Combined Submission

Of

HKEx in Response To
The FSTB and SFC Consultation Papers
On Proposals to Give Statutory Backing
To Major Listing Requirements

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Hong Kong Exchanges and Clearing Limited

HKEx submission in response to the FSTB and SFC consultation papers on proposals to give statutory backing to major listing requirements

1. Executive Summary

1.1 HKEx continues to support statutory backing for the more important Listing Rule requirements as proposed in the Consultation Conclusions on Proposals to Enhance the Regulation of Listing ("ROL Conclusions"). HKEx submits that the proposed legislative provisions, in particular the Securities and Futures (Stock Market Listing) Rules ("SMLR"), should give effect to the ROL Conclusions.

1.2 HKEx is concerned that the draft SMLR go beyond what was proposed in the ROL Conclusions and what is necessary and appropriate to achieve the objective of the ROL Conclusions i.e. to give additional enforcement "teeth" to key listing requirements. The current proposals would result in significant administrative and enforcement duplication between the Stock Exchange of Hong Kong Limited ("Exchange") and the Securities and Futures Commission ("SFC"). This is inconsistent with the recommendation in the ROL Conclusions that the Exchange continue to be the frontline regulator.

1.3 HKEx submits that there should be a clear principle that the Exchange administers and interprets the Listing Rules and the SFC enforces those requirements which receive statutory backing.

1.4 Apart from periodic financial reporting, the only requirements that should be incorporated into the Securities and Futures Ordinance ("SFO") and SFC rules are the key requirements for the protection of investors and the reputation of the market, namely, the general obligation of disclosure and prior independent shareholder approval for material connected party transactions.

1.5 The statutory requirements should be revised such that:

(a) the key provisions are set out in the SFO (rather than the statutory listing rules). Those provisions would include the general obligation to disclose price sensitive information, the requirements as to the publication and contents of periodic financial reports (with the form and content set out in the regulations) and the prohibition on connected transactions (although the definition of associate could be in the regulations). Prohibiting conduct, particularly when the possible consequences of engaging in such conduct include criminal prosecution, is the responsibility of the legislature. We do not agree that the SFC should have the broad rule making power it has been given under the proposed amendments to section 36 of the SFO. Subsidiary legislation should fill in the detail and procedures not set the main requirements.

(b) the obligations are clearly defined and the SFC's role is clearly confined to investigate breaches of those obligations and the SFC does not have power to waive, interpret or otherwise administer the relevant listing requirements; and

(c) the SFO differentiates sanctions depending on the nature of the conduct.

1.6 As regards the proposed sanctioning powers, HKEx supports the SFC having the power to impose limited fines. However, HKEx considers that a power for the SFC to disqualify directors is unnecessary. None of the US, UK, Singapore or Australian

statutory regulators has an equivalent power.

1.7 Furthermore, there should be a clear differentiation between the level of sanctions the Market Misconduct Tribunal ("MMT") can impose and those the SFC can impose. The absence of such clear differentiation may mean there is insufficient incentive for the SFC to take action before the MMT.

1.8 HKEx is concerned that some of the SFC's rules are not sufficiently clear or are very broadly worded but do not contain appropriate carve-outs or safe harbours. HKEx suggests a number of the proposed requirements would benefit from revision. The Financial Services and the Treasury Bureau ("FSTB") and SFC might consider establishing a suitably qualified working group to assist with framing the key and substantive obligations in clear terms. HKEx would welcome the opportunity to contribute to such a working group and to a dialogue with the FSTB and the SFC in order to refine the proposed reforms.

2. General comments

2.1 In the interests of enhancing market quality and Hong Kong's reputation, HKEx has long supported statutory backing for key Listing Rule requirements in order to give additional "teeth" to those obligations. HKEx agreed with the thrust of the ROL Conclusions, in particular that statutory backing to the Listing Rules would not disturb the role of the Exchange as the frontline regulator of its securities market. HKEx submits that statutory backing should not result in two regulatory bodies administering very similar and in many cases identical sets of requirements.

2.2 To this end we consider it is critical to maintain a clear focus on the objective of the current exercise. The starting point was a recognition that dual filing lacked a positive obligation to disclose price sensitive information and that the Listing Rules did not contain the range of sanctions necessary to deter serious breaches of such requirements. In HKEx's view, the proposals go significantly further than is necessary to address these concerns.

2.3 The FSTB in its Consultation Paper ("CP") states that the objective of the current proposals is to give statutory backing to the "more important listing requirements" which are: (a) financial reporting and other periodic disclosure; (b) disclosure of price sensitive information; and (c) shareholders' approval for certain connected transactions.

2.4 At paragraph 8 of the ROL Conclusions, the FSTB states that in Phase I of implementation SFC rules would only be prepared for the "more important listing requirements" as defined. HKEx submits that the draft SFC rules in Schedules 1 to 8 of the SMLR are more extensive than the "most important listing requirements".

2.5 In Chapter 2 of the ROL Conclusions the FSTB analysed which listing requirements should be given statutory backing and concluded that while there was a consensus that the "most important listing requirements" as defined, be given statutory backing, there were divergent views on whether other listing requirements should be given statutory backing. Accordingly, FSTB deferred consideration of this issue to Phase II with a view to allowing decision making on the question to be influenced by the regulatory experience from the implementation of Phase I, the public reaction to that and market

development needs. We remain of the view that this is the correct approach to implementation.

2.6 The SFC at paragraphs 31 and 32 of its CP note that they considered the matter more fully and decided that discloseable transactions should be given statutory backing in addition to notifiable transactions because not to do so "would result in an internally inconsistent regime, … would be confusing and there is no benefit to such an arrangement".

2.7 It appears that the SFC CP may operate on the assumption that the ROL Conclusions recommended that all notifiable transactions should be given statutory backing. However, the ROL Conclusions only referred to certain notifiable transactions being given statutory backing.

2.8 Consistent with the ROL Conclusions, the Exchange suggests that the test for determining which notifiable transactions be given statutory backing should be "serious risk of prejudice to shareholders or investors". Based on experience of the range of misconduct seen in Hong Kong, the Exchange is of the view that only one type of notifiable transaction, namely connected transactions requiring prior shareholder approval, consistently meets this test.

2.9 As statutory backing would be limited to one clearly defined category of transactions, arguments about the internal consistency of the regime if discloseable transactions are excluded fall away.

2.10 HKEx views discloseable transactions and the other disclosure obligations, such as in relation to announcement of changes of directors and auditors, as subsidiary to the general disclosure obligation. This provides a neat materiality test. If the failure to comply with any of the disclosure requirements is also clearly a potential breach of the general disclosure obligation, then it is sufficiently serious to warrant use of the SFC's investigation powers. If not, then it should be left to the Exchange to administer and enforce.

2.11 In the event that the contents of announcements or circulars issued in compliance with the notifiable and discloseable transaction requirements were false or misleading, then the SFC would be able to investigate and prosecute the directors under section 384 of the SFO.

2.12 The obvious benefit of excluding less serious notifiable transactions and all discloseable transactions is that it reduces the extent of overlap between the Listing Rules and the SMLR and eliminates any duplication in the administration of the respective rules by the Exchange and the SFC.

2.13 Furthermore, administration and enforcement of notifiable and discloseable transactions is important to the Exchange's statutory function of operating a fair, orderly and informed market and its commercial interest in protecting its brand as a well regulated market.

2.14 We submit that any overlap of responsibility between the Exchange and the SFC is only warranted if it furthers the objective of giving additional enforcement teeth to the Listing Rules. But that is not the case for many of the duplicated requirements.

2.15 The Exchange also reiterates its previously expressed view that statutory backing of the relevant listing requirements should be revenue neutral i.e. the overall cost of administering and enforcing the new requirements (which the SFC will request be funded from the Exchange's listing fees) will be equivalent to savings by the Exchange from reducing the resources it devotes to such regulatory activity. Given the potential overlap in administration and enforcement it is not clear to the Exchange that the current proposals will be revenue neutral.

3. Proposed SFC rules not an extension of the dual filing regime

3.1 The ROL Conclusions referred to the proposed statutory backing of key listing requirements being achieved by an extension of the dual filing regime. HKEx considers, however, that the proposed amendments to the SFO and the SMLR are very different in character and effect from the dual filing regime.

3.2 The dual filing regime was devised to fill a perceived gap in the regulatory framework; namely, in respect of false and misleading information (including by way of omission) in prospectuses, announcements, circulars and other documents filed with the Exchange.

3.3 This had two aspects: (1) the SFC's power to object to the issue of such documents in the event that they have concerns about the accuracy or completeness of the disclosures; and (2) SFC investigation of possible breaches of section 384 of the SFO with a view to criminal prosecution.

3.4 In dual filing there is a clear dividing line between the role and responsibility of the Exchange and the role and responsibility of the SFC. This is not the case for the proposed amendments to the SFO and SMLR, which would give rise to extensive overlap in the roles and responsibilities of the SFC and the Exchange.

3.5 The elements of the dual filing regime contained in the SFC rules are simple, are set out succinctly and clearly, and are administrative in character, including the requirement to file with the Exchange and the Exchange's power to object. The substantive offence of providing false and misleading information in a dual filed document is, as noted above, contained in section 384 of the SFO. HKEx is concerned that this is not the case in respect of the proposed amendments to the SFO and SMLR as the substantive requirements, breach of which attracts serious sanction, are set out in the SFC rules rather than the legislation and the SFC rules and the associated guidance is complex and highly detailed.

4. Structure of the legislation

4.1 As discussed above, in light of the ROL Conclusions that in Phase I statutory backing should focus on the "more important listing requirements", HKEx expected that the legislation would contain some high level provisions relating to financial reporting, continuous disclosure and connected party transactions and that the SFC rules would contain interpretation, prescriptive detail (e.g. in relation to the content of financial reports) and carve-outs from the high level provisions.

4.2 HKEx submits that, instead, the legislation is virtually silent on the content of the obligations because the relevant contravention is breach of a listing requirement and

listing requirement is defined as any requirement made under the SFC's rule-making power in section 36(1)(i) of the SFO and expressed to be a listing requirement. In this way HKEx considers that the SFC's rules have strayed into areas which ordinarily would belong in primary legislation. Our concern is whether the proposed amendments to section 36 of the SFO have given the SFC too broad a rule-making power.

4.3 A further concern is that, as a consequence of the structure adopted, the legislation does not differentiate the sanction to be imposed based on the nature of the breach. That is, the "listing requirements" cover a variety of Listing Rule obligations, breach of which range from minor and technical to serious, yet the same range of sanctions apply in respect of all breaches of "listing requirements".

4.4 HKEx is also concerned that the range of Listing Rule requirements covered in the SFC rules is more extensive than is necessary to give "teeth" to the key Listing Rule disclosure requirement. That is, as noted in our general comments above, HKEx considers that the SFC rules cover too many minor and technical Listing Rule requirements, breach of which should only result in a shaming sanction or the issue of a warning letter. The extent of the listing requirements covered in the proposed SFC rules would create substantial overlap with the Listing Rules. However, neither the FSTB CP nor the SFC CP address how difficulties arising from this duplication of regulation will be resolved. Such difficulties include:

- to the extent that the SFC rules are not identical to the Exchange's Listing Rules (as discussed in section 5 below, many of SMLR have substantive wording differences from the corresponding Listing Rules), listed issuers and directors will have to ensure that both sets of requirements are satisfied, which will raise the cost of compliance;

- to minimise such problems, the Exchange, when seeking to amend those Listing Rule requirements also covered by the SFC rules, would have to ensure that the SFC rules are amended in the same respect. As amendments to the SFC rules are subject to negative vetting by the Legislative Council, this would complicate and delay amendments to the Listing Rules, which are a "living" set of acceptable market standards; and

- to the extent the SFC rules overlap with the Listing Rules and both the Exchange and the SFC have powers of interpretation or to grant waivers, it will be necessary for listed issuers to deal with both regulators, who may give different and even contradictory rulings. This will further increase uncertainty and compliance costs.

4.5 Implicit in the proposals, particularly in the SFC CP, is a suggestion that following implementation of the SFC rules, neither the SFC nor HKEx would pre-vet announcements, circulars etc and Hong Kong would move to a post-vetting regime in which the SFC would be able to take enforcement action in respect of any failure to meet the requisite standards or requirements. HKEx agrees that a reduction in pre-vetting of announcements, circulars and other listing related documents is a desirable long term policy objective and this is consistent with the steps the Exchange has taken over the last year to gradually reduce the pre-vetting of certain types of

announcement. However, the Exchange does not envisage the elimination of all pre-vetting and is concerned that the Hong Kong market may not be ready for immediate adoption of a post-vetting only regime. We are also concerned that in eliminating the interactive relationship between the Listing Division and listed issuers on disclosure matters, listed issuers may shift from a culture of disclosure to a culture of compliance (i.e. disclosure occurs from fear of enforcement rather than from a genuine acceptance that striving to apply best practice standards of disclosure is a necessary feature of listing status), which may have the unintended consequence of lowering the quality of listed company disclosures.

5. Proposed SFC rules not sufficiently clear and lack carve-outs

5.1 The ROL Conclusions recognised that the Listing Rules, because of the commercial context in which they operate, can have and be applied with a degree of flexibility. On the other hand, legislative requirements, particularly those imposing serious sanctions, need to be clear and certain.

5.2 The ROL Conclusions also suggested that one of the purposes of the SFC rules would be to contain carve-outs or safe harbours from the substantive obligations in the legislation.

5.3 HKEx is concerned that the "listing requirements" contained in the SFC rules, breach of which attract criminal or civil penalty sanctions, are not sufficiently clear and certain for the purpose and do not contain carve-outs or safe harbours from broadly worded obligations. In any event, HKEx suggests that a number of the proposed requirements would benefit from revision. The FSTB and SFC might consider establishing a suitably qualified working group to assist with framing the key and substantive obligations in clear terms.

5.4 We note below some observations in relation to the two key disclosure obligations. Executive staff of HKEx's Listing Division have prepared a more comprehensive review of the implications of differences in wording between the Listing Rules and the SMLR, which we will provide separately.

General disclosure requirement: generally

5.5 The changes made to the wording of the general disclosure obligation are substantive and in our view are likely to be controversial.

5.6 This is of particular concern because the obligation of disclosure of price sensitive information is one of the most difficult areas of securities regulation. It involves very difficult judgments about the type of information that needs to be disclosed and the timing of such disclosure.[1] Such judgments involve a balance between facilitating business efficacy and the need to keep investors informed on a fair and timely basis,

[1] In this respect it is useful to note the views of the Business Council of Australia in its submission to the Australian Parliamentary Joint Committee on Corporations and Financial Services on the CLERP 9 Bill said: "The subjectivity of continuous disclosure decisions means there is often considerable scope for differences of opinion on what information is material to the market and therefore requires disclosure. There is also considerable scope for differences of opinion on the appropriate time for the release of that information to the market. … This makes compliance with the continuous disclosure regime more difficult than, for example, compliance with periodic financial reporting requirements."

and between too little or not timely disclosure of critical information and too much information of marginal value.

5.7 Clarity and certainty is essential given that issuers will be strictly liable for any breach of the proposed provisions.

General disclosure requirement: relevant information

5.8 The definition of the categories of information that are subject to the general disclosure listing requirement is broader than the equivalent Listing Rules (Main Board Listing Rule ("MBLR") 13.09 and GEM Listing Rule ("GEMLR") 17.10).

5.9 HKEx submits that the legislative general disclosure obligation should be narrower and simpler than the obligation contained in the Listing Rules. The first limb, however, has been expanded considerably when compared with the first limb of MBLR 13.09 and GEMLR 17.10. The Listing Rules refer to information necessary to enable investors "to appraise the position of the group". By comparison, the draft statutory rule refers to information that:

"is necessary to enable the public to make an informed assessment of the –

(i) activities;

(ii) assets and liabilities and financial position;

(iii) profits and losses;

(iv) management and prospects; or

(v) rights attaching to the securities,

of the group;"

5.10 This formulation follows the general standard of disclosure applicable to prospectuses. It appears, in effect, to require issuers to ensure that prospectus standard information is disclosed to the market on a daily basis.

5.11 The proposed drafting covers virtually any information relating to the operations of the group. The only apparent limiting of the information caught is the reference to "material" information in the opening paragraph of the rule. But HKEx submits that it is unclear as to what "material" means in this context and how it differs from the current standard which relates to price or volume movements.

5.12 As regards the second limb, this has been changed from "is necessary to avoid the establishment of a false market …" to "is necessary for the maintenance of an orderly market".

5.13 HKEx submits that the drafting change has both changed the meaning of this limb of the current rule and made it less clear. That is, in the context, it is unclear what is meant by the maintenance of an orderly market but it may mean disclosure that would prevent panic selling or wild buying based on unsubstantiated rumours. The Exchange has interpreted the existing limb as covering disclosures required to correct any false

rumour, which is price sensitive in nature; not just those that could create a disorderly market.

5.14 As regards the third limb, the draft statutory rule has again broadened the definition by removing reference to "materially" in relation to the expected effect on market activity in, and price of, securities. This amendment may be because of the addition of "material" in the rule's opening. However, HKEx is concerned that the test of materiality of information may be very different from the test of materiality of the effect of the information on the market activity and price of the securities.

5.15 We propose that the definition of "information" requiring disclosure in the legislative provisions should be both simpler and narrower than that in the Listing Rules. Accordingly, for the sake of clarity and simplicity, we suggest the Administration and the SFC consider incorporating into the statutory general disclosure obligation only limb (c) of the Listing Rule, namely "information relating to the group which might be reasonably expected to affect materially market activity in and price of [the company's] securities".

General disclosure requirement: timing for disclosure

5.16 The Administration and the SFC may also wish to reconsider a proposed drafting change in relation to the required timing for disclosure.

5.17 The existing Listing Rule obligation refers to disclosure being made "as soon as reasonably practicable". The proposed SFC rules provide for that timing to be changed to "promptly".

5.18 HKEx considers this to be a very significant change. The existing wording deliberately provides for delayed disclosure in relation to commercially sensitive developments in progress and incomplete proposals or negotiations of a price sensitive nature, where strict confidentiality is maintained. (Refer the notes to MBLR 13.09 and GEMLR 17.10.)

5.19 By changing the timing to "promptly", the SFC appears to have removed this dispensation. The commentary at paragraphs G6.1 to G6.3 of the guidance note at Appendix 1 of the SFC's draft handbook draws on the notes to MBLR 13.09, including references to incomplete negotiations. But HKEx submits that, because of the change in the wording of the guidance in line with the substitution of "promptly" for "as soon as reasonably practicable", the guidance no longer provides certainty.

5.20 The only way the change in timing from "as soon as reasonably practicable" to "promptly" could be justified is if a clear carve-out from the disclosure obligation was created for commercially sensitive developments, proposals or negotiations provided strict confidentiality is maintained and the disclosure is made immediately a decision is reached or the negotiation is concluded. HKEx considers this is very important to ensure that the market is not flooded with information about deals that are incomplete and may not come to fruition and to give issuers confidence that the disclosure obligations will not unreasonably impede their legitimate business activities.

General disclosure requirement: waiver

5.21 There is reference in paragraph G1.1(c) of the SFC's guidance note at Appendix 1 of its draft Handbook, to the possibility, in circumstances in which an issuer considers that disclosure of price sensitive information to the public might prejudice the issuer's business interest, of the directors of the issuer making an application to the SFC for a waiver from the general disclosure obligation.

5.22 HKEx submits that further consideration should be given to the workability of such a waiver mechanism in light of the requirement to disclose "promptly". For example, would the issuer's directors be entitled to withhold disclosure while a waiver application was being considered? If so, an issuer could hold off disclosure by submitting a waiver application and then reviewing any refusal to grant a waiver. If not, because of uncertainty about whether the waiver would be granted, a prudent issuer would disclose the information. (Again, such a concern is only heightened by strict liability attaching to these provisions.)

Disclosure requirement: response to enquiries

5.23 HKEx suggests that further consideration should also be given to proposed rule 5 of Part 1 of the Schedule.

5.24 This rule, in relation to the obligation to disclose price sensitive information, appears to be intended to translate an obligation such as is set out in MBLR 13.10 and GEMLR 17.11 into a general obligation.

5.25 The difficulty, however, is that the existing Listing Rule requirement is very specific to its context, which is that the Exchange monitors unusual price and volume movements as a mechanism to check listed companies have disclosed price sensitive information under the general disclosure obligation and to open a dialogue between the Exchange and the issuer in relation to any non-public information that might potentially be price sensitive in nature.

5.26 To generalise the requirement in the manner proposed duplicates the general obligation of disclosure and is therefore unnecessary and potentially confusing. Consequently HKEx suggests removing proposed rule 5.

6. SFC's proposed power to impose sanctions on "primary targets"

6.1 When the FSTB published its ROL Conclusions, the HKEx Executive had reservations about the proposed third tier of enforcement, namely the SFC's power to impose additional sanctions directly on primary targets.

6.2 That preliminary view has been reinforced by a review of the sanctions it is proposed would be available to the MMT and SFC. We note that there is not a material difference in the level of sanctions it is proposed the MMT could impose and those that the SFC could impose.

6.3 Although the MMT may impose a greater variety of sanctions, many of those sanctions and in particular the disgorgement sanction, have next to no relevance to the range of conduct which is the subject of the proposed SFC rules. Consequently, in

virtually all cases, the MMT will choose between three options: public reprimand, disqualification of directors and civil fine. These options are the same sanctioning options that would be available to the SFC save that:

- the MMT would be able to order disqualification up to five years compared to the SFC being able to order a maximum of three years disqualification; and

- the maximum fine able to be imposed by the MMT would be HK$8 million as compared with HK$5 million by the SFC.

6.4 In this way the current proposals do not contain sufficient graduation or demarcation in the level of sanctions as between the SFC and the MMT.

6.5 Furthermore, if the reason for the substantial overlap between the sanctioning powers of the MMT and the SFC is, as stated in the FSTB CP, due to concerns about the length of time it takes to achieve an outcome through the MMT, then HKEx submits that a better approach may be to address the issues affecting the timeliness of MMT decisions rather than giving another decision-maker sanctioning powers that effectively allow the MMT to be bypassed.

6.6 However, the MMT is not currently set up to deliver timely resolution for any significant volume of cases involving less serious misconduct and there is a risk that the potential benefits to the Hong Kong market of an effective civil sanctioning regime might be jeopardised if the MMT is the only body handling civil enforcement of the SMLR.

6.7 On balance, HKEx supports the three pronged approach to enforcement and to the SFC having the power to impose limited fines. Further comments on this issue are made under section 8 below.

7. Sanctioning Powers of Comparable International Statutory Regulators

7.1 The ROL Conclusions states that one of the advantages of giving statutory backing to the most important listing requirements is to bring Hong Kong's regulatory regime into line with international standards and practices. A review of the sanctioning powers of statutory securities regulators in the UK, the US, Australia and Singapore suggests that the proposed power of the SFC to disqualify directors for breach of listing requirements exceeds the sanctioning powers available to statutory regulators in all four of those jurisdictions.

7.2 In the UK, the UKLA, as the regulator with exclusive jurisdiction over Main Board equivalent listing matters, has the power to issue public censures and unlimited fines but does not have the power to disqualify directors.

7.3 In the US, the SEC does not have the power to disqualify directors but does have a power to fine for failure to make disclosures required by law. There are three tiers of fines, the maximum being US$100,000 (HK$800,000) for individuals and US$500,000 (HK$4 million) for corporations. Findings of breach and imposition of fines is determined at first instance by an administrative law judge internal to the SFC and reviewable, if challenged, by the SEC's Commission.

7.4 In Australia, ASIC has a power to impose nominal fines (see section 8 below) for breaches of the general disclosure obligation but not in relation to any other conduct. ASIC's power to disqualify directors only applies in a very clear factual scenario, namely if a person has been a director of two or more companies that have become insolvent. This is clearly not relevant to listing requirements. ASIC may bring civil penalty actions before the courts to disqualify directors. ASIC does not have a power to publicly censure or reprimand listed issuers and directors.

7.5 In Singapore, the Monetary Authority of Singapore cannot itself impose fines directly on listed issuers. It can take civil penalty action itself through the courts for fines up to S$2 million for a failure to disclose as required by the Singapore Exchange's Listing Rules. It may also refer serious breaches to the Public Prosecutor for criminal prosecution.

8. Quantum of fines

8.1 In the FSTB CP, the Administration invites submissions in respect of the proposed quantum of fines.

8.2 As set out at section 6 above, HKEx supports both the MMT and SFC having fining powers but submits that there should be a material difference in the level of sanctions the MMT could impose (for more serious misconduct) and those that the SFC could impose (for lesser misconduct).

MMT fines

8.3 In relation to the MMT fines HKEx's view is that the quantum should be set at a level which would genuinely act as a deterrent. Given the diversity in size of companies listed on HKEx's markets, it is virtually impossible to set a maximum civil fine. For example, the average market capitalisation of the top 20 listed companies is HK$205 billion whereas the average market capitalisation on GEM is HK$325 million. For the larger listed issuers, a fine of HK$8 million is analogous to a parking fine and might be considered by some to be an incidental cost of some business practices. For smaller listed issuers, such a fine may affect their financial viability.

8.4 Accordingly, HKEx recommends in relation to corporations, that no limit be set on the fines which the MMT may impose.[2] The UKLA has the ability to impose unlimited fines for breaches of its listing requirements by listed issuers. HKEx suggests that, in considering the quantum of financial penalty to be imposed, there should be an explicit expectation that regard be had to similar factors as are mentioned in the UK Financial Services Authority's policy statement on the imposition of financial penalties, 8.8.3(4) of the UKLA Manual, including size, financial resources and other circumstances such as verifiable evidence of serious financial hardship or financial difficulties that may arise if a fine that fully reflected the seriousness of the conduct were imposed. HKEx recommends that if no limit is set

[2] If it is not considered feasible to propose no limit on the amount of fines the MMT may impose, HKEx would recommend that the maximum fine for a corporation could be a multiple of that applying to an individual (to reflect the fact that there is little point in obtaining a criminal conviction of a company) depending on the market capitalization of the company for example HK$80 million for large companies, HK$40 million for medium companies and HK$20 million for small companies.

on the quantum of fines the MMT may impose, then similar guidance be provided to the MMT as to the factors to be taken into account in setting fines.

8.5 HKEx also recommends that the level of the fine to be imposed on an individual be capped at HK$8 million on the basis that it should be less than the maximum criminal fine.

SFC fines

8.6 HKEx submits that it would be inappropriate for the SFC, which is not a judicial or quasi-judicial body, to impose fines of a quantum that would genuinely act as a deterrent. The quantum of fines able to be imposed by the SFC should also reflect the clear demarcation between the type of breaches that would be subject to MMT sanctions and those that would be subject to SFC sanctions.

8.7 Accordingly, whilst HKEx considers the issue of quantum needs further careful consideration, the Administration might consider a lower quantum than the amount currently proposed of HK$5 million.

8.8 HKEx notes that in Australia, fines for breaches of the continuous disclosure obligation can be imposed by a court in a civil penalty action or by ASIC through the issue of infringement notices. The maximum fine that can be imposed by an Australian court was recently increased to A$1 million (HK$6 million approx.). The maximum fine that can be imposed by ASIC is A$100,000 (HK$600,000 approx.) and even then only if the entity has a market capitalisation in excess of A$1 billion (HK$6 billion approx.). If the entity has a market capitalisation of less than A$100 million, then the maximum fine ASIC can impose is A$33,000 (HK$200,000 approx.).

8.9 Clearly in the Australian context, the legislature was uncomfortable about giving the statutory regulator a fining power which was more than nominal. The ASIC fines would have little deterrent value in their own right. The only purpose would be to shame the corporation using the relative size of the fine in comparison to the maximum as an indicator of the seriousness of the relevant conduct. This would only be useful to ASIC because neither ASIC nor the ASX have the power to issue public reprimands or public censures for breaches of the continuous disclosure obligation.

8.10 In respect of fines against individuals, HKEx suggests that the question of whether or not it is appropriate for legislation to prohibit relevant individuals from insuring against such fines should be researched and a clear policy position established. We do note, however, given the extensive nature of the listing requirements contained in the statutory rules proposed by the SFC, which potentially give rise to civil or criminal fines, it is likely that listed companies will argue that a prohibition on insuring against such fines may deter qualified individuals from acting as directors or senior managers.

9. HKEx recommendations regarding content of legislation and SFC rules

9.1 As set out above, HKEx considers the SFC rules are far more detailed and extensive than is necessary to achieve the objective of giving enforcement teeth to the Listing Rule requirements.

9.2 HKEx submits that, apart from periodic financial reporting, the only requirements that should be incorporated into the SFO and SFC rules are the key requirements which have the most significant role to play in the protection of investors and investor confidence in the market, namely, the general obligation of disclosure and prior independent shareholder approval for material connected party transactions.

9.3 We support the periodic financial reporting requirements being included in the legislation because they are very clear and therefore can easily be translated into statutory provisions. They are also already covered, to some extent, in the Companies Ordinance, which includes a somewhat ineffectual sanctioning regime in the form of low level fines for late reporting.

9.4 HKEx proposes that once such requirements come into force under the SFO, the overlapping requirements in both the Companies Ordinance and the Listing Rules be removed. However, the Exchange would retain discretion to impose additional periodic financial reporting requirements beyond those contained in statute, should, in its view, a need arise.

9.5 As regards connected transactions, HKEx believes that only certain types of connected transactions should be subject to statutory backing. Specifically, that is those connected transactions giving rise to a serious risk of prejudice to minority shareholders. In this regard, we consider that the statutory provision should be limited to transactions:

- of a character or size that requires independent shareholder approval under the Listing Rules (i.e. connected transactions not on commercial terms and in the ordinary and usual course of business and other transactions with a consideration of the greater of 2.5% of the applicable ratios or HK$10 million); and

- between the listed company or its subsidiaries and any major or controlling shareholder of the listed company or any associate of any major or controlling shareholder of the company.

9.6 We are also of the view that, in the interests of clarity, the definition of the transactions that are caught should not be subject to any waiver or modification power. We do, however, agree with the deemed aggregation of certain types of continuing connected transactions and the reverse onus on the relevant party to prove why they should not be aggregated.

9.7 As set out above, HKEx considers the key provisions should be in the SFO. Those provisions include the general obligation to disclose price sensitive information, the requirements as to the timing to publish periodic financial reports (with the form and content set out in the regulations) and the prohibition on connected transactions (although the definition of associate could be in the regulations).

9.8 The following table adopts the subject matter referred to in paragraphs 28 – 30 of the SFC CP and addresses HKEx's submission as to whether it should be codified or excluded from the statute and left solely in the Listing Rules.

	Include	Exclude
Disclosure	General obligation to disclose price sensitive information.	• Disclosure of substantial advances to entities; • Disclosure of substantial amounts due from affiliates; • Disclosure of change in directors; • Disclosure of change of auditors; • Disclosure of issue of shares under general mandate; • Disclosure of share pledges; and • Disposals of shares by a director during the blackout period.
Financial Reporting	• Timing on publication of annual and interim reports etc; and • Content of disclosure in annual and interim reports except those from Schedules 3 and 5 of the SMLR listed as excluded.	• SMLR Schedule 3 rules 8 to 18; and • SMLR Schedule 5 rules 5, 7, 10, 14, 15, 23(1) to (3), 24, 31, 32, 43, 46(g), 48(g) and 50(n).
Notifiable and Discloseable Transactions	• connected transactions requiring prior independent shareholder approval.	• Classification of transactions; • Disclosure of transactions in announcements and circulars; • Content of the disclosure in announcements and circulars; and • Independent financial advice and shareholder approval requirements.