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Panel on Financial Affairs
Meeting on 18 April 2017

**Background brief on the Consultation on Proposed Enhancements to
The Stock Exchange of Hong Kong Limited's Decision-Making and
Governance Structure for Listing Regulation**

Purpose

This paper provides background information on the consultation on proposed enhancements to the decision-making and governance structure for listing regulation ("the Consultation") jointly conducted by the Securities and Futures Commission ("SFC") and Hong Kong Exchanges and Clearing Limited ("HKEX") in June 2016. It also summaries the major views and concerns raised by Members on the subject at meetings of the Panel on Financial Affairs ("FA Panel") and the Legislative Council ("LegCo") in the 2016-2017 legislative session.

Background

Respective roles of the Stock Exchange of Hong Kong Limited and the Securities and Futures Commission in listing regulation

2. The Stock Exchange of Hong Kong Limited¹ ("SEHK") is the frontline regulator of all listing-related matters and issuers listed on its markets. Under the Securities and Futures (Transfer of Functions – Stock Exchange Company) Order, SEHK is responsible for vetting prospectuses for any shares in or debentures of a listed corporation. SEHK's listing-related functions, which mainly include establishment, promulgation and administration of the Listing Rules, are discharged by the Listing Department

¹ The Stock Exchange of Hong Kong Limited ("SEHK") is a wholly owned subsidiary of Hong Kong Exchanges and Clearing Limited ("HKEX") and is responsible for the operation and front-line regulation of the Hong Kong stock market.

and the Listing Committee² ("LC") (which currently has 28 members). The Listing Department is the primary point of contact of all listing applicants and their advisers, and vets materials submitted by listing applicants for compliance with Listing Rules and prospectus requirements under the Companies Ordinance (Cap. 622). LC is not involved in the day-to-day administration of the Listing Rules but acts as an independent review body for decisions made by the Listing Department. It has an oversight role of the Listing Department to ensure the latter's exercise of powers and carrying out of day-to-day functions in a professional and impartial manner.

3. SFC performs a lead role in market regulation and certain areas of listing regulation including the disclosure of interests in securities and ensuring that the disclosures made in corporate documents filed under the Listing Rules satisfy applicable requirements under those rules. SFC's powers and functions in listing regulation are complemented by its powers to object to the listing of, and to suspend trading in or de-list, any securities under the Listing Rules, as well as the powers of investigation and enforcement in cases involving corporate misconduct under the Securities and Futures Ordinance (Cap. 571). SFC also has a statutory duty to supervise and monitor SEHK's performance of its listing-related functions and responsibilities.

4. Under the dual filing regime, SEHK passes copies of materials submitted by listing applicants to SFC. SFC may object to a listing if the disclosure in the listing materials appears to SFC to contain false or misleading information. To enhance cooperation, SFC and SEHK have entered into the Listing Memorandum Of Understanding which set out their respective roles and responsibilities relating to listing matters.

Review of the listing regulatory regime

5. Given that regulatory considerations relating to listing in Hong Kong have become increasingly complex and involve new risks and operational challenge, SFC and SEHK see the need to review the current decision-making structure for listing regulation and adopt enhancements that will enable both organizations to better coordinate and address future regulatory needs in listing.

² To separate the commercial role of SEHK from its regulatory role, SEHK has delegated its powers and functions relating to listing matters, including the formulation of listing policy, to the Listing Committee ("LC"). The current 28 members of LC include representatives of investors, listed companies and market practitioners as well as the Chief Executive of The Hong Kong Exchanges and Clearing Limited ("HKEX") as an ex officio member.

6. On 17 June 2016, SFC and HKEX jointly issued a consultation paper entitled "Proposed Enhancements to The Stock Exchange of Hong Kong Limited's Decision-making and Governance Structure for Listing Regulation" to invite views from the public. The consultation period ended on 18 November 2016.³

Proposed listing regulation regime

7. The proposals in the consultation paper are highlighted below:

- (a) Two new committees namely the Listing Policy Committee⁴ ("LPC") and the Listing Regulatory Committee⁵ ("LRC") will be established. These two committees will respectively decide listing policy and initial public offering ("IPO") applications and post-IPO matters that have suitability concerns or broader policy implications.
- (b) LC,⁶ in conjunction with the Listing Department, will continue to be the decision-maker for IPO applications and matters involving listed issuers that do not involve suitability concerns or broader policy implications, which should constitute the large majority of cases. The Listing Department will be responsible for deciding whether an IPO application or a post-IPO matter has such concerns or implications and, if so, will refer it to LRC for decision.

³ The consultation period originally ended on 19 September 2016. In light of the great deal of interest and a wide range of views expressed since the publication of the consultation paper, the Securities and Futures Commission and HKEX decided on 9 September 2016 to extend the deadline of consultation to 18 November 2016.

⁴ The Listing Policy Committee ("LPC") will have seven members comprising the Chairperson and two Deputy Chairpersons of LC, the Chief Executive of HKEX, the Chairperson of the Takeovers Panel, the Chief Executive Officer of SFC and one senior executive from the Corporate Finance Division of SFC. The Chairperson of LC will act as the Chairperson of the LPC.

⁵ The Listing Regulatory Committee ("LRC") will consist of six members namely three senior executives from the Corporate Finance Division of SFC, the Chairperson and two Deputy Chairpersons of LC. The Chairperson of LC will act as the Chairperson of LRC.

⁶ LC will continue to comprise representatives of investors, listed issuers and market practitioners. The Chief Executive of HKEX will cease to be a member of LC.

- (c) LPC will steer SEHK's work on Listing Rule amendments and overall listing policy. It is designed to be an efficient "one-stop shop" to respond to policy issues which are often multi-faceted and difficult.
- (d) LC will provide non-binding views to LRC and LPC on their decisions.
- (e) To enhance the structure for reviews of listing decisions, LRC will replace the current Listing (Review) Committee as the review body for decisions made by LC. A new Listing Regulatory (Review) Committee, which comprises members of the board of directors of SFC and former members of LC, will also be set up to replace the existing Listing Appeals Committee as the highest review body within SEHK. The Listing Regulatory (Review) Committee will review listing decisions of LRC on specified matters.
- (f) To enhance procedural fairness for disciplinary matters, a Listing Disciplinary Chairperson Group, consisting of practicing or retired senior counsel (or other individuals of equivalent qualification), will be established by SEHK. Each disciplinary hearing (whether at first instance or upon review) will be chaired by a member of this Group.

8. According to the consultation paper, the proposed LPC and LRC will enable SFC and SEHK to work together within a collaborative setting, better share their respective knowledge and perspectives, and promote consensus-building and efficiency in decision-making in listing, as well as policy- and rule-making in listing. The vetting and approval process for IPO applications that do not present suitability concerns or give rise to broader policy implications is expected to be streamlined. LPC is designed to represent the different bodies within the current listing regulatory system that make policy-related decisions. It will be proactive in identifying and addressing public interest issues arising out of new or prospective market developments or practices, and in related areas such as corporate and intermediaries' behaviour. SFC's powers and functions in relation to listing matters will remain unchanged but it will have earlier and more direct input on listing policy matters and listing regulation. In addition, SFC will no longer as a matter of routine issue a separate set of comments on the statutory filings made by listing applicants. As pointed out in the consultation paper, the proposals involve no legislative change. SFC and SEHK will retain their separate powers and functions as provided by SFO (including subsidiary legislation) and the Listing Rules.

Major views and concerns expressed by members of the Panel on Financial Affairs

9. FA Panel has not scheduled any discussion on the Consultation. Panel members expressed concerns on related issues during the briefing on SFC's proposed budget for 2017-2018 at the Panel meeting on 6 February 2017 which are summarized in the below paragraphs.

The consultation process

10. Some members expressed dissatisfaction that SFC and the Government seemed to have taken a stance on the proposals while the Consultation was still underway. They stressed the importance for SFC and the Government to maintain a neutral stance on the subject, and called on SFC to study carefully the views from respondents and formulate detailed proposals for further consideration by stakeholders. Given the controversies surrounding the subject, they also urged SFC to refrain from making any decisions hastily and implementing any proposals before commencement of the new term of Government.

11. SFC assured members that it maintained an open mind to all views received and would study all views jointly with HKEX carefully. SFC stressed that there was no timetable for implementing any of the proposals in the Consultation. The Government advised that the objectives of the Consultation were to enhance market efficiency and streamline the listing regulation procedures. SFC and HKEX would not finalize the recommendations impetuously.

Concerns of the securities industry

12. Some Panel members stressed the need for SFC to accord priority in dealing with issues in the Consultation concerning public interest, protection of investors and ensuring a level playing field in the securities industry. Some other members considered that SFC should review whether the proposals in the Consultation were ultra vires SFO, in particular whether SFC was empowered to establish the proposed LPC and LRC under SFO. They also cautioned that SFC should refrain from interfering with the operation of HKEX.

13. SFC stressed that it would not act beyond its powers. Proposals included in the Consultation had been agreed by the leaderships of SFC and HKEX before publication. The overarching goal of the Consultation was to enhance market quality, efficiency, accountability and transparency. SFC

would carefully analyse all views received, including those dealing with legal aspects of the proposals. The Government pointed out that the Consultation had been conducted within the framework of the existing legislation. Some of the submissions received had raised legal issues, and such issues would be taken into account in SFC's analysis.

Council question

14. At the LegCo meeting on 9 November 2016, Hon Mrs Regina IP raised an oral question on the Consultation. The Council question and the Government's reply are hyperlinked in **Appendix II**.

15. Major issues covered in the oral question and raised by Members in the follow-up questions included the functions and powers of LRC, how LRC and LPC could address various current regulatory issues and facilitate a more efficient vetting and approving process for listing applications, and whether it was necessary to introduce legislative amendments for implementing the proposals in the Consultation. Some Members were concerned that the proposed LRC would be redundant and the consultation paper had not set out clearly the powers and duties of LRC. Some other Members questioned whether SFC and HKEX had reached any agreement on the proposals before launching the Consultation.

16. The Government reiterated that LRC would process listing applications involving suitability issues. It was estimated that such applications should account for less than 10% of the total, while the remaining cases would still be vetted and processed by LC. Regarding the necessity to amend SFO, the Government said that the proposed changes would not necessitate any amendments to the Ordinance and it would examine whether such changes would entail any subsequent amendments after collecting the public views.

Motion passed at Council meeting

17. At the LegCo meeting on 30 November 2016, Hon Christopher CHEUNG moved a motion urging the Government to prudently formulate a comprehensive listing policy. The motion, as amended by Hon James TO, was passed. The wording of the passed motion is in **Appendix I**. The details of the debate and the progress report provided by the Government are hyperlinked in **Appendix II**.

18. During the debate on the motion, Members generally agreed with the broad direction of the Consultation in enhancing the listing regulatory regime and the decision-making structure which were important in addressing problems associated with the quality and governance of listed companies, such as the presence of "cheating shares" and "shell companies", backdoor listing, price volatility in newly listed companies etc. These problems have adversely affected investors' interests and confidence in the Hong Kong stock market. Some Members pointed out that the proposed new structure would enable SFC to directly participate in the early decision-making stage concerning listing regulation and in the policy formulation process, which could enhance overall efficiency, transparency and accountability. There was also support for the proposed LPC enabling participation by more stakeholders in the formulation of listing policy. However, some Members expressed a number of concerns on the Consultation. There were worries about the creation of LRC would make the existing listing regulatory structure cumbersome, pose more hurdles for listing applicants, and might slow down the approval process of listing applications. The smaller and fixed membership of LRC would give rise to concentration of power. In contrast, the existing LC, with a large and diversified membership was closer to the market and more adaptable. Moreover, as half of the members of LRC would be from SFC, this would increase SFC's power in vetting and approving listing applications, thus turning it into a frontline regulator and violating the long standing principle of the minimal market intervention. Some Members were also concerned that the Consultation had created a de facto power struggle between SFC and SEHK, and had not touched on more important issues, such as promoting the sustainable development of the local stock market and enhancing operational transparency of the regime. In order to address concerns raised by the industry, some Members suggested that SFC and HKEX should clarify the definitions of "suitability issues" and "broad policy implications" and the criteria to be adopted in referring listing applications to LRC, explain how SFC would cooperate with Listing Department, and respond to the question as to whether the establishment of LRC and LPC under SEHK might breach SFO. Members called on SFC and SEHK to study the comments from different stakeholders, and urged the Government to play an active part in formulating a comprehensive listing policy.

19. The Government reassured Members that SFC and HKEX had no preconceived conclusion on the way forward, and were maintaining an open attitude to all views. They would come up with appropriate proposals after taking all views received in the Consultation into account. Regarding the concern about the Consultation aiming to expand the power of SFC, the Government pointed out that SFC was already exercising the relevant powers under existing legislation and arrangements in vetting and approving listing

applications. One of the objectives of the proposals was to allow early engagement of SFC in the decision-making process. There was no case of conferring excessive power on SFC.

Latest development

20. The Government and SFC will brief FA Panel on the progress of the Consultation at the meeting on 18 April 2017.

References

21. A list of relevant papers is at **Appendix II**.

Council Business Division 1
Legislative Council Secretariat
13 April 2017

Motion on
“Formulating a comprehensive listing policy”
moved by Hon Christopher CHEUNG
at the Council meeting of 30 November 2016

Motion as amended by Hon James TO

That the Securities and Futures Commission (‘SFC’) and The Stock Exchange of Hong Kong Limited (‘SEHK’) are conducting a joint consultation on proposed enhancements to SEHK’s decision-making and governance structure for listing regulation; proposals made in the consultation paper have aroused great controversies in the industry and there are views, among others, that the proposals, once implemented, will seriously disrupt the current listing process for companies and undermine the long-term development of the Hong Kong securities market; in this connection, this Council urges the Government to, after seriously listening to the views expressed by the industry on the consultation paper, prudently formulate a comprehensive listing policy, clarify the definition of suitability for listing and ensure that SEHK has no conflict of roles between vetting and approving listings and marketing; the Government should also review the existing relevant regulatory legislation, strengthen co-operation with the Mainland regulatory authorities to combat any cross-boundary illegal activities and market misconduct carried out through the flow of funds between the two places and in the international financial market, especially in respect of the regulation of insider dealings and disclosure of information, and enhance the transparency of SFC’s regulatory work to pre-empt loopholes in regulation, so as to ensure the healthy and orderly development of the Hong Kong securities market and, while protecting the interests of investors, actively promote financial innovation, in order to enhance Hong Kong’s status as an international financial centre and attract the investment of more Mainland and overseas capital in the Hong Kong securities market.

List of relevant papers

Date	Event	Papers/Minutes of meeting
18 June 2016	Joint press release by The Securities and Futures Commission ("SFC") and Hong Kong Exchanges and Clearing Limited ("HKEX") on issuing of the consultation on listing regulation	SFC and HKEX joint press release
18 June 2016	SFC and HKEX Joint Consultation Paper - Proposed Enhancements to The Stock Exchange of Hong Kong Limited's Decision-Making and Governance Structure for Listing Regulation	Consultation paper
9 November 2016	Hon Regina IP raised an oral question on the consultation on listing regulation	Hansard (pages 220 – 230)
30 November 2016	Motion on "Formulating a comprehensive listing policy" moved by Hon Christopher CHEUNG	Hansard (pages 1591 – 1655) Wording of the motion passed Progress report