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**Panel on Financial Affairs**  
**Meeting on 3 May 2010**

**Background brief on**  
**proposals to give statutory backing to major listing requirements**

**Purpose**

This paper provides background information on the Administration's proposals to give statutory backing to major listing requirements, and summarizes the views and concerns on the subject expressed by members of the Panel on Financial Affairs (the Panel).

**Listing Rules**

2. At present, the Listing Rules are made and administered by the Stock Exchange of Hong Kong Limited (SEHK). The Rules are non-statutory and compliance with which by issuers is based on the contractual listing agreements between the SEHK and the issuers. The existing Listing Rules contain detailed requirements relating to, among other things, the following matters:

- (a) criteria for initial and continuing listing;
- (b) disclosure in listing documents;
- (c) disclosure in periodic reports by listed issuers;
- (d) disclosure of price sensitive or material events and information;
- (e) duties of directors and advisers of listed issuers;
- (f) trading by directors of a listed issuer in its securities;
- (g) certain categories of transactions, etc.; and

- (h) certain corporate activities of listed issuers, including secondary issues and placements, rights issues, and granting of share options.

### **Events leading to the proposal to codify major Listing Rules in legislation**

3. In the wake of the Penny Stocks Incident<sup>1</sup> on 26 July 2002, the Financial Secretary announced on 31 July 2002 the appointment of a Panel of Inquiry on the Penny Stocks Incident (PIPSI) to look into the circumstances surrounding the incident. One of PIPSI's recommendations was that the Government should review the three-tier regulatory structure of the securities and futures markets relating to listing matters (i.e. the Government, the Securities and Future Commission (SFC), and SEHK), with a view to increasing the effectiveness, efficiency, clarity, fairness and credibility of the regulatory system.

4. The Financial Secretary accepted PIPSI's recommendation and announced on 26 September 2002 the appointment of the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure (the Expert Group) to take forward the recommendation. One of the key recommendations of the Expert Group was to give statutory backing to major listing requirements.

5. At its meeting on 13 June 2003, the Panel discussed the Expert Group's report and the Administration's plan to issue a public consultation paper on regulation of listing matters. Subsequently, the Administration published a Consultation Paper on Proposals to Enhance the Regulation of Listing on 3 October 2003, covering issues about the legal status of certain fundamental requirements in the Listing Rules, the manner of their enforcement, and the respective roles of SFC, as the statutory regulator, and SEHK, as the market operator, in performing the listing functions.

6. On 26 March 2004, the Administration released the consultation conclusions and briefed the Panel on 2 April 2004 on the proposed way forward. On account of the public support received, the Administration recommended to codify the major requirements in the Listing Rules into subsidiary legislation, and make SFC responsible for enforcing those provisions, while continuing to have SEHK receive applications at the frontline and administer the listing process.

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<sup>1</sup> On 25 July 2002, the Hong Kong Exchanges and Clearing Limited (HKEx) released a "Consultation Paper on Amendments to the Listing Rules Relating to Initial Listing and Continuing Listing Criteria and Cancellation of Listing Procedures". HKEx proposed, among other things, that shares of listed companies should be consolidated if their trading prices fell below HK\$0.50 (penny stocks). Delisting would follow, after certain procedures and with recourse to appeal, if the companies concerned failed to consolidate their shares. On 26 July 2002, 577 (76%) of the 761 stocks on the Main Board suffered a loss. The total market capitalization of the stocks with a quoted closing price of HK\$0.50 or lower fell by HK\$10.9 billion (US\$1.4 billion), roughly equivalent to 10% of the market capitalization of these stocks and about 0.3% of the total market capitalization of the Main Board.

## Public consultation in 2005

7. To facilitate further consideration of the aforesaid proposals, the Administration and SFC issued consultation papers in parallel on 7 January 2005<sup>2</sup> to gauge the views of the public and the market.

8. In its consultation paper, the Administration proposed certain amendments to the Securities and Futures Ordinance (SFO) (Cap. 571) with the following effects -

- (a) providing that SFC may make rules to prescribe listing requirements and ongoing obligations of listed corporations under section 36 of the SFO;
- (b) extending the market misconduct regime in Parts XIII and XIV of the SFO to cover breaches of the statutory listing rules made by SFC;
- (c) empowering the Market Misconduct Tribunal (MMT)<sup>3</sup> to impose, in addition to existing sanctions such as disqualification orders and disgorgement orders, new civil sanctions, namely public reprimands and civil fines, on the primary targets, i.e. issuers, directors and officers<sup>4</sup>, for breaches of the statutory listing rules made by SFC; and
- (d) empowering SFC to impose civil sanctions, namely public reprimands, disqualification orders and disgorgement orders, on the primary targets for breaches of the statutory listing rules made by SFC under the amended Part IX of the SFO.

9. In its consultation paper, SFC proposed amendments to the Securities and Futures (Stock Market Listing) Rules<sup>5</sup> under the SFO to codify existing important Listing Rules covering the following three areas -

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<sup>2</sup> The "Consultation Paper on the Proposed Amendments to the Securities and Futures Ordinance to Give Statutory Backing to Major Listing Requirements" and "A Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules (the Rules)" were issued by the Administration and SFC respectively on 7 January 2005 to invite public views on the proposed amendments to SFO and the proposed Rules to be made under the amended SFO.

<sup>3</sup> The Market Misconduct Tribunal established under Part XIII of the SFO is an independent full-time body chaired by a Judge to deal with a range of market misconduct through civil proceedings and sanctions. Its scope covers, in addition to insider dealing, false trading, price rigging, disclosure of information about prohibited transactions, disclosure of false or misleading information including transactions and stock market manipulation, etc. It can impose by order a range of civil sanctions on a person identified as having engaged in market misconduct.

<sup>4</sup> Due to human rights concern, officers will not be subject to civil fines to be imposed by MMT.

<sup>5</sup> The Securities and Futures (Stock Market Listing) Rules are subsidiary legislation made by SFC pursuant to its rule-making power under section 36 of the SFO.

- (a) disclosure of price-sensitive information and specific events;
- (b) disclosure/publication of annual and periodic reports; and
- (c) disclosure and shareholders' approval requirements for notifiable transactions and connected transactions.

10. In briefing the Panel on the comments received during the consultation period and the proposed way forward on 4 April 2005, the Administration advised that the majority of the submissions received supported the proposals. The Administration also indicated its plan to introduce an amendment bill in June 2005 based on the proposed legislative amendments attached to its consultation paper, subject to certain amendments to address concerns in relation to SFC's powers to make code and guidelines relating to listing, and MMT's power to impose fines.

11. Panel members in general concurred that it was important for Hong Kong to enhance regulation of listing matters with a view to increasing the protection for investors, upgrading market quality, and reinforcing Hong Kong's position as an international financial centre. While supporting in principle the Administration's proposals, some members raised the following views and concerns:

- (a) It was necessary to ensure a clear division of responsibilities between SFC and HKEx in administering the listing functions in future so as to avoid possible regulatory overlaps and gaps.
- (b) In view of the new regulatory responsibilities proposed to be conferred on SFC, the Administration should put in place appropriate checks and balances on SFC's powers.
- (c) The proposal might turn SFC into the police, the prosecutor and the judge in respect of enforcement actions against listed corporations and their management.
- (d) On the proposal of empowering SFC to impose direct sanctions on issuers, directors and corporate officers for breaches of the statutory listing requirements relating to information disclosure, there should be a limit on the period within which these relevant persons should be held liable for corporate disclosure. Consideration should also be given to providing appropriate exemption for independent non-executive directors because they were not closely involved in day-to-day decision making and management of the company.

- (e) On the question of whether SFC should also be empowered to impose civil fines on issuers and directors for breaches of statutory listing rules, some members saw merits in the proposal as it would provide the necessary regulatory tool to SFC to impose a medium level of sanction in between reprimands and disqualifications. Some members however considered that the need for the proposed fine-imposing power should preferably be reviewed at a later stage given SFC's relatively short history.

### **Consultation with the Panel in 2007 on revised proposals**

12. On 2 March 2007, the Administration briefed the Panel on a new approach to giving statutory backing to major listing requirements. While the Administration's proposal in 2005 was to codify the more important listing requirements by incorporating detailed provisions in the existing Listing Rules into the subsidiary legislation to be made by SFC, the new approach had the following features -

- (a) The statutory listing requirements would comprise a set of general principles to be prescribed in the SFO. These principles would be based on the existing requirements provided for in the Listing Rules. Breaches of these general principles would be regarded as market misconduct which may be subject to SFC disciplinary action, sanction by MMT, or criminal prosecution.
- (b) The general principles would be supported by provisions in a new schedule to the SFO which would set out the factors for the SFC/MMT/court to consider when determining whether there is a breach of general principles.
- (c) To assist compliance with the statutory provisions, SFC would promulgate a non-statutory listing code to provide guidance for the market.

13. According to the Administration, the new approach sought to strike an appropriate balance between certainty and flexibility, and address the concerns that minor breaches could potentially attract severe statutory sanctions. Besides, the question as to whether SFC as the law enforcement agency should be empowered to make statutory listing rules by way of subsidiary legislation would not arise.

14. The Administration also informed the Panel of the following proposals in response to market comments -

- (a) the maximum level of fines that SFC might impose on issuers and directors should be pitched at \$10 million, which would be on a par with the fining limit applicable to the fines imposed by SFC on regulated persons;
- (b) to allay the concern that the same group of SFC executives would play the dual roles of an investigator and the judge at the same time, SFC would establish a panel of full time decision-makers to make enforcement decisions in relation to breaches of statutory listing requirements. The panel would comprise senior staff employed by SFC e.g. experienced lawyers, regulators, tribunal members, etc. They would be functionally separate from the SFC operational divisions including the Enforcement Division;
- (c) to address the market's concern about the division of responsibilities between SFC and SEHK under the new regime, SFC and SEHK would work out an agreed approach/mechanism that could avoid dual regulation, ensure certainty and clarity, and ensure that the SEHK's existing practice of interpreting the listing requirements will continue into the new regime to provide a smooth transition.

The then intention of the Administration was to introduce a Securities and Futures (Amendment) bill 2007 to implement the above proposals.

15. Recognizing that the lack of regulatory teeth over listing requirements had all along been a concern to the market and the regulators, Panel members in principle supported the legislative proposals to give statutory backing to major listing requirements.

16. As regards the proposed new legislative approach, some members were concerned whether the new approach could ensure sufficient legal certainty for enforcement purposes and in criminal prosecution, and whether the new approach was in line with the best international practice. SFC's response was that the concern about legal certainty could be addressed through appropriate drafting of the legal provisions. There was no single global blueprint that could be followed by all jurisdictions. While the European Union had set out broad principles on insider dealings and market manipulation for its member states to follow, the Financial Services Authority of the United Kingdom, on which Hong Kong modelled its principle-based approach, was delegated the power to make statutory rules.

17. A number of Panel members expressed concern about the compliance burden of the new statutory listing requirements, when enacted, on small and medium listed companies. They were keen to ensure that SFC would not target enforcement actions at small companies only. The Administration and SFC

assured members that all listed companies, irrespective of their size, would be subject to the same statutory requirements.

18. Some members considered that SFC should exercise flexibility in enforcement, particularly when dealing with alleged breaches of statutory requirements relating to disclosure of price-sensitive information, as commercial dealings were subject to changes in the negotiation process. They urged SFC to issue clear guidelines to facilitate compliance. Members also urged SFC to enhance the transparency in its enforcement and disciplinary actions.

19. During the policy briefing on 27 October 2007, the Secretary for Financial Services and the Treasury advised the Panel that in view of the market's concern about the content of the statutory listing requirements, the Bureau intended to further consult the market on the provisions concerned before introducing an amendment bill into the Legislative Council.

### **Recent developments**

20. When the Panel discussed issues related to the proposed extension of the "black out" period on 26 February 2009, the Panel noted that the Listing Committee of SEHK was pursuing other enhancements to the disclosure regime including quarterly financial reporting and implementation of a statutory obligation to disclose price sensitive information, to be supported by a proportionate range of statutory sanctions which would act as an effective deterrent to noncompliance. A relevant press release of the Listing Committee issued on 12 February 2009 is at **Appendix I**.

21. On 29 March 2010, the Administration launched a three-month public consultation on the proposed statutory codification of certain requirements to disclose price sensitive information by listed corporations. The Administration will brief the Panel on the proposals in the consultation paper at its meeting on 3 May 2010.

### **Relevant papers**

22. A list of relevant papers is in the **Appendix II**.

# HKEx News Release

Updated: 12/02/2009

## Appendix I

### **Listing Committee Announces Proposed Modification of the “Black Out” Period Extension and Suggests Measures to Enhance Hong Kong’s Disclosure Regime**

The Listing Committee of The Stock Exchange of Hong Kong Limited\* (the Exchange), which acts both as an independent administrative decision maker and an advisory body for the Exchange, held one of its regular meetings today and, amongst other items of business, continued its discussions on the rule to extend the “black out” period, which is due for implementation from 1 April 2009.

As part of its preparation for this discussion, the Listing Committee invited the Securities and Futures Commission (SFC), the statutory body that is the principal regulator of Hong Kong’s securities market, to provide its considered and authoritative advice on this issue and associated issues concerning enhancements to the Hong Kong disclosure regime.

The Listing Committee considered this advice and new material prepared by the Listing Division including the findings of the Division’s analysis of dealings by directors during the year ended 31 December 2008; a memorandum dealing with the recent criticism and other comments concerning the extension of the black out period; and observations concerning the impact of the formulation of the new rule.

The Listing Committee made the decisions discussed below in respect of how to proceed with the extension of the black out period and other proposals to enhance the disclosure regime applicable to Hong Kong issuers.

Given the current framework of disclosure, the Listing Committee remains of the view that the current rule on the black out period, providing for a one month restricted period, is insufficient to bolster investor confidence by reducing suspicions of abuse by company insiders of information that they might have or might be thought to have leading up to a results announcement.

The Listing Committee sets out below its views on how the current disclosure regime can be enhanced and its proposed modification of the extension of the black out period.

#### Enhancements to the disclosure regime

The Listing Committee strongly supports, as a minimum, the early implementation of a statutory obligation to disclose price sensitive information supported by a proportionate range of sanctions which would act as a serious deterrent to non-compliance. Such requirements are the central pillar of a properly functioning disclosure regime. In the interim the Stock Exchange will work with the SFC to consult, as early as possible, on amendments to improve the current formulation of the disclosure of price sensitive information rule in the Listing Rules.

To ensure a regular flow of timely information concerning issuers’ financial performance and position, the Listing Committee believes that the Listing Rules should be enhanced to require issuers to report to the market on a quarterly basis. Under such a regime the Listing Committee views quarterly financial reporting as a long term goal. As an interim enhancement the Exchange will explore alternative approaches and undertake a further consultation with stakeholders on the alternatives to quarterly financial reporting. The Listing Committee notes and welcomes the SFC Executive’s support for further engagement on this important topic.

Early implementation of the proposals set out in the SFC’s April 2008 consultation conclusions paper “Consultation Conclusions on the Proposal to Make Electronic Submission of Disclosure of Interests Notices Mandatory” would address concerns about possible abuse of the current filing requirements and could, if thought appropriate, provide a platform for shortening of the related reporting deadlines at a future date.

The Listing Committee notes and is encouraged that the SFC continues to take action in respect of insider dealing. To support the SFC in its endeavours the Listing Committee has directed the Listing Division to undertake an enhanced programme of monitoring dealings by directors which is intended to increase confidence that suspicious dealings are subject to close regulatory scrutiny. The timely pursuit of complementary regulatory action by the SFC and the Exchange should help contribute to greater investor confidence and mitigate suspicions of abuse by company insiders of information that they might have or might be thought to have leading up to results announcements.

#### Proposed modification of the black out period extension

The Listing Committee recognises that it may take some time to address the enhancements noted above, save for the initiative to enhance monitoring of transactions which the Exchange will address immediately, and in the interim has decided to put forward a modification of the rule due to come into effect on 1 April 2009 for the SFC

Board' s consideration.

The modified proposal is an extension of the black out period applicable to the publication of an issuer' s annual financial results from one month to 60 days. The black out periods for half year and other interim periods will be 30 days, in line with the current requirement of one month. To assist the Exchange in monitoring the revised black out arrangements issuers will be required to give prior notification to the Listing Division of the imminent commencement of any black out period relating to the publication of financial results.

The text of the proposed rule revision is [attached](#).

Subject to approval by the SFC Board, the revised rule amendment will come into effect on 1 April 2009 and replace the rule amendment announced by the Exchange on 28 November 2008.

\* The Stock Exchange of Hong Kong Limited is a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited, or HKEx.

## List of relevant papers

Committee	Paper	LC Paper No.
Meeting of Panel on Financial Affairs (FA Panel) on 13 June 2003	<ul style="list-style-type: none"> <li>✧ Report by the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure  <a href="http://www.legco.gov.hk/yr02-03/english/papers/fa/papers/fa-1199-e-scan.pdf">http://www.legco.gov.hk/yr02-03/english/papers/fa/papers/fa-1199-e-scan.pdf</a></li> <li>✧ Administration's paper on "Proposed Framework for Consultation on the Regulation of Listing Matters"  <a href="http://www.legco.gov.hk/yr02-03/english/papers/fa/papers/fa0613cb1-1908-3e.pdf">http://www.legco.gov.hk/yr02-03/english/papers/fa/papers/fa0613cb1-1908-3e.pdf</a></li> <li>✧ Minutes of the FA Panel meeting on 13 June 2003  <a href="http://www.legco.gov.hk/yr02-03/english/papers/fa/minutes/fa020613.pdf">http://www.legco.gov.hk/yr02-03/english/papers/fa/minutes/fa020613.pdf</a></li> </ul>	<p>CB(1)1199/02-03</p> <p>CB(1)1908/02-03(03)</p> <p>CB(1)2543/02-03</p>
Meeting of FA Panel on 2 April 2004	<ul style="list-style-type: none"> <li>✧ Consultation Paper on Proposal to Enhance the Regulation of Listing  <a href="http://www.legco.gov.hk/yr02-03/english/papers/fa/papers/fa1015-2545-e-scan.pdf">http://www.legco.gov.hk/yr02-03/english/papers/fa/papers/fa1015-2545-e-scan.pdf</a></li> <li>✧ Administration's paper on "Consultation Conclusions on Proposals to Enhance the Regulation of Listing" (with the Consultation Conclusions)  <a href="http://www.legco.gov.hk/yr03-04/english/papers/fa/papers/fa0402cb1-1393-3e.pdf">http://www.legco.gov.hk/yr03-04/english/papers/fa/papers/fa0402cb1-1393-3e.pdf</a></li> <li>✧ Minutes of the FA Panel meeting on 2 April 2004  <a href="http://www.legco.gov.hk/yr03-04/english/papers/fa/minutes/fa040402.pdf">http://www.legco.gov.hk/yr03-04/english/papers/fa/minutes/fa040402.pdf</a></li> </ul>	<p>CB(1)2545/02-03</p> <p>CB(1)1393/03-04(03)</p> <p>CB(1)2084/03-04</p>

Meeting of FA Panel on 4 April 2005	<p>✧ Consultation papers on:</p> <p>(a) Proposed Amendments to the Securities and Futures Ordinance to Give Statutory Backing to Major Listing Requirements (published by the Administration); and</p> <p>(b) Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules (published by SFC).</p> <p><a href="http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/facb1-670e.pdf">http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/facb1-670e.pdf</a></p>	CB(1)670/04-05
	<p>✧ Administration's paper on "Securities and Futures (Amendment) (No.2) Bill 2005 - Proposals to Give Statutory Backing to Major Listing Requirements"</p> <p><a href="http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/fa0404cb1-1160-4e.pdf">http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/fa0404cb1-1160-4e.pdf</a></p>	CB(1)1160/04-05(04)
	<p>✧ Submission dated 31 March 2005 from the Securities and Futures Commission</p> <p><a href="http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/fa0404cb1-1200-1e.pdf">http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/fa0404cb1-1200-1e.pdf</a></p>	CB(1)1200/04-05(01)
	<p>✧ Background Brief on proposal to give statutory backing to major listing requirements</p> <p><a href="http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/fa0404cb1-1160-5e.pdf">http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/fa0404cb1-1160-5e.pdf</a></p>	CB(1)1160/04-05(05)
	<p>✧ Information on practices in overseas jurisdictions provided by the Administration after the meeting</p> <p><a href="http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/fa0404cb1-1463-1-e.pdf">http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/fa0404cb1-1463-1-e.pdf</a></p>	CB(1)1463/04-05(01)
	<p>✧ Minutes of the FA Panel meeting on 4 April 2005</p> <p><a href="http://www.legco.gov.hk/yr04-05/english/papers/fa/minutes/fa050404.pdf">http://www.legco.gov.hk/yr04-05/english/papers/fa/minutes/fa050404.pdf</a></p>	CB(1)1677/04-05

2 March 2007	<p>✧ Administration's paper on proposals to give statutory backing to major listing requirements</p> <p><a href="http://www.legco.gov.hk/yr06-07/english/panels/fa/papers/fa0302cb1-1007-7-e.pdf">http://www.legco.gov.hk/yr06-07/english/panels/fa/papers/fa0302cb1-1007-7-e.pdf</a></p> <p>✧ Background brief on major proposals of the Securities and Futures (Amendment) Bill 2007</p> <p><a href="http://www.legco.gov.hk/yr06-07/english/panels/fa/papers/fa0302cb1-1008-e.pdf">http://www.legco.gov.hk/yr06-07/english/panels/fa/papers/fa0302cb1-1008-e.pdf</a></p> <p>✧ Minutes of the FA Panel meeting on 2 March 2007</p> <p><a href="http://www.legco.gov.hk/yr06-07/english/panels/fa/minutes/fa070302.pdf">http://www.legco.gov.hk/yr06-07/english/panels/fa/minutes/fa070302.pdf</a></p>	<p>CB(1)1007/06-07(07)</p> <p>CB(1)1008/06-07</p> <p>CB(1)1477/06-07</p>
29 March 2010	<p>✧ Administration's consultation paper on the proposed statutory codification of certain requirements to disclose price sensitive information by listed corporations</p> <p><a href="http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/facb1-1498-1-e.pdf">http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/facb1-1498-1-e.pdf</a></p>	CB(1)1498/09-10(01)