing policy in so far as such will involve the assessment and determination of whether the applicant meets the parameters of the prevailing policy on suitability for listing. Consultation Paper para 40-43. For as long as we believe it should be a capital *market*, suitability must in turn be dealt with as having a strong indisputable commercial element. Market trends and market forces should come together to develop (and in turn police) the market. Listing policy should complement not stifle the market.

The Listing Committee at present has a composition that “in its entirety represents the diverse views of the market and brings valuable expertise in specialized areas such as industry knowledge, business analysis, accounting and law.” Consultation Paper para 54. That should not be a surprise, as the LC with a diverse view of the market is well-suited and probably best-suited to make those decisions that so much require a finger-tip sense of market reality and the newest trends in commerce. To send matters involving suitability issues away from the Listing Committee to the LRC (with a 3:3 representation, see above) will relegate the LC to a rudimentary role deciding on rudimentary matter while the LRC will be the forum to

decide on “difficult decisions” when it only has indirect if not restricted access to industry expertise and market sense (since the LC is only able to give non-binding views). In this light, are the LC and LRC each fit for purpose under the Proposals?

Among the purposes of the Proposals are “better coordination between the SFC and the Exchange” and “to provide SFC earlier and more direct input on listing (and listing policy) matters.” See Consultation Paper para 1. Could such not be achieved by keeping the current form and mechanism of the LC but augmenting the membership of it to include SFC reps?

If the change, what effect on Listing Policy?

Under the Proposals, the LPC is to ‘steer the Exchange’s work on Listing Rule amendments and overall listing policy.’ The LPC is designed to be the one-stop shop to respond to issues which are often multi-faceted and difficult. Consultation Paper Para 10.

Under the Proposals, the LRC is to consider applications or post-listing matters which have “suitability concerns or broader policy implications”. Consultation Paper para 15.

For sure, “suitability for listing” is not an invention under the Proposals. It has been an element of the current regulatory regime. In the context of the Proposals, a focus on “suitability for listing” would also appear to be a device “to ensure that quality is maintained and that all participants can have confidence in a system which is fair, efficient, orderly, transparent and competitive.” Consultation Paper para 3.

As stated in the Consultation Paper, the decision on whether an applicant should be viewed as suitable for listing and its application approved will also be a decision concerning the “type and nature of companies that should be permitted to access public capital markets in Hong Kong through listing”. Consultation Paper para 85. We are aware of concerns voiced in the community that the Proposals will, in combination with Guidance Letter GL68-13A (Guidance on IPO vetting and suitability for listing), work to the detriment of many Hong Kong-based SMEs, denying them – however promising they may otherwise be – the prospect of becoming listed via an IPO.

And then there are those companies that live and breathe the newer economy that may have ownership and/or governance structures quite different from what the Hong Kong market may have been used to, but nonetheless could be very viable businesses with commensurate opportunities for return to investors.

If it indeed turns out that the LC and the Listing Department each try to show their worth by disposing of case applications to the strictest interpretation of the Listing Rules and related policy and guidance (including GL68-13A), there may be no occasion for the LRC to resolve any “difficult decisions”, and there may be no occasion for the LPC to feel the need to revise its listing policy, including policy on suitability for listing.

That a healthier market is a better quality market and therefore more competitive is a sensible postulation. A listing policy regime that does not meet the need and evolving norms and features of the economy could nevertheless lead to market development steps that miss the beat and which in turn hurt the quality and reputation of the market.

If we are to have and keep up a health capital market, are there alternatives?

If the purpose is to enhance the quality of companies listing on the market, a more direct approach may be to overtly revise the listing requirements, which have not seen a major review for many years now. We are aware of talks about an upcoming consultation on listing requirement, and HKIoD will be glad to participate in such consultation.

To revise the listing requirements could well mean more of a hurdle, making it harder for the smaller companies to get listed on the main board at least. There is, however, the possibility of a vibrant Growth Enterprise Market and/or some other form of a “second board”. We are aware of talks about holding a consultation on GEM regulatory matters and to further explore the viability of a trading platform for accredited professional investors who need to meet prescribed qualification requirements.

The Proposals may be there to meet another purpose, which is to better deal with regulatory issues, including stock market manipulation, corporate governance shortfalls, disclosure problems and misconduct which prejudice public investors. Consultation Paper para 4. There may be felt a need to screen out certain companies and their owners-promoters for their potential to manipulate the market. The application of “suitability” along the lines of GL68-13A could nonetheless inadvertently deny viable and credible businesses their chance of seeking capital from a public offering when that is the best appropriate option for them. We appreciate the need to maintain an orderly market and to fight against market misconduct, but would this not be achievable with better more diligent enforcement post-listing?

Sponsors may have already been placed under a lot of pressure for their liability undertaking IPO work. Could there yet be ways for sponsors to play the better more effective role as gate-keepers? It may not be totally fair to add to the punishment sponsors may face for bad happenings, but a rational incentive and punishment mechanism, if we can devise it, could better tap market forces to self-police the market, and not having to solely rely on the proposed LRC’s review as the basis for who is suitable for listing.

Most markets/exchanges will have some suitability criteria, but the ultimate investor protection tool is for investors to assess information and make an investment decision accordingly. If the purpose is for investor protection, can we not help investors fend for themselves? Investor education, and more of it, will have its purpose and value. As investors become more educated and sophisticated, they should become more able to be their own guard, and not need the hand-holding of regulators all along. Can we not trust that investors can and will assess information and make an investment pick accordingly? It is not necessarily an undue risk to investors if the status and situation of a company is properly disclosed and investors have reasonable access to the information to consider whether to buy in.

For investors to really be able to fend for themselves, one essential element will be the availability of corporate information in digestible form to assess and make investment decisions accordingly. Disclosure is a central part of the Hong Kong regulatory regime, and shall we not want to keep it so? A disclosure regime is only effective when it provides investors with the information they need to make informed investment and voting decisions, but does not overwhelm them with either extraneous information or with a form of presentation that obscures and detracts investors from what is material. We believe it is worthwhile to consider what changes, if any, could be made to our disclosure regime to help

investors (particularly retail investors) understand the companies they may want to buy into. GL68-13A after all calls for more robust analysis of the applicant's suitability for listing. We tend to think that an effective disclosure regime will allow all investors make their own analysis and in turn help companies lower their cost of capital.

Better more sophisticated investors will also know to diversify their portfolio and not lay all eggs in one basket. There is indeed the perception that some of our retail investors may be more in the habit of concentrating their investments in a few bets on hot stocks of the day. This may translate into a stronger perceived need for emphasis on suitability in order to protect investors. Will a culture of investing through mutual funds or institutional intermediaries help more individual investors achieve portfolio diversification? Professional and institutional investors arguably have better bargaining power against issuers and better ability to price shares to discount risks. We are not to say that investing through a long intermediary chain does not present yet another set of governance and/or regulatory issues, but if we can devise solutions to overcome those issues there might still be a strong basis to rethink the listing policy on suitability.

A healthy capital market probably should not just mean a healthy stock market, but also a wide range of possibilities for capital, whether from public offering or private placement or from debt instruments or loans. Going about an IPO and becoming listed does carry some notion of a company making progress and on a successful path. An IPO, however attractive, should be just one option for capital. Is there something more we could do to the breadth and depth and efficiency of the capital market, so companies at different developmental stages and different financing needs can have viable and effective options and not all vying for a listing when that may not be exactly right or ripe for them?

An efficient market should enable capital to flow from investors to companies when investors have knowledge of what they are buying into, and when companies have market incentives to compete for investors' capital through the signaling effect of responsible corporate governance. HKIoD agrees that there will always be bad elements in the market which will require some heavy-handed enforcement to stamp out. But we also tend to think that company directors and their shareholders by and large aim to do good, and they can further enhance their corporate governance qualities capability with initial and continuing training. If indeed a stricter more stringent accreditation scheme will give market investors better confidence in those who make corporate decisions affecting investor interests, perhaps we can also explore that path.

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