

**For discussion
on 18 April 2017**

Legislative Council Panel on Financial Affairs

**Progress Report on Joint Consultation on Proposed Enhancements to
The Stock Exchange of Hong Kong Limited's Decision-making and
Governance Structure for Listing Regulation**

Purpose

1. This paper provides Members with a progress report on the joint consultation on proposed enhancements to The Stock Exchange of Hong Kong Limited's (SEHK) decision-making and governance structure for listing regulation (Proposals) conducted by the Securities and Futures Commission (SFC) and the SEHK¹.

Background

2. The joint consultation on the Proposals was launched by the SFC and the SEHK on 17 June 2016 to seek market views. The consultation period ended on 18 November 2016.
3. Key Proposals include the setting up of the following two new committees -
 - (a) the Listing Policy Committee (LPC) - to initiate, steer and decide listing policy; and
 - (b) the Listing Regulatory Committee (LRC) - to decide on listing matters that raise suitability concerns or broader policy implications.

The listing function would remain within the SEHK which would continue to be the frontline regulator for listing matters, with the Listing Department (LD) administering the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (Listing Rules) on a day-to-day basis.

¹ See the joint consultation paper which can be downloaded from the SFC website (<http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/openFile?refNo=16CP2>) or the HKEX website (<http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201606.pdf>).

Preliminary Summary of Responses

4. The consultation attracted a high level of interest with over 8 500 submissions from various stakeholders. A significant number of the responses did not contain detailed explanation or detailed comments on the Proposals. The responses expressed a wide spectrum of views.
5. To analyse the responses, we have categorised them as follows -
 - (a) Companies and related entities;
 - (b) Investment managers;
 - (c) Brokerage firms, corporate finance advisers and sponsors;
 - (d) Accounting firms;
 - (e) Law firms;
 - (f) Legislators / political parties / think tanks;
 - (g) Academia;
 - (h) Public and regulatory bodies;
 - (i) Other respondents (including professional associations not included in the above categories); and
 - (j) Individuals.

Responses from professional bodies and industry associations that represent individuals or entities that fall within one of the categories in (a) to (i) above are included in the specific category.

6. A brief summary of the views expressed by each category of respondents is set out at **Annex** for reference.
7. It is important to note that this high-level analysis is preliminary. The analysis is still in progress, and is subject to in-depth study and formal discussion between the SFC and the SEHK. Accordingly, the preliminary summary of responses as set out in this paper is subject to further refinement and discussion, and no conclusions have been formed at this stage.

Further Work Required

8. We will continue to carefully consider and analyze all the submissions received in order to prepare the consultation conclusions, which will be published in due course, and decide the way forward.

Securities and Futures Commission
The Stock Exchange of Hong Kong Limited
6 April 2017

Brief Summary of the Views Expressed by Respondents

(a) Companies and related entities

1. The respondents in this group consist primarily of listed companies, and also include chambers of commerce, industry associations and private companies. The vast majority of the respondents opposed the Proposals.
2. The arguments or reasons put forward by those opposing the Proposals include, amongst others that: the proposed structures are inconsistent with the existing three-tier regulatory system and would give the SFC the front- and back-line regulatory authority without check and balance; the objectives could be achieved under the current arrangements; the compositions of the LPC and the LRC give SFC dominant control; LPC's appraisal of LD's performance would make the LD a subordinate of the SFC; and that the Listing Committee (LC) would be sidelined.
3. Some respondents in this group also submitted that market problems could be tackled without changing the regulatory structure. The proposed structures would move Hong Kong away from a disclosure-based regime and towards a merit- or regulator-based regime and would stifle market development.
4. Some of the opposing listed companies made alternative suggestions, including having SFC representatives in the LC; re-designating the Chief Executive of the Hong Kong Exchanges and Clearing Limited (HKEX) as an "adviser" rather than a member of the LC and expanding the membership of the LPC.
5. The small number of listed companies who supported the Proposals saw the Proposals as an improvement to the current regulatory regime.

(b) Investment managers

6. Respondents in this category include investment managers of mutual funds, pension funds, hedge funds and private equity funds. Industry associations representing the interests of the investment community are included in this category.

7. The vast majority of investment managers that responded expressed support for the Proposals, including international fund managers.
8. Reasons put forward include that the launch of the Proposals is timely and imperative as there are increasing concerns that the quality of the market in Hong Kong has dropped; there is an urgent need to develop a more holistic and coordinated regulatory structure as existing mechanisms no longer serve the needs of the market; the creation of the LPC provides a suitable framework for incorporating market interests and that the Proposals address long-standing and complex issues of coordination with Mainland and other global market regulators.
9. A significant number of investment managers believed that a higher degree of SFC involvement in listing matters would help address concerns over potential conflicts of interest arising from the HKEX's role as both a commercial organization and a regulator. A few investment managers suggested that the regulatory function should ultimately be transferred to the SFC or an independent regulator.
10. Opposing views include the points that alternatives should be considered, the stated objectives of the Proposals could be better achieved by a simpler solution, and a more streamlined approach could be adopted by adding SFC representatives to the existing LC, as either observers or regular members.

(c) Brokerage firms, corporate finance advisers and sponsors

11. The respondents in this category include brokerage firms, corporate finance advisers and sponsors, and relevant industry associations.
12. The vast majority of the responses submitted by individual firms opposed the Proposals. These respondents were mainly local brokerage firms. They expressed concern about the risks of over-regulation, the slowing down of market development, concentration of powers in the SFC and that the Proposals may not achieve the stated objectives. Supporting comments included the Proposals are an improvement to the current regulatory regime.

13. Views of the industry associations varied. Some were generally supportive and agreed with the establishment of the LPC but with an expanded member base including industry professionals. However, there were views that disagreed with the establishment of the LRC and the appraisal of LD executives by the LPC. Other associations expressed objections to or concerns about the Proposals.

(d) **Accounting firms**

14. Accounting firms generally expressed their support for the Proposals with suggestions for their enhancement, including expanding the composition of the LPC and/or the LRC; and more detailed guidance and specified assessment criteria of the type of cases that would be referred to the LRC.

15. There was support for the consultation's objectives to improve the efficiency and effectiveness of the listing process and listing policy formulation and to enable closer coordination and cooperation between the SFC and the SEHK. Some respondents commented that the power of the LC would be significantly reduced under the Proposals.

16. Accounting professional associations that responded expressed support for the establishment of the LPC to steer listing policy and Listing Rules amendments; agreed that it would be more efficient to involve the SFC upfront in the policy setting and development process; and believed that the composition of the LPC and the LRC should be reviewed / expanded.

(e) **Law firms**

17. A majority of the law firms that responded opposed the Proposals.

18. Key comments/concerns of law firms opposing the Proposals were that the Proposals would not improve the quality of listed companies or the efficiency of the listing process; the Proposals would significantly increase the SFC's power and the LC would be sidelined; the referral of matters to the LRC might lengthen the IPO vetting process; and the proposed changes might bypass the statutory process for objecting to a listing application and for the listing applicant to have the decision reviewed by the Securities and Futures Appeals Tribunal.

19. Some respondents questioned whether the Proposals would combat abusive practices such as shell companies and backdoor listings and that regulators should focus on more robust enforcement actions. Instead of establishing new committees, they suggested SFC representatives could join the LC or attend LC meetings involving listing matters that raise suitability concerns or broader policy implications.
20. A small number of law firms supported the view that the existing regime has been in place for many years during which time the market has changed dramatically and the current system has issues with efficiency, transparency and competitiveness. They considered that the establishment of the LRC and the LPC would enhance coordination between the SFC and the SEHK on policy formulation and streamline the IPO vetting process in most cases.

(f) Legislators / political parties / think tanks

21. A majority opposed the Proposals in general. The opposing respondents shared similar views, including that: the current regime is working well; the LC would be sidelined; current checks and balances would be lost; the proposed structures would reduce efficiency of processing IPO applications; the SFC would have excessive power; and LPC's appraisal of LD's performance would deprive the SEHK of its independence and impact on LD's day-to-day operation.
22. Those who supported the Proposals and the consultation objectives considered that the Proposals move in the right direction and would be a step towards building a more transparent listing process resulting in a closer coordination between the regulators on policy matters and in regulatory decision-making.
23. A Legislative Council (LegCo) oral question and a LegCo motion debate were raised on this subject on 9 November 2016 and 30 November 2016 respectively². Some of the arguments for or against the Proposals as set out in this summary were also taken up by LegCo members at these LegCo sessions.

² See (a) the oral question at the Council Meeting on 9 November 2016 (<http://www.legco.gov.hk/yr16-17/english/counmtg/agenda/cm20161109.htm>) and (b) the motion debate on "Formulating a comprehensive listing policy" at the Council Meeting on 30 November 2016 (<http://www.legco.gov.hk/yr16-17/english/counmtg/agenda/cm20161130.htm>).

(g) Academia

24. A majority of these respondents supported the Proposals on the basis that they could mitigate the potential conflict of interests between the HKEX's role as a regulator and its status of being a commercial entity, and hence improve Hong Kong's corporate governance.
25. Comments have been raised on a number of legal issues including, amongst others, whether the Proposals risk weakening the regulatory mandate of the SFC in relation to the admission and trading of listed securities, blur the roles of the SFC and the SEHK, and bypass statutory checks and balances, etc.. Similar comments have been raised by a few respondents in other categories.
26. Some concerns were raised over the establishment of the new committees including, among others, whether the Proposals are consistent with the current statutory scheme governing listing regulation, the role and the size of the new committees and how cases will be referred from the LD to the LRC.
27. There were suggestions that the listing function should be transferred to the SFC or an independent listing authority in the long-run.

(h) Public and regulatory bodies

28. Opposing views include the Proposals may not achieve the stated objectives and did not support the creation of the LRC as it added an extra layer to the listing process and would reduce efficiency. There were suggestions that non-executive directors of the HKEX should be invited to join the LPC and that the performance of LD's senior executives and staff should not be appraised by the LPC.
29. Supporting views include the Proposals would enhance the dual regulatory structure and facilitate more efficient and coordinated approval process which would be in the interest of the public.

(i) Other respondents (including professional associations not included in the above categories)

30. A number of respondents in this category supported the Proposals and the consultation objectives and considered that the implementation of the Proposals would strengthen listing policy and listing regulation.

31. Concerns raised by opposing respondents include that the implementation of the Proposals would undermine the checks and balances in the current listing regulation regime and stifle market development; the SFC's power would be excessive and the LC's power would be substantially reduced and there could be an excessive referral of cases to the LRC; the establishment of the new committees would reduce efficiency of the listing decision-making process.
32. Some respondents preferred the roles and responsibilities of the LC to remain unchanged and suggest that SFC representatives join the LC so that their views could be heard directly. A number of respondents suggested that the number of members of the LRC and the LPC should be increased (e.g. senior members of the LD should be included in the LPC).

(j) Individuals

33. Over 8 000 responses were received from individuals.
34. A significant number of the individual respondents provided submissions that did not contain detailed explanation or detailed comments on the Proposals. A large number of individual respondents provided template-style submissions. The vast majority of the individual respondents opposed the Proposals.
35. The comments from individual respondents opposing and supporting the Proposals are similar to those outlined in the other categories.

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