

Dear Sirs

Re. Joint Consultation Paper: Proposed Enhancements to the Stock Exchange of Hong Kong Limited's Decision-making and Governance Structure for Listing Regulation (the Consultation)

Introduction

We very much welcome the opportunity to respond to the Consultation's proposals with respect to the regulation of companies listing on The Stock Exchange of Hong Kong Limited (the **Exchange**) which raise a number of concerns with regard to the SFC taking a far more direct role in determining the most important listing-related decisions and in policy setting. Capitalised terms in this letter have the same meaning as in the Consultation.

Before setting out our comments under the specific headings as requested by the Consultation, we outline below more general objections to the Consultation's proposals.

1. Lack of Rationale for the Proposed Changes

1.1 Success of the Exchange

It is our view that the need or rationale for the proposed changes to the Exchange's decision-making and governance structure has not been articulated in any convincing way in the Consultation. General market sentiment is that the current system, in place for more than 20 years, has worked well: the Exchange ranked as the world's top IPO fundraising exchange in 2015¹ and has ranked in the world's top 5 IPO-fundraising exchanges for the last 14 consecutive years. The number of "problematic" listings is also relatively small given the number of private Chinese companies which have listed on the Exchange in recent years. Moreover, the Exchange has not seen anything like the number of scandals related to accounting irregularities and corporate governance failures that resulted in the delisting of many US-listed Chinese companies, despite the much larger number of Chinese companies listed in Hong Kong. The existing regime has served the Hong Kong market well through a number of challenging situations including the financial crises of 2008 and 1997. Its proven success and resilience therefore suggest that there is no compelling reason for change.

1.2 Considerable Powers of the SFC under the Existing Regime

A stated objective of the proposals is to allow the SFC to have earlier and more direct input on listing matters² which is to be achieved by decisions involving suitability issues, novel matters, or wider policy implications, being made by the proposed new Listing Regulatory Committee (LRC).

However, the SFC already has significant powers to intervene at the very outset of the listing approval process under the dual filing process. Section 6 of the Securities and Futures (Stock Market Listing) Rules (SFSMLR) entitles the SFC to object to any listing application within 10

¹ HKEx "Market Statistics 2015" at page 8.

² Paragraph 1(b) of the Consultation.

business days of its filing (or within 10 business days of an SFC request for further information) where it appears to the SFC that, among others:

- (i) the listing application does not comply with the Exchange's Listing Rules. The SFC is thus entitled to object to a listing application in the first 10 business days following its submission, if it considers that the application does not meet the Listing Rules' requirement³ that a listing applicant and its business must be suitable for listing; or
- (ii) it would not be in the interest of the investing public or in the public interest for the applicant's securities to be listed.⁴

The SFC's power to intervene at this early stage is facilitated by the filing of listing applications with the SFC under the dual filing regime⁵ which currently enables the SFC to receive listing application documentation at an earlier stage than the Listing Committee. The Listing Department is additionally obliged to provide the SFC with a copy of all documents given to the Listing Committee for listing applications submitted for its approval as well as any other materials reasonably requested by the SFC.⁶ The stated justification that the proposals will give the SFC earlier input on listing matters⁷ does not therefore seem to be borne out.

As acknowledged in the Consultation, in accordance with paragraphs 6.5 and 6.6 of the MOU, the Listing Department currently informs the SFC, as soon as reasonably practical, of any matter of a novel or potentially controversial or sensitive nature arising in connection with a listing application. Consequently, many novel and controversial issues arising at the listing application stage are already resolved between the Listing Department and the SFC at the listing application stage (i.e. before the involvement of the Listing Committee) and the Consultation proposes that this practice should continue. Under the proposals, the Listing Department will continue to have the discretion to reject any IPO application (including an LRC IPO case) without referring the case to the Listing Committee or the Listing Regulatory Committee, subject to the right of review. The SFC thus already has considerable ability to influence the outcome of listing applications at the very outset of the approval process which may result in listing applications being rejected by the Listing Department so that the case never comes before the Listing Committee.

The SFC also has the right to ask the Listing Committee and the Listing Appeals Committee to consider or review any matter, including a decision of the respective committee itself (Paragraph 10.6 of the MOU). This entitles the SFC to call for a further review of any decision with which it disagrees.

³ Main Board Listing Rule 8.04 and GEM Listing Rule 11.06.

⁴ Securities and Futures (Stock Market Listing) Rules, ss. 6(2)(a) and (d).

⁵ Ibid. s. 5.

⁶ Paragraphs 7.3(b) and (c) of the MOU.

⁷ At paragraph 1(b) of the Consultation Paper.

In relation to listed issuers, the SFC has the right under section 8 of the SFSMLR to direct the Exchange to suspend dealings in a listed issuer's securities in a range of circumstances, including, among others, where it appears to the SFC that:

- (i) it is necessary or expedient in the interest of maintaining an orderly and fair market in securities traded through the facilities of a recognized exchange company;
- (ii) it is in the interest of the investing public or in the public interest, or it is appropriate for the protection of investors generally or for the protection of investors in any securities listed on a recognized stock market.

The SFC's broad statutory powers to require the suspension of a listed issuer gives it a broad right of oversight. This statutory right is entirely in line with the SFC's role as the regulator of the Exchange. However, the case for the SFC to be able to intervene on the frontline, as proposed by the Consultation, is not made out. Moreover, the Consultation has not addressed the potential conflict which would arise from the SFC's role as statutory supervisor of the Exchange. As noted in the response of the Financial Services and Development Council to the Consultation, the SFC's proposed role in the new committees could create conflicts vis-à-vis its supervision role *"where the SFC may find itself holding review or appeal jurisdiction over a decision in which it has previously participated through its representatives on these committees"*.⁸

1.3 Alternative Means of Dealing with Shell Company Listings

Comments in the media⁹ have suggested that a key driver of the proposed reforms is the SFC's desire to clamp down on certain practices it regards as undesirable, particularly shell listings and reverse takeovers.

There are however a number of ways in which these practices can be addressed and there have been intimations that a further review of relevant Listing Rules will be conducted in the near future. According to the Exchange's Update on Regulation of Listed Issuers,¹⁰ the Exchange's policy agenda for 2016 and beyond includes: (i) conducting a holistic review of regulations in connection with listed company activities including RTOs and cash companies; (ii) reviewing the handling of long suspended companies, de-listings and related requirements; and (iii) reviewing the Growth Enterprise Market.

We feel strongly that efforts to clamp down on shell listings and reverse takeovers should be a post-listing matter. The danger in the case of trying to screen out shells at the listing application stage is that the listings of genuine SMEs could be stymied in the process. We

⁸ The Financial Services and Development Commission. *"Response to SFC/HKEx Joint Consultation Paper issued in June 2016: Proposed Enhancements to The Stock Exchange of Hong Kong Limited's Decision-Making and Governance Structure for Listing Regulation"*.

⁹ The Standard. *"Bourse split over listing row"*. 2 August 2016. Reuters. *"Update 1-Hong Kong proposes changes to stock market listing regime"*. 17 June 2016.

¹⁰ HKEX. *"Exchange's Update on Regulation of Listed Issuers"*. 20 May 2016. Page 19. <https://www.hkics.org.hk/hkicsFckEditor/file/PD/ACRU%202016%20handouts%20for%20website/HKEX.pdf>

are currently seeing new listing applicants, particularly on GEM, volunteering ridiculously long lock-up periods on controlling shareholders in an attempt to pre-empt suggestions that the applicant is seeking to become a listed shell. This is manifestly unfair on genuine SME listing applicants and risks discouraging the listing of the types of companies who are most in need of investment. Care must also be taken to ensure that any post-listing restrictions imposed, e.g. further restrictions on change in the nature of the business, does not prevent genuine cases of expansion into new business sectors to the detriment of both listed issuers and their shareholders.

The Listing Committee's 2015 Report outlines the measures being adopted, and further measures under consideration, in respect of backdoor listings, cash companies, reverse takeovers, long-suspended companies and the Exchange's delisting policy. It seems to us that concerns relating to shell companies and reverse takeovers are best dealt with through more robust post-listing enforcement, such as more efficient de-listings to remove so-called "zombie" shell companies from the market thereby protecting its reputation. This must be preferable to the necessarily speculative and subjective process of trying to ascertain pre-listing whether particular listing applicants are prospective shells on the basis of the very broad criteria outlined in the Exchange's latest guidance on IPO vetting and suitability for listing.¹¹ If the way to achieve this is to grant the regulators greater enforcement powers, we would welcome this, as it would enable action to be taken at a stage when there is a real likelihood that a company is seeking to profit from its status as a listed shell, rather than a mere possibility. With regard to reverse takeovers, increased monitoring of post-listing acquisitions and disposals (i.e. shell cleansing) could catch a number of reverse takeovers which are currently missed.

Given that the relevant regulatory provisions involved in shell listings and reverse takeovers are already under consideration and will be subject to further review in the near future, the Consultation's proposals should perhaps be put on hold until such time as these alternative means of dealing with shell companies and reverse takeovers have been implemented and given time to prove whether they succeed in discouraging these activities. This would allow the regulators to tackle the areas of most concern without having to undertake the wholesale reform of a regime which is otherwise working well.

1.4 Existing Provision for Cooperation between the SFC and the Exchange

A further objective of the proposals is the perceived "*need for enhancing the coordination and cooperation [between the SFC and the Exchange] when developing new policy in listing regulation and in regulatory decision making*".¹² Yet substantial interaction and cooperation between the SFC and the Exchange is already provided for by the monthly Listing Matters Liaison Meetings which are required to be held by paragraph 10.3 of the MOU. Matters for discussion include "*any policy or other matters, including potential changes to the Listing Rules, relating to any of the functions and responsibilities of the [Exchange] or the SFC*". It

¹¹ HKEX. "*Guidance Letter HKEX-GL68-13A*". June 2016.

¹² Paragraph 47 of the Consultation.

would seem that the stated objective can be achieved without any change to the existing regime.

1.5 Questionable Need for Improvement in Efficiency

The Consultation claims that its proposed amendments will “*simplify the process for IPO applications so that they can be vetted and approved more efficiently*”.¹³

Since the changes to the listing application process were implemented in October 2013, there have been improvements in the efficiency of the listing approval process thanks largely to the requirement for submission of substantially complete Application Proofs at the listing application stage and the Exchange’s focus on substantive issues. As a result, the time taken for the Exchange to comment and reach a decision on listing applications has been significantly reduced. In 2014, 72% of listing applications were reviewed by the Listing Committee within 120 days of submission¹⁴ compared to just 33% in 2012.¹⁵ Inefficiencies in the listing approval process have already been largely resolved by the substantial changes to the listing process implemented in 2013. The need to improve efficiency in the listing approval process is more perceived than real. While the objective should be to reduce further the time required to approve a new listing, we cannot see that the proposals would help achieve this goal by introducing a second committee to review listing applications involving LRC matters.

1.6 Consultation’s Failure to Make the Case for Reforms

In summary, therefore, the Consultation has not made a sufficient case to justify the significant reforms proposed. With global IPO activity in the first half of 2016 significantly lower than the same period last year,¹⁶ any proposal to substantively reform listing approval procedure, with its potential to cause listing applicants to go elsewhere, must be carefully and fully justified. While Hong Kong looks set to retain its ranking as the world’s top IPO fund-raising market in 2016,¹⁷ the regulators must not risk complacency. Drastic regulatory change could have a significant detrimental effect on Hong Kong’s attractiveness as a listing venue. There has been a noticeable lack of interest from overseas companies in listing on the Exchange: this contrasts with the position in 2010 and 2011 which saw the listings of a number of foreign companies in the luxury goods and mining sectors (including Prada, Samsonite, L’Occitane, Coach, Vale S.A. (since delisted), SouthGobi, and Rusal).

It should also be remembered that Hong Kong’s regulatory regime, which comprises the Securities and Futures Ordinance (the **SFO**) with its stringent Market Misconduct and inside information disclosure regimes, as well as the Takeovers Code and Code on Share Buy-backs

¹³ Ibid. at paragraph 1(c).

¹⁴ SFC. “*Report on the Securities and Futures Commission’s 2015 annual review of the Exchange’s performance in its regulation on listing matters*”. June 2016. Paragraph 30.

¹⁵ SFC. “*Report on the Securities and Futures Commission’s 2013 annual review of the Exchange’s performance in its regulation of listing matters*”. December 2013. Paragraph 33.

¹⁶ Ernst & Young. “*EY Global IPO Trends 2016 2Q*”. Page 1.

¹⁷ Deloitte. “*Hong Kong sets to be world’s largest IPO market in 2016*”. 26 September 2016..

in addition to the Listing Rules, provides substantial protections for investors in Hong Kong's securities market. Much is made of the benefits of the US class action regime, yet the SFC has been extremely successful in recent years in obtaining redress for investors who have suffered loss as a result of misconduct by Hong Kong listed companies.¹⁸ In 2016, Hong Kong was ranked first worldwide for protection of minority investors' interests by the World Bank's report "Doing Business 2016, Measuring Regulatory Quality and Efficiency". In short, the existing regime has seen the Exchange top rankings for both IPO funds raised and the protection provided to minority shareholders. There thus seems to be no convincing reason for changing the Exchange's existing decision-making structures.

While the Consultation bears the promising title "Proposed Enhancements to the Exchange's Decision-Making and Governance Structure", its stated objectives are already provided for and are either already achieved, or are achievable, under the present regime. The Consultation does not set out the inefficiencies or mischief the proposals are intended to address and there is no elaboration of the "enhancements" promised by the paper's title. In short, the Consultation's stated objectives and vague promises of improvements to the existing regime appear to be a smokescreen for the SFC's consolidation of control over the companies which are allowed to list, and remain listed, on the Exchange, as well as the Exchange's policy direction, control which will be unfettered by the vital checks and balances which are built into the current regime.

2. Questionable Legitimacy of Increased SFC Powers

According to the Consultation,¹⁹ if its proposals are implemented, this will be effected by the SFC and Exchange entering into an addendum to the Memorandum of Understanding Governing Listing Matters entered into between the SFC and the Exchange²⁰ (the **MOU**). The changes to the Exchange's decision making procedures would be effected by resolutions of the Exchange's Board and relevant amendments to the Listing Rules. There will be no amendment of the SFO or the SFSMLR.

Although the Exchange's Articles of Association allow its directors to appoint to its committees such members "*of their body and/or such other person(s) as they think fit*"²¹, it is not clear what authority the SFC would have to reject listing applications involving LRC Matters, through its three representative members of the LRC, to . The role of the SFC with respect to listing applications is set out in the SFSMLR. As discussed at paragraph 1.2 above, the SFC has the right to object to a listing application within 10 business days of its submission (or within 10 business days of its receipt of further information it requests) on

¹⁸ Exercising its powers under sections 213 and 214 SFO, the SFC obtained a HK\$1 million share repurchase order against Hong Kong-listed Hontex International Holdings Company Limited following false and misleading disclosure in its prospectus.

¹⁹ Paragraph 53 of the Consultation.

²⁰ "*Memorandum of Understanding Governing Listing Matters*" entered into between the Securities and Futures Commission and The Stock Exchange of Hong Kong Limited. 28 January 2003.

²¹ Article 92 of the Exchange's Articles of Association.

the grounds specified in section 6(2) of the SFSMLR. It also has the right to suspend dealings in the securities of a listed issuer in the circumstances specified in section 8 of the SFSMLR.

3. The Consultation proposes that the SFC, through its members of the LRC, would be able to reject a listing application at a meeting of the LRC held *at any time*, i.e. after the expiry of the statutory periods for the SFC to object to the application under sections 6(2) and 6(6) of the SFSMLR. This appears to represent an increase in the SFC's powers which would appear to require amendment to the SFSMLR. **Fundamental Conflict of Interest between the SFC's Role as Statutory Regulator and the Need to Develop the Exchange as a Highly Performing and Innovative International Market**

The SFC's primary role in relation to the Hong Kong IPO market under the SFO is "to supervise, monitor and regulate ... the activities carried on by recognized exchange companies".²² It is further tasked with securing "an appropriate degree of protection for members of the public investing in or holding financial products, having regard to their degree of understanding and expertise of investing in or holding financial products".²³

The provision that the SFC should have regard to "the desirability of maintaining the status of Hong Kong as a competitive international financial centre" and "the desirability of facilitating innovation in connection with financial products" in performing its function²⁴ is very much a secondary consideration. It is worth noting here that the SFC's role under the SFO is a much watered down version of its role under the SFO's predecessor ordinance, the Securities and Futures Commission Ordinance (Cap. 24) (the **SFCO**) (now repealed). The SFC's functions under the SFCO included "to encourage the development of securities and futures markets in Hong Kong and the increased use of such markets by investors in Hong Kong and elsewhere".²⁵ Perhaps because of the inherent incompatibility with its role as protector of investors' interests, that laudable objective has now been replaced with a secondary duty to consider "maintaining" (not developing) Hong Kong's status as a competitive international financial centre. With the dropping of the specific function/obligation to develop the Hong Kong securities market, the role of the SFC today is primarily that of market regulator and protector of investors' interests. It is unfortunate that the requirement enshrined in the Basic Law, that "The Government of the Hong Kong Special Administrative Region shall provide an appropriate economic and legal environment for the maintenance of Hong Kong as an international financial centre",²⁶ is not provided for by any corresponding obligation on either the SFC or the Exchange to maintain the international status and competitiveness of its stock exchange. The Exchange's position as an international listing venue is clearly essential to Hong Kong's status as an international financial centre, yet there is no corresponding responsibility on any body to maintain that status as is envisaged by the Basic Law.

²² S.5(1)(b)(i) of the SFO.

²³ S.5(1)(l) of the SFO.

²⁴ S6(2)(a) of the SFO.

²⁵ S4(1)(j) of the Securities and Futures Commission Ordinance (Cap. 24).

²⁶ Article 109 of the Basic Law of the Hong Kong SAR.

It is arguable therefore that the SFC is irredeemably conflicted: its primary function of regulating the market and protecting investors is antithetical to the very real need to develop the Hong Kong securities market. Development of Hong Kong's market requires both an innovative and pragmatic approach to regulation to secure Hong Kong's continued attractiveness to issuers and investors alike and to maintain its position as Asia's leading international Exchange.

If the Exchange fails to remain competitive, it will inevitably lose out to the Chinese exchanges which are possibly already ahead of the Exchange in the proposals to adopt a US-style registration- (i.e. disclosure-) based listing regime.

It should also be remembered that the rationale for the Listing Committee's role lies in its make-up by market practitioners. The Report of the Securities Review Committee on the Operation and Regulation of the Hong Kong Securities Industry, commonly referred to as the Hay Davison Report, was adamant in its view that a practitioner-based regulatory system was best suited to Hong Kong as it would "*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*".²⁷ Noting 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*", the Hay Davison report concluded that there was no alternative to practitioner-based regulation.²⁸ The SFC members of the new LRC and Listing Policy Committee (LPC) will be regulators, and are thus likely to be unduly risk-averse since they will be more intent on preventing potential problems and protecting investors' interests than on market development. There is a real concern therefore that the proposals will stifle market development and innovation which may adversely affect the competitiveness of the Hong Kong market and Hong Kong's position as Asia's premier financial centre.

4. Lack of Conflict of Interest under the Current Regime

Much is made of the perceived conflict of interest in the Exchange's role in the listing approval process. The argument goes something like this: the Exchange collects listing fees - thus it is in its interest to approve more new listings than may be objectively justifiable. Except that the Exchange currently has only one representative, its chief executive, on the 28-member Listing Committee which approves or rejects listing applications. The SFC also has the power to direct changes to the Listing Rules and to impose its own rules governing the operation of the market, such as listing.

The Listing Committee, currently responsible for listing decisions and policy, is independent of the Exchange. As acknowledged in the Consultation, the Exchange Board delegated all its powers and functions in respect of all listing matters to the Listing Committee precisely in order to "*manage potential conflicts of interests and ensure the independence of the listing*

²⁷ Hay Davison Report. May 1988. At paragraph 3.24.

²⁸ Ibid. at paragraph 3.26.

function”.²⁹ Furthermore, if maximising listing fees were the Exchange’s primary motivation, then surely that objective is in complete alignment with the objective of providing a high performing, innovative market which is in the interests of issuers, investors and the Hong Kong financial market in general.

5. Increase in SFC’s Powers

The SFC has been at pains to deny that the proposals will increase its powers given that it is already able to veto new listing rules and cases.³⁰ In fact, the SFC’s right to object to a new listing exists only in the circumstances and within the time limits specified under section 6 of the SFSMLR. Provided that a listing applicant satisfies the listing requirements and complies with the prospectus disclosure requirements, its listing should be approved except where it is considered not to be suitable for listing. Decisions on suitability are currently made by the independent Listing Committee, although whether or not the applicant’s listing is contrary to the public interest, which overlaps substantially with the suitability issue, is determined by the SFC who can object to the listing if it considers the listing to be contrary to the interests of the investing public. The determination of suitability for listing is currently made by an independent Listing Committee comprising 28 individuals, the Exchange’s CEO and 27 market practitioners (including lawyers, investment bankers and accountants) and investor representatives. When the SFSMLR were implemented, it was clear that the intention was for the SFC’s powers to object to a listing application to be a reserve power³¹ which would be subject to external mechanisms of checks and balances “including judicial review by the courts, the Process Review Panel, the Ombudsman, and the Independent Commission Against Corruption”.³² The Consultation’s proposals will see the SFC take a considerable step forwards from a check on the Exchange towards front-line regulation.

5.1 The SFC will effectively Control the Composition of both New Committees

Under the proposals, decisions on suitability and other novel or controversial issues will be made by the LRC consisting of just six individuals: three senior executives of the SFC’s Corporate Finance Division and the Chairman and two Deputy Chairmen of the Exchange’s Listing Committee. While this is presented as a sharing of power between the Exchange and the SFC, the SFC will in fact control and dominate the composition of the LRC and LPC.

The Chairman and Deputy Chairmen of the Listing Committee (i.e. the three LRC members under the proposals) are nominated by the Listing Nominating Committee (LNC) (Listing Rule 2A.21). The LNC is made up of three non-executive directors of the Exchange’s Board and the Chairman and two executive directors of the SFC. This effectively gives both the SFC and the Exchange the ability to veto the nomination of any individual as Chairman or Deputy Chairman of the Listing Committee. The SFC’s right to veto any individual’s nomination to

²⁹ At paragraph 40 of the Consultation Paper.

³⁰ The Standard. “SFC allays fears on power”. Daisy Wu. 5 August 2016.

³¹ SFC. “A Consultation Paper on the Securities and Futures (Stock Market Listing) Rules and the Securities and Futures (Transfer of Functions – Stock Exchange Company) Order. May 2002. Paragraphs 21 and 28.

³² Ibid. Paragraph 27.

these positions (and thus to membership of the LRC) will give the SFC absolute control over who is appointed as the Listing Committee's members of the LRC. Neither the Exchange nor the Listing Committee will have a comparable influence over who are the SFC representatives on the LRC. Moreover, it should be recognised that while the SFC representatives are all employees of the SFC who represent its views, the same is not the true of the Listing Committee Chairman and Deputy Chairmen. These are independent individuals who will vote according to their conscience as they currently do as members of the Listing Committee. They are not bound to follow the Exchange's views on any issue and are not its representatives.

The LPC will also be under the control of the SFC. The SFC will directly control the composition of half its members who will be the CEO of the SFC, two senior executives of the SFC's Corporate Finance Division and the Chairman of the Takeovers Panel, who is appointed Chairman by the SFC under section 8(3) of the SFO notwithstanding that the Takeovers Panel would have the right to elect its own Chairman under section 8(6) of the SFO, if the SFC hadn't already appointed him. The other four members of the LPC will be the Exchange's Chief Executive, and the Chairman and two Deputy Chairmen of the Listing Committee (the appointment of the latter three being within the SFC's control as mentioned above). The suggestion that there will be no increase in the SFC's power is therefore questionable given that the make-up of both new committees will be under the effective control of the SFC.

5.2 SFC to Influence Most Significant Listing Decisions

The SFC has insisted that there will be no increase in its powers since the new LRC will only decide the 10% of new listings which involve suitability issues. These are however the most important new listings since the LRC's decisions on these cases will determine those companies which are considered unfit for listing in Hong Kong notwithstanding that they meet the objective listing criteria. The increase in the SFC's influence will therefore be disproportionate to the number of cases reviewed by the LRC. While the Listing Committee will review all listing applications, including those to be referred to the LRC for decision, and its comments will be conveyed to the LRC, the latter will not be bound to take those comments into account in reaching its decision. Nor will there be any requirement for the LRC to explain why it does not follow the Listing Committee's advice in any particular case, giving it *carte blanche* to ignore the Listing Committee's views.

According to SFC figures³³, it commented on or raised concerns with respect to 216 of the 218 listing applications submitted to it under the dual filing process in 2015. Of these, 3 were returned for not being substantially complete,³⁴ while 6 were rejected by the Listing Committee.³⁵ Thus of 216 listing applications only 6 were rejected for listing. Even assuming that these 6 were all rejected due to lack of suitability or public interest concerns, they only

³³ SFC. "Regulation for Quality Markets – Annual Report 2015-16".

³⁴ HKEX Listing Decision HKEX-LD101-2016. April 2016.

³⁵ HKEX Listing Decision HKEX-LD100-2016. April 2016.

represented 2.8% of the listing applications reviewed by the SFC. If the numbers are really that small, there surely must be a question as to whether the proposed substantive reforms are justifiable.

5.3 Lack of Scrutiny of "Routine" Listing Applications

Of perhaps greater concern, is that the vast majority of listing applications which do not involve suitability or public policy concerns will no longer be commented on by the SFC under the Consultation's proposals. Given that the SFC last year commented on, or had concerns about, 216 out of 218 listing applications, there must be a concern that these supposedly non-controversial or routine applications will be deprived of the degree of SFC scrutiny to which they have previously been subjected.

Request for Comment

Our specific comments under the headings suggested by the Consultation are set out below.

1. Policy Development

The establishment of a new LPC is unnecessary as the existing regime already provides for the SFC to play a significant role in policy setting as set out in Appendix 1. The SFC already has the ultimate say in policy matters since any Listing Rule amendment, or waiver having general effect, is subject to SFC approval.³⁶ It is also entitled to require the Exchange to make new Listing Rules or amend the existing Listing Rules under section 23(3) of the SFO.

As noted at paragraph 1.3 of the "Introduction" above, the SFC and Exchange hold "Listing Matters Liaison Meetings" monthly to discuss, among others, policy or other matters including potential changes to the Listing Rules.

The SFC and the Exchange have already established a "High-Level Group" that meets from time to time to review systemic and policy issues concerning listing-related matters³⁷, the membership of which comprises: the Chairmen of the Exchange, the Listing Committee, the GEM Listing Committee, the Takeovers Panel, and the SFC and the Executive Director of the Corporate Finance Division of the SFC, the Chief Executive of the Exchange and the Exchange's Head of Listing, Regulation and Risk Management.³⁸ If this High-Level Group is not already discussing and reviewing policy issues as envisaged by the MOU, it is perhaps now time that it should start to do so. The addition of market practitioner members of the Listing Committee to this High-Level Group would make it a preferable alternative to the currently proposed LPC.

A particular concern regarding the proposed new LPC is that there is no provision for the publication of policy decisions. The Listing Committee, on the other hand, publishes its

³⁶ Section 24 of the SFO and Listing Rule 2.04.

³⁷ Memorandum of Understanding Governing Listing Matters between the SFC and the Exchange of 28 January 2003 at paragraph 5.1.

³⁸ Ibid. at Appendix II.

policy agenda for the year ahead in its annual reports which are publicly available on the website of the Exchange. This would appear to represent a step backwards in terms of transparency since policy decisions will be made behind closed doors by just eight individuals with no obligation to disclose the policy matters discussed and the reasons they are not pursued where that is the case.

2. Listing Applications by New Applicants

Under the proposals, the determination of suitability for listing will generally be made by the six members of the LRC. Of all the issues to be determined in respect of a listing, this is the most subjective and arguably the most difficult. As far as we are aware, there is no comparable suitability requirement for listing on other international stock markets – so that a listing applicant will be listed provided it can demonstrate compliance with objectively ascertainable criteria. Suitability defies precise definition. Thus the factors the Exchange (through the Listing Committee) takes into account in determining suitability as stated in its Guidance Letters³⁹ are non-exhaustive and are outlined in broad terms only. Factors affecting suitability include, among others, excessive reliance by the listing applicant on a third party (e.g. the parent group, connected persons or a major customer); an unsustainable business model as indicated for example by a deteriorating financial performance after the track record period or a changing regulatory environment and industry outlook. These are clearly highly subjective decisions which require careful consideration of the particular facts and circumstances by those with appropriate commercial and market expertise. It is precisely these complicated decisions which benefit most from the broad expertise of Listing Committee members. Instead, under the proposals, the Listing Committee will be largely reduced to rubber stamping the most straight-forward listing cases.

The Consultation's proposals will mean that the most complex decisions will be made by just six individuals, three of whom are regulators with little commercial experience, while the three Listing Committee representatives do not include an investment banker or other corporate finance adviser). It is also stipulated that one of the three Listing Committee representatives on the two new committees must be an investor representative. Given that the SFC's statutory functions include securing protection for members of the investing public⁴⁰ and the SFC has three representatives on the LRC, the interests of the investing public are arguably already sufficiently safeguarded without a further requirement for an investor representative to be one of the Listing Committee's members of the LRC.

3. Matters Involving Listed Issuers

Our comments relating to the LRC's ability to decide listing applications apply equally to its decision-making role on matters involving listed issuers. Decisions in relation to listed issuers' compliance with Listing Rule 13.24, for example, as to whether a listed issuer has

³⁹ Guidance Letters HKEx-GL68.13 (Guidance on suitability for listing) and HKEx-GL68-13A (Guidance on IPO vetting and suitability for listing).

⁴⁰ Section 5(1)(l) of the SFO.

sufficient operations or assets to warrant its continued listing, are highly subjective and require considerable commercial expertise. Again, the presence of market practitioners on the body making these decisions is in our view essential to the proper functioning of the Hong Kong market.

4. Reviews of Listing Decisions

The Consultation proposes that the LRC (whose composition, as discussed above, will be effectively under the SFC's control) will replace the Listing (Review) Committee as the body to review the decisions of the Listing Committee on non-LRC listing applications. A decision of the LRC to reject a listing application will be subject to review by a newly formed Listing Regulatory (Review) Committee (the **LRRC**). It is proposed that the new LRRC will be made up of the Chairman and CEO of the SFC (as ex officio members) and a non-executive director of the SFC nominated by the SFC board and three individuals who have formerly served on the Listing Committee, one of whom must be an investor representative. The former Listing Committee members will be nominated by the Listing Nominations Committee, thus raising the same issue that the committee's composition is under the control of the SFC as discussed in relation to the LRC and LPC above.

Of greater concern is the lack of clarity surrounding the interaction between the SFC's right to object to a listing application under section 6 of the SFSMLR, and the right of the SFC, through its representatives on the LRC, to block the approval of a listing application. The Consultation proposes that the new LRRC should be the final review body within the Exchange of decisions of the LRC. However, where the SFC exercises its right under section 6 of the SFSMLR to object to a listing application, the listing applicant has the right to have the SFC's decision reviewed by the Securities and Futures (Appeal) Tribunal (**SFAT**) pursuant to section 217 of the SFO.⁴¹ The listing applicant then has a right of appeal to the Court of Appeal against a decision of the SFAT on a point of law. Since the SFC's statutory right to object to a listing application will remain unchanged, so too will the listing applicant's right to appeal the decision to the SFAT. Where the SFC exercises its right to object, it is required to give notice to the listing applicant and the Exchange.⁴²

The area of uncertainty surrounds a vote by the SFC representative members of the LRC to not approve a listing application in circumstances where the SFC would have been entitled to exercise its statutory right of objection under the SFSMLR. The outcome is essentially the same – the listing application is rejected, although at a later stage in the application process in the case of rejection by the LRC. It is particularly concerning that these arrangements would potentially allow the SFC to eliminate the possibility of an SFAT review of its decision to object to a listing application, by choosing instead to block the application by voting against its approval at the LRC hearing stage. This would appear to represent a substantial reduction in listing applicants' rights and in the accountability of the SFC. The SFAT is

⁴¹ An SFC objection to a listing application pursuant to section 6(2) of the Stock Market Listing Rules is a "specified decision" for the purposes of the right of review by the SFAT under section 217 SFO.

⁴² Section 6(2) of the SFSMLR.

chaired by a judge and has the statutory purpose of ensuring that the SFC's regulatory decisions are reasonable and fair and thus of enhancing SFC accountability.⁴³ The LRRC, on the other hand, would be comprised of three SFC representatives and three former listing committee members as nominated by the Listing Nominating Committee. There is no requirement for any of the LRRC members to have legal expertise.

According to paragraph 18 of the Consultation, the SFC's existing statutory right to object to a listing application, and its power, through its representatives on the LRC, are essentially one and the same. Paragraph 18 states:

"The proposed voting arrangement means that, for those cases that are put to the Listing Regulatory Committee, the SFC would in effect be able to exercise its power under [section 6 of] the Stock Market Listing Rules to object to a listing through its participation on the Listing Regulatory Committee." (Emphasis added)

If the LRC's rejection of a listing application (brought about by the SFC LRC members voting against it) is intended to essentially replace or be equivalent to the SFC's statutory right of objection, then there is surely a strong argument that a decision of the LRC to reject a listing application should be subject to SFAT review under section 217 of the SFO (in precisely the same way as an objection under section 6(2) of the SFSMLR), at least in cases where the SFC representative members of the LRC voted against its approval (in effect exercising the SFC's power under section 6 of the SFSMLR). There should also be the further right to appeal to the Court of Appeal under section 229 of the SFO on a point of law.

5. Disciplinary Matters

Under the Consultation's proposals, the disciplinary powers of the Listing Committee under Chapter 2A of the Listing Rules will be removed. Disciplinary powers will instead be vested in the Listing (Disciplinary) Committee and the Listing (Disciplinary Review) Committee which will be chaired by a practising or retired senior counsel (or another individual of equivalent qualification) who is a member of the proposed new Listing Disciplinary Chairperson Group.

Currently, disciplinary hearings are conducted in accordance with the Exchange's statement on its approach to the enforcement of the Listing Rules⁴⁴ (the **Enforcement Statement**) and its procedures for disciplinary matters involving breaches of the Listing Rules⁴⁵ (the **Procedures**). When these were last updated in September 2013, the Exchange noted that the disciplinary process remains informal and is designed to be flexible.⁴⁶ The proposal that disciplinary hearings are chaired by a senior counsel would fundamentally alter the nature of

⁴³ Homepage of the Securities and Futures Appeals Tribunal at <http://www.sfat.gov.hk/english/aboutus/welcome/>.

⁴⁴ HKEX. "Statement on the enforcement of the Listing Rules by the Exchange". http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/documents/enfs_0913.pdf

⁴⁵ HKEX. "Disciplinary Hearings Procedures". http://www.hkex.com.hk/eng/rulesreg/listrules/listdisciplinarypro/documents/dis_0913.pdf

⁴⁶ HKEX. "Stock Exchange Publishes New Statement on Enforcement of Listing Rules and Implements New Procedures for Disciplinary Action Involving Listing Rules". 13 September 2013.

these proceedings, resulting in a far more formalised and legalistic forum than is presently the case. Under the existing Listing Rules⁴⁷, while the party the subject of disciplinary proceedings is entitled to make submissions and may be accompanied by professional advisers, the professional adviser has no right to address the Listing Committee or Listing Appeals Committee, as the case may be. Under the principles of natural justice, the chairing of the new committees by senior counsel might suggest that issuers' counsel should be given rights of audience at relevant hearings which is likely to increase the length of hearings and the legal costs incurred by issuers.

While the Listing Rules provide for the suspension or cancellation of a listing in the case of a breach of the Listing Rules, in the vast majority of cases the sanctions imposed are reputational public sanctions, remedial actions, or denial of the market's facilities in the case of wilful or persistent failure by an issuer to discharge its Listing Rule responsibilities. Given the nature of these lesser sanctions, which constitute the vast majority, it is questionable whether it is appropriate to risk rendering the disciplinary hearings more legalistic and formal.

During 2015, there were eight disciplinary hearings – six at first instance and two review hearings involving six cases.⁴⁸ The disciplinary committees will be comprised of Listing Committee members and chaired by senior counsel. The risk in making disciplinary proceedings more formalised is that this will impact the length of such proceedings making them less efficient than is currently the case. The revisions to the procedures made in September 2013 were intended to expedite disciplinary proceedings and ensure that regulatory outcomes are *"delivered in a timely and efficient manner"*.⁴⁹

6. Oversight of the Listing Function

It is proposed that the LPC will replace the Listing Committee as the body responsible for oversight of the listing function and, generally, the performance of the Listing Department's regulatory responsibilities.⁵⁰ The LPC is also to be given *"primary responsibility for appraising senior executives of the Listing Department in the performance of their regulatory responsibilities"* and the Exchange's Remuneration Committee, which is responsible for determining the overall compensation of the Listing Department and its senior executives, *"will take into account the assessment of the Listing Policy Committee when determining such compensation"*.⁵¹ This latter proposal is completely unacceptable given the obvious need for the Listing Department to be independent of, and to be seen to be independent of, the LPC, and indirectly, the SFC.

The Listing Committee was originally made responsible for oversight of the listing function and the Listing Department's performance precisely because it is independent of the

⁴⁷ Listing Rule 2A.16.

⁴⁸ HKEX. *"Listing Committee Report 2015"*. Paragraph 68.

⁴⁹ Enforcement Statement at page 3.

⁵⁰ Paragraphs 28 and 129 of the Consultation Paper.

⁵¹ Ibid.

Exchange. While the Listing Committee has a right of oversight, it is not responsible for the review of Listing Department remuneration, as is proposed for the LPC.

7. Publication of Decisions

We welcome the proposal that decisions of the LRC, the LRRC, the Listing (Disciplinary) Committee (the **LDC**) and Listing (Disciplinary Review) Committee (the **LDRC**) will be routinely published on the HKEx website together with reasons for those decisions. It would also suggest that the LRC decisions should include an explanation of why comments made by the Listing Committee in relation to the subject listing were not followed where this is the case. In the interests of greater transparency, it is also suggested that decisions of the LPC should be published setting out the policy matters considered by the LPC and the reasons for not pursuing any particular policy or the further steps to be taken in respect of a policy which the LPC considers should be adopted.

8. Composition and Procedures of the LPC, LRC, LDC and LDRC

8.1 Composition

Please see our comments above as to the undesirability of the composition of the new committees being under the effective control of the SFC and the lack of market practitioners on the new committees contrary to the Hay Davison conclusion that practitioner-based regulation is the best option for Hong Kong. Despite that decision having been made over 20 years ago, it still holds true today.

A number of parties have suggested that instead of the new committees, the same objective of giving the SFC greater and earlier input on policy and listing decisions could be achieved by allowing SFC representatives to attend Listing Committee meetings which consider listing matters involving LRC Matters and policy issues. The Financial Services and Development Council has suggested that SFC representatives should attend in the capacity of observers (rather than Listing Committee members) due to potential conflict issues with the SFC's role as the Exchange's supervisory authority. This suggestion definitely appears worth consideration since it would allow discussion between all relevant parties: the SFC, the Exchange, the Listing Committee and, where appropriate, listing applicants and their sponsors. Such a forum would facilitate the greater cooperation and coordination between the Exchange and the SFC which is an objective of the Consultation, while retaining the crucial input from the Listing Committee's market practitioners. With respect to policy setting, the regular listing committee meetings on policy could be supplemented by meetings of the High-Level Liaison Group which would be able to look at over-arching principles and the broader considerations relevant to policy setting.

8.2 Procedures

As regards the procedures of the new committees, it is noted that each committee will have an even number of members with no provision for a casting vote in the event of a dead-lock. The Consultation fails to specify how issues such as suitability for listing will be determined

in the event of a tied vote. The Listing Rules require that listing applicants must be considered to be suitable for listing. In the event of a tied vote, it is not clear whether the application will be disapproved because there is no majority considering the applicant to be suitable for listing, or whether it would be approved, as a majority failed to find the applicant unsuitable. Assuming for the time being that it would be the former, i.e. the application would be rejected because the majority did not consider the applicant “suitable”, then will the same reasoning apply to post-listing cases?

For example, Practice Note 17 of the Listing Rules enables the Exchange to suspend dealings in the securities of listed issuers which are unable to comply with the requirements of Listing Rule 13.24 as to sufficiency of operations or assets. Where a case involves LRC Matters, the issue would be decided by the LRC. The issue for decision would be “does the issuer have insufficient operations or assets to justify its continued listing”, that is “is it unsuitable to remain listed?” This would presumably require a majority vote that the issuer’s operations/assets are insufficient for the issuer to be suspended. But if there is a tied vote, applying the same reasoning as for listing applications above, this should mean that there would be no suspension since a majority has failed to find that the issuer cannot comply with Rule 13.24. The regulators should clarify how the proposals are intended to operate in a deadlock situation. With such a small number of individuals on the LRC, in particular, it seems unfair to give any one a casting vote. Yet without a casting vote dead lock cannot be avoided, unless SFC and Exchange representatives were to be given the casting vote on alternate decisions.

It is proposed that the new LRC and LPC would be committees of the Exchange. However the proposal that the Chairman of these committees should not have a casting vote is contrary to the Articles of Association of the Exchange (i.e. The Stock Exchange of Hong Kong Limited) and those of Hong Kong Exchanges and Clearing Limited (HKEC). The relevant article on “Procedures at Committee meetings”⁵² states that:

“Questions arising at any meeting shall be determined by a majority of votes of the members present and, in the case of an equality of votes, the chairman of a meeting shall have a second or casting vote.”

The Consultation’s proposal as to the lack of a Chairman’s casting vote will therefore require an amendment to the Articles of the Exchange. Alternatively, the chairmen, who will be the Listing Committee Chairman, could be given a casting vote in the event of deadlock.

9. Other Matters

9.1 Reduced Efficiency

One of the Consultation’s stated objectives is the improvement of efficiency in the listing approval process. For those listing applications involving LRC matters, the proposed

⁵² Article 93 of the Articles of Association of The Stock Exchange of Hong Kong Limited and Article 105 of the Articles of Association of Hong Kong Exchanges and Clearing Limited.

approval procedure has the potential to become less efficient. Instead of one hearing by the Listing Committee, the new proposals envisage initial consideration of the application by the Listing Committee whose views are then relayed by the Listing Department to the LRC (as well as the listing applicant and its sponsor). The decision on the listing will then be made by the LRC which will have the benefit of, but will not be bound by, the Listing Committee's views. Quite apart from a second layer of regulatory hearings, a further inefficiency lies in the requirement for the Listing Committee's views to be relayed to the LRC by the Listing Department and the lack of direct discussion between the Listing Committee and the LRC. This inefficiency could easily be cured by the suggestion above that instead of having a separate LRC, members of the SFC could instead attend listing committee meetings hearing applications involving suitability issues or having wider policy implications. Although the SFC has estimated that only some 10% of listing applications will be referred for decision to the LRC, it is likely that, at least during the initial stages of the regime's implementation, the Listing Division will tend to err on the side of caution and refer to the LRC any case having the slightest suspicion of an LRC matter. This could overload the LRC leading to reduced efficiency.

9.2 *Removal of Checks and Balances*

A major concern is the proposed removal of the vitally important checks and balances built into the current regime. The Listing Committee currently acts as an independent reviewer of the Listing Department's decisions, while the SFC's ability to object to a listing application operates as an important check on the Listing Committee's exercise of its powers. The proposals represent a move by the SFC towards front-line regulation, but they do not provide for a corresponding check on the SFC's powers. If anything, the accountability of the SFC will be diminished if listing applicants' right of appeal against an LRC decision is only to the LRRC. As already mentioned, we believe that the SFC's exercise of its powers through its participation in the LRC must be subject to the right of appeal to the SFAT under section 217 of the SFO.

9.3 *Misguided Emphasis on Consensus as a Good in Itself*

The Consultation places great rhetorical emphasis on 'consensus' as a good in itself. Yet one of the greatest dangers in systemic or case-based failures of regulation is a misguided prevalence of group-think. Pressure for consensus and resultant group-think is antithetical to proper and full scrutiny and oversight. Excessive emphasis on the desirability of consensus (with its virtue-signaling tone) may discourage the expression of dissenting opinions which need to be heard and properly considered. The concentration of policy-making and regulatory decision making in the hands of such a small group of people who are then deprived of the benefit of alternative viewpoints and challenge could be highly detrimental.

9.4 *Problems inherent in proposed 2-track approval process*

The Consultation essentially proposes a new 2-track approval process for listing applications. Those assessed by the Listing Department as not giving rise to LRC Matters, i.e. as routine or

safe, will be submitted for decision to the Listing Committee, while those considered to involve LRC Matters will be regarded as problematic and will be decided by the new LRC, with the benefit of the non-binding comments of the Listing Committee.

The dangers are that:

- designating cases as “routine” at the Listing Department assessment stage means that the cases presented to the Listing Committee for decision will come with the presumption that they are straightforward and are thus likely to be waved through with a lighter-touch than those subjected to the heavier scrutiny of the LRC;
- those tasked with deciding “routine” cases will be de-professionalised as a result of being deprived of experience of deciding problematic cases. Although the Listing Committee will continue to review all listing applications (including the ones to be decided by the LRC), a review and commenting process is different in key respects from the decision making process;
- since the SFC will cease to comment on listing applications as it does currently under the dual filing process, routine listing applications will not benefit from the scrutiny of the SFC; and
- the Listing Committee, being largely relegated to the role of rubber-stamping routine listing applications, will cease to attract the high quality, experienced professionals it has attracted to date.

9.5 Lack of Certainty

The proposed changes will cause considerable uncertainty which may adversely affect the attractiveness of the Exchange as a listing venue.

In addition, it could make it increasingly difficult for sponsors and financial advisers to advise their clients. A recent example of problems of uncertainty has been the recent guidelines in respect of IPOs. No one has the slightest idea how these guidelines are being implemented resulting in absurdly long lock-up periods being volunteered to try and pre-empt any suggestion that the applicant is seeking to become a listed shell. Fundamental changes to how the IPO process works are the last thing the market needs and they will do nothing to encourage access to the capital markets. The new regime implemented in October 2013 already caused substantial disruption and additional costs, further disruption and costs should not be triggered without very good reason, which has not been established by the Consultation.

The SFC might be more successful in discouraging practices such as shell listings if it were to allocate greater resources for active surveillance and monitoring of parties engaged in price rigging of “shell companies”. Trying to determine whether any particular listing applicant is intending to list as a shell at the listing application stage is fraught with difficulty. Even post-listing, it can be difficult to distinguish between a listed issuer facilitating a reverse takeover

and one genuinely pursuing new business. Yet there are procedures already in place under the Listing Rules on reverse takeovers and related guidance which can be applied in dealing with potential attempts to circumvent the listing application process through a reverse takeover. The major advantage of dealing with these cases post rather than pre-listing, is that it avoids the possible rejection of genuine listing applicants which could equally be potential shells.

Appendix 1

SFC's Existing Rights in relation to Listing Policy

1. Right to approve Listing Rule amendments

SFC approval is required for any amendment to the Listing Rules under section 24 of the SFO.

2. Right to approve waivers or decision not to require compliance having general effect

Listing Rule 2.04 requires the Exchange to obtain the SFC's prior approval of any proposed waiver or modification of any Listing Rule, or decision not to require compliance with any Listing Rule, which will have general effect (i.e. affect more than one issuer).

3. Right to approve Exchange policy decisions

Paragraph 6.4 of the MOU requires that the Exchange forward to the SFC any policy decision it intends to implement that will have mandatory effect or be of general application, including practice notes, guidance notes, and waivers from requirements. The Exchange may not publish, rely on, or impose on any person any such note, waiver or decision until the SFC has approved it in writing.

4. Right to be informed of novel or controversial issues

The Exchange must inform the SFC, as soon as is reasonably practicable, of any matter of a novel or potentially controversial or sensitive nature, or which appears to involve public policy implications, arising from a listing application, a transaction by a listed issuer, or otherwise (Paragraph 6.5 of the MOU).

5. Rule Changes

The SFC and Exchange hold "Listing Matters Liaison Meetings" monthly to discuss, among others, policy or other matters including potential changes to the Listing Rules.

6. Review of Systemic and Policy Issues

The MOU envisages a "High-Level Group" of Exchange and SFC representatives that meets from time to time to review systemic and policy issues concerning listing-related matters,⁵³ the membership of which comprises: the Chairmen of the Exchange, the Listing Committee, the GEM Listing Committee, the Takeovers Panel, and the SFC and the Executive Director of the Corporate Finance Division of the SFC, the Chief Executive of the Exchange and the Exchange's Head of Listing, Regulation and Risk Management.⁵⁴

⁵³ Paragraph 5.1 of the MOU.

⁵⁴ Ibid. at Appendix II.