

## **CHEETAH INVESTMENT MANAGEMENT**

**By Hand**

18 November 2016

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

Attention: Corporate Finance Division

Dear Sir/Madam:

**Re: Response to the "Consultation Paper on Proposed Enhancements to the Exchange's Decision-Making and Governance Structure for Listing Regulations"**

We now enclose one (1) original copy of the response on behalf Cheetah Investment Management Limited to the "Consultation Paper on Proposed Enhancements to the Exchange's Decision-Making and Governance Structure for Listing Regulations" for your further handling.

Please acknowledge receipt of the same by signing and returning to us the duplicate copy of this letter

Yours faithfully,

**Cheetah Investment Management Limited**

encl.

## CHEETAH INVESTMENT MANAGEMENT

BY HAND

18 November 2016

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

and

Corporate Communications Department  
c/o Hong Kong Exchanges and Clearing Limited  
12/F, One International Finance Centre  
1 Harbour View Street  
Central, Hong Kong

Dear Sir / Madam:

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

We commend the efforts of both The Stock Exchange of Hong Kong Limited ("**Exchange**") and the Securities and Futures Commission ("**SFC**") in conducting this joint consultation on the proposed enhancements to the Exchange's Decision Making and Governance Structure for Listing Regulation as we believe that this is long overdue.

However, we believe that this Consultation has only taken "modest" steps by: (1) the establishment of the 2 new committees: namely the Listing Policy Committee ("**LPC**") and the Listing Regulatory Committee ("**LRC**") to enable the SFC to have earlier and more direct participation concerning listing policy and listing regulation matters; (2) the removal of the Chief Executive of Hong Kong Exchanges and Clearing Limited ("**HKE**x") from the Listing Committee; and (3) have the LPC taking over the responsibility for the oversight of the listing function and the performance of the Listing Department of its regulatory responsibilities.

We believe that the Consultation should instead be addressing the question of whether the listing function should remain with HKEEx, a listed and for-profit company or the listing function should be moved over to the SFC and a separate Listing Authority be established as recommended in the Expert Group Report.<sup>1</sup>

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<sup>1</sup> The report issued in March 2003 by the 3-member Expert Group appointed by the Government to review the Operation of the Securities and Futures Market Regulatory Structure following the Penny Stocks Incident in July 2002.

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Its recommendations and conclusions were given with due regard to the Government's stated objective at the relevant time of developing Hong Kong market into "the premier capital formation centre of China" and "the Asian-time-zone pillar of the global futures and derivative markets and one of the top five equities markets in the world".<sup>2</sup> The Expert Group made the following recommendations, amongst others:

1. The listing function must be removed from HKEx and should be performed by a new division of the SFC called the Hong Kong Listing Authority ("HKLA").
2. Decisions of the HKLA should be subject to appeal to a Listing Panel, which should function as an advisory body providing guidance on listing policies and changes to Listing Rules, in particular practitioner and investor input – the constitution of which is similar to the current Listing Committee.

The above recommendations were made in response to considerable comments and feedback, summarized as follows:<sup>3</sup>

1. The composition of the Listing Committee (then at 2003) was "excessively issuer biased" as the majority committee members were made up of brokers, listed companies, investment banks, lawyers and accountants. Many respondents suggested that the structure of the Listing Committee needed substantial overhaul with much more investor representation. Some very senior practitioners have even suggested that half of the Committee should be investor based.
2. Listing Committee members were "part-time volunteers" and it was impractical and unfair to expect a part-time body to fulfil the function of ensuring the quality of new listings. This job should be left with full time highly skilled, independent and experienced professionals, capable of establishing the suitability of companies for listing and exercising discretion on whether exemptions from compliance with the Listing Rules would be justified. The Listing Committee would become more of an advisory and appeal panel.
3. There was inherently a conflict of interest issue for HKEx as a listed company to maintain its role as the frontline regulator. As a listed company with one of its primary objectives to maximize returns for its shareholders, HKEx had a clear interest in listing as many companies as possible as listing fees and annual recurring fees for listed companies represent a significant portion of revenues. Although there was a "separation" of commercial and regulatory functions, the allocation of resources to the regulatory function was still being decided by HKEx.

The above still stands true today:

1. Today the Listing Committee comprises of 28 members, aside from the Chief Executive of HKEx as an ex-officio member and 8 investor representatives, the remaining members are made up listed companies, sponsors, brokers, lawyers and accountants. Whether or not there are sufficient investor representatives are open to further debate and discussion.
2. Listing Committee members are still "part-time volunteers" who have high demanding full time professional commitments due to their seniority in their respective organizations.

<sup>2</sup> Paragraph 2.3 of the paper titled "Hong Kong Exchanges and Clearing Limited: Reinforcing Hong Kong's Position as a Global Financial Centre" issued by the then Financial Services Bureau in July 1999.

<sup>3</sup> Extracted from Chapter 3 - Recommendations of the Expert Group Report.

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3. The inherent conflict of interest still exists as HKEx is a listed company and hence has a fiduciary duty towards its shareholders to maximize returns. Although there exists a “Chinese wall” intended to separate its business and regulatory functions, the Board of HKEx still decides the allocation of resources to the Exchange, the principal subsidiary carrying out the regulatory function. Further, the Board of the Exchange all comprises of senior executive management of HKEx.

There are those who argue that that the three-tier regulatory structure first recommended in the Hay Davison Report should be maintained as it has worked well. However, it has been nearly 30 years since the Hay Davison Report was published in 1988 – which was the result of the aftermath of the closure of the Exchange for 4 days in 1987 and the prosecution of the then Chairman, who also headed the then Listing Committee.

The Hay Davison Report found that the self-regulation system at the time had failed. It stated, “at the Stock Exchange of Hong Kong, which had opened in April 1986 after the unification of the four smaller exchanges, an inside group treated the Exchange as a private club rather than a public utility for the general benefits of members, investors and issuers. ... Thus, while the governing Committee had been successful in developing the business of the Exchange, they had not introduced proper management and regulatory arrangements and, in particular, had failed to take into account the risks in an overheated system.”<sup>4</sup>

Despite the failure of self-regulation, the Hay Davison Report nevertheless recommended the practitioner-based system as “the best available to meet our objectives for Hong Kong. ... Market management and regulation by practitioners offers scope for flexibility and adaptability in a rapidly changing market.” However, it has to be taken in the context at the time this was written. At the relevant time which was in 1988, Hong Kong was largely a domestic market. At the end of 1987, there were 276 listed companies on the Exchange and market capitalization was HK\$420 billion. There were 99 fund management companies managing 504 unit trusts/mutual funds and the goal then was to develop Hong Kong to be a regional or international market.<sup>5</sup>

Today, the situation is vastly different. Hong Kong is now a major international financial centre. In 2016, it is very likely that Hong Kong will rank No. 1 in IPO fundraising. We now have 1,930 listed companies with total market capitalization at HK\$25.3 trillion.<sup>6</sup> There are now also 555 asset management or fund advisory companies licensed by the SFC with US\$1.55 trillion assets under management. The SFC estimates the combined fund management businesses, including private banking and other non-SFC regulated entities, have HK\$17.4 trillion assets under management.<sup>7</sup> Hong Kong’s goal now is to become the leading international fund management centre in Asia.

Therefore, it is necessary and critical that the listing regulatory regime be on par with the other major international financial centres such as New York and London.

Moreover in 1988, the Exchange was still a private company with brokers as its members. When the Expert Group conducted its review on the three-tier regulatory structure relating to listing matters in September 2002, HKEx already became a listed for-profit entity.

<sup>4</sup> Extracted from Chapter 3 of the Hay Davison Report.

<sup>5</sup> Figures extracted from Chapter 3 of the Hay Davison Report.

<sup>6</sup> Information as at 15 November 2016.

<sup>7</sup> Extracted from the SFC Fund Management Survey July 2016.

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We understand that due to the current political environment, it may not be possible for the Government, the Exchange and the SFC to implement the recommendations of the Expert Group Report as it will necessarily involve legislative changes. However, with the rising concerns about the quality of listings on the Exchange as well as corporate fraud and misfeasance on some IPOs as evidenced by recent probes on IPO sponsors' misconduct, it is imperative that bolder steps be taken – i.e. by revisiting the Expert Group recommendations of setting up a separate Listing Authority housed under the SFC to take over the listing regulatory function.

As an interim measure, if the proposals in the Consultation are to proceed, we would suggest the following enhancements to be made in addition to the current proposals:

### **Oversight of the Listing Function by Exchange Board instead of LPC**

One of the principal functions that the Exchange has delegated to the Listing Committee is the oversight of the Listing Department (to the extent practicable given the Listing Committee's mode of operation)<sup>8</sup>. In reality the Listing Committee, being comprised of members (other than the Chief Executive of HKEx as an officio member) who are "part-time volunteers" is not in a position to oversee the Listing Department at all.

Dr Marvin Cheung GBS OBE JP, the then Chairmen of the Listing Committee in 2003 was quoted as saying the following:

"My priority is to make sure that the role of the Listing Committee is transparent and accessible to the public so that people are aware that we are not a committee that has accepted from the Board of the Exchange the full responsibility for listing matters. From time to time the chairman of the Exchange, and others, have loosely suggested that they have delegated items or functions to the Listing Committee – "If that is the case, where is the budget? Do I have the right to hire and fire people? If not how have you delegated it to me." We are simply a panel of people to which the Board has delegated decision-making on matters they choose to place before us. If they do not put such matters before us, the Listing Committee is powerless."<sup>9</sup>

As the Listing Committee mainly comprises of part-time professionals, it has sub-delegated much of its work and daily administration of the Listing Rules back to the Listing Department.

It is proposed in the Consultation that the LPC will replace the Listing Committee's oversight of the listing function and the performance of the Listing Department of its regulatory responsibilities. The LPC will have primary responsibility for appraising senior executives of the Listing Department. The current delegation of this power to the Listing Committee will be revoked.

As mentioned above, the Listing Committee in reality is not having much "oversight" of the Listing Department. With respect to the performance appraisal of the staff in the Listing Department, presumably this is being performed by the Board and/or the Chief Executive of the Exchange or the HKEx Board.

<sup>8</sup> Listing Committee Report 2015, Appendix 1, paragraph 3.

<sup>9</sup> HK Accountant Magazine, The Interview in October 2003.

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However, instead of LPC having this oversight, we believe that this function could be better achieved by replacing the current board of the Exchange with independent directors of HKEx or members of the proposed LPC or others appointed by the Nominating Committee. Currently, the Board of the Exchange comprises all of senior executive management of HKEx and the Chief Executive of the Exchange is also the Head of Markets.<sup>10</sup> The current board structure of the Exchange has at the minimum a perception of, if not a real conflict of interest. This would effectively render the “Chinese wall” concept of separating the business and regulatory function of HKEx more of a “form” over “substance”.

As the Government appoints a majority of independent directors onto the Board of HKEx including the Chairman of HKEx, it should be relatively easy to implement the changes at the Exchange board level. The Exchange Board would then be responsible for Listing Department’s performance. We believe that the change in Board structure at the Exchange would help strengthen the “Chinese wall” between the regulatory and business functions of HKEx.

In fact, it was mentioned in the Expert Group Report that HKEx had recognized the perception of conflict of interest problems and had proposed a formation of a separate subsidiary company where its board would be appointed by HKEx, using a nomination procedure similar to the current Listing Committee. The board would consist of non-executive, senior and experienced individuals from the market and may include the independent directors of HKEx Board as well as investor representation and would be the decision-making body on all listing policy matters.<sup>11</sup>

### **Establishment of an Independent Secretariat for the Listing Committee**

Besides the oversight of Listing Department function, the Exchange has also delegated the following functions to the Exchange:

1. To provide policy advice to the Listing Department on listing matters and to approve amendments to the Listing Rules.
2. To take decisions of material significance for Main Board listing applicants, Main Board and GEM listed issuers and individuals concerned. These include approvals of listing applications and cancellations of listing and disciplinary matters.
3. To act as a review body (in its role as the Listing (Review) Committee) for decisions made by the Listing Department and by the Listing Committee<sup>12</sup>.

It is proposed in the Consultation that the LPC and LRC be established. Moreover, the Listing Committee will continue to perform the functions listed above, except for certain cases involving suitability concerns or of a novel nature, and certain reviews. Currently, the Listing Committee is supported by a secretariat comprising of Listing Department staff and who may be performing other functions in the Department. In order for the Listing Committee to be more effective in discharging its functions, the establishment of an independent secretariat for the Listing Committee should be considered. The secretariat should be staffed with full time experienced professionals well versed in financial and asset management industry in order to perform research and analysis work for the Listing Committee. The Listing Committee should have full

<sup>10</sup> See full board of the Exchange in Appendix I.

<sup>11</sup> Extracted from Chapter 2 of the Expert Group Report.

<sup>12</sup> Listing Committee Report, Appendix 1, paragraph 3.

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discretion and authority in the recruitment of secretarial staff. The secretariat should be funded generously by the Government and/or the Exchange.

### **Listing Rules Review**

Aside from the current proposals to enhance the governance structure of the Exchange for Listing Regulation, we believe that the following areas of the Listing Rules should be reviewed as a matter of urgency in order to stem the poor quality listings and "shell" manufacturing which has affected Hong Kong's reputation as a leading international financial centre:

- GEM Board review: the current policy of having GEM Board as a "stepping stone" to the Main Board should be reviewed as well as the type of companies being listed on GEM affecting the quality of the market.
- Main Board / GEM Board Initial Listing Criteria: the "entry" requirements for both boards should be reviewed including the profit track record and market capitalization requirements.
- Corporate governance issues for listed companies including the composition of INEDs, director / controlling shareholder disclosures.
- Continuing listing criteria and delisting procedures – particular for long suspended / problematic companies and cash companies.

Despite the compromise reached now between the SFC and the Exchange, we firmly believe the right direction is to implement the recommendations of the Expert Group Report. HKEx, a for-profit listed entity, has a conflict of interest issue in retaining its role as a frontline regulator of listed companies. Regardless of how well the conflict can be managed, the existence of such conflict, is not conducive to the development of Hong Kong as a leading fund management centre.

With our suggestions above, we support the Proposals.

Yours faithfully,

**Cheetah Investment Management Limited**

## CHEETAH INVESTMENT MANAGEMENT

### Appendix 1

	<b>Name</b>	<b>Position at Exchange</b>	<b>Position at HKEx</b>
1	LI Xiaojia Charles	Director and Chairman of Board	Executive Director, Chief Executive
2	LEE Kwok Keung, Roger	Director and Chief Executive	Head of Markets
3	KENNEDY Paul Michael	Director	Group CFO
4	LAMBA Romnesh	Director	Co-head of Market Development
5	SPANNER Trevor William	Director	COO & Group Risk Officer