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**Legislative Council**

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**Panel on Financial Affairs**  
**Meeting on 4 April 2005**

**Background Brief**  
**on proposal to give statutory backing to major listing requirements**

**Purpose**

This paper sets out the background of the Administration's proposal to enhance the regulation of listing by amending the Securities and Futures Ordinance (SFO) (Cap. 571) to give statutory backing to major listing requirements, and summarizes the major views and concerns expressed by members when the relevant proposal was deliberated at meetings of the Panel on Financial Affairs (FA Panel) on 13 June 2003 and 2 April 2004.

**Background**

2. Following the Penny Stocks Incident<sup>1</sup> on 26 July 2002, the Financial Secretary (FS) 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. The PIPSI submitted its report to FS on 9 September 2002. One of the recommendations in the report 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, Securities and Future Commission (SFC), and Hong Kong Exchanges and Clearing Company Limited (HKEx)), with a view to increasing the effectiveness, efficiency, clarity, fairness and credibility of the regulatory system.

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<sup>1</sup> On 25 July 2002, the Hong Kong Exchanges and Clearing Company 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". The 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.

3. FS 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. The Expert Group submitted its report to FS on 21 March 2003. Its major recommendations included, among others, giving Listing Rules statutory backing and enhancing enforcement efforts of SFC.

4. FS announced on 21 March 2003 that the general direction recommended by the Expert Group was appropriate and would enhance market quality. However, in view of the far-reaching implications of the recommendations and to ensure effective implementation, FS announced on 10 April 2003 that the community would be consulted on how the recommendations should be taken forward.

5. At its meeting on 13 June 2003, the FA Panel discussed with representatives of the Expert Group, SFC, HKEx and the Administration on the report of the Expert Group and the Administration's plan for issuing a public consultation paper on regulation of listing matters in the third quarter of 2003.

6. On 3 October 2003, the Administration published the "Consultation Paper on Proposals to Enhance the Regulation of Listing" to seek public views on a number of issues which were critical for the better regulation of listing. The issues included the legal status of certain fundamental requirements in the Listing Rules, the manner of their enforcement, and the roles of both SFC, as the statutory regulator, and HKEx, as the market operator, in performing the listing functions.

7. The Administration released the Consultation Conclusions on 26 March 2004. The FA Panel was briefed at its meeting on 2 April 2004 on the recommendations in the Consultation Conclusions and the implementation roadmap. Responses to the consultation indicated that the lack of regulatory teeth in the Listing Rules had remained an issue of concern to the market as well as the general public. In view of strong public support, the Administration recommended giving the more important listing requirements statutory backing to create a statutory obligation for compliance with these requirements, including the need to ensure accurate, timely and full disclosure. The two relevant major recommendations in the Consultation Conclusions are summarized as follows:

- (a) To give the more important listing requirements statutory backing  
This recommendation covers those important listing requirements relating to financial reporting and other periodic disclosure (e.g. annual and interim reports) by listed companies, disclosure of price-sensitive information by listed companies, and shareholders' approval for notifiable transactions. This will be achieved by amending section 36 of SFO to empower SFC to make rules (i.e.

subsidiary legislation to be made under SFO) in this respect.

(b) To make breaches of statutory listing requirements a new type of market misconduct under SFO

Any persons who breach the statutory listing requirements can either be subject to civil sanctions imposed by the Market Misconduct Tribunal under Part XIII of SFO, or criminal sanctions under Part XIV of SFO following prosecution. SFC will also be empowered to impose direct civil sanctions, namely reprimands and disqualification orders, on issuers, directors and corporate officers who are primarily accountable for corporate disclosure and other corporate activities under the listing regime.

8. The Administration aimed to take forward the two proposals in paragraph 7(a) and (b) above by introducing a Securities and Futures (Amendment) Bill (the Amendment Bill) into the Legislative Council (LegCo) in early 2005. To facilitate consideration of the Amendment Bill and the related rules by LegCo, the Administration and SFC undertook to gauge the views of the public and the market before end of 2004.

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

9. At the FA Panel meetings on 13 June 2003 and 2 April 2004, members stressed the importance for Hong Kong to enhance regulation of listing matters with a view to increasing protection of investors, upgrading market quality, and reinforcing Hong Kong's position as an international financial centre. Members indicated support for the Administration to conduct public consultation on the recommendations for improving the listing regime. However, some members also raised the following major views and concerns-

- (a) There should be a clear division of responsibilities between SFC and HKEx in administering the listing functions so as to avoid possible regulatory overlaps or gaps;
- (b) Given the increase in duties and responsibilities of SFC, there were concerns over expansion in SFC's power and the recovery of cost for undertaking the new function of enforcing the statutory Listing Rules. There was a need to strength the monitoring system over SFC to ensure proper oversight of its regulatory powers and cost-effectiveness in the deployment of its resources. A suggestion was to expand the membership of the Process Review Panel;
- (c) 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 decision making and management of the company; and

- (d) To address the concern about the need to avoid possible conflict of interests on the part of the members of the Listing Committee, the Administration should review the system for appointing members of the Committee with reference to the appointment systems adopted by other jurisdictions.

10. The extracts of the minutes of the FA Panel meetings on 13 June 2003 and 2 April 2004 are in **Appendices I** and **II** respectively.

### **Recent developments**

11. On 7 January 2005, the Administration issued the “Consultation Paper on the Proposed Amendments to the Securities and Futures Ordinance to Give Statutory Backing to Major Listing Requirements” to consult the public on specific proposals on how SFO might be amended to introduce statutory listing requirements. In parallel, SFC issued on the same day “A Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules (the Rules)” to invite public views on the proposed amendments to the Rules to be made under the amended SFO. The consultation period of the two papers ended in March 2005.

12. The Administration’s up-dated Legislative Programme for the 2004-05 session issued on 28 February 2005 includes the Securities and Futures (Amendment) (No.2) Bill 2005. The Bill aims to enhance the quality of the equity market by giving statutory backing to major listing requirements, and to make miscellaneous amendments to keep up with market developments. The Administration will brief the FA Panel at its meeting to be held on 4 April 2005 on the proposals under the Bill.

### **References**

13. A list of relevant papers is in **Appendix III**.

**Extract from the minutes of special meeting  
of the Panel on Financial Affairs on 13 June 2003**



**II Discussion on the Report by the Expert Group to Review the  
Operation of the Securities and Futures Market Regulatory Structure  
(LC Paper Nos. CB(1)1199/02-03, 1861/02-03(01) & 1908/02-03(03))**

Briefing on the Report

17. The Secretary for Financial Services and the Treasury (SFST) recapped the background for the appointment of the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure (the Expert Group). The Expert Group was appointed by the Financial Secretary (FS) in late 2002 to follow up on the recommendation of the Panel of Inquiry on the Penny Stocks Incident to review the three-tier regulatory structure relating to listing matters. While the general direction recommended by the Expert Group was appropriate, the Administration recognized that the specific implementation issues would need to be spelt out clearly and considered carefully to facilitate community-wide consensus building. In this connection, the Administration would embark on a public consultation exercise on the recommendations of the Expert Group on specific issues relating to the listing regime. SFST welcomed members to give views in this regard. SFST assured members that consultation would not in any way impede the on-going measures to improve the listing regime, including the implementation of the Corporate Governance Action Plan presented to the Panel in January 2003.

18. At the invitation of the Chairman, Mr Alan CAMERON, Chairman of the Expert Group, briefed members on the work of the Expert Group and its major recommendations. He pointed out that the Expert Group had conducted extensive consultation during its course of work and met different parties including the Government in its study of the three-tiered structure. The observations and conclusions outlined in the Report represented a distillation of the views expressed, and the recommendations were unanimous. Mr CAMERON advised that as the issues under study involved the role and functions of HKEx, which was a listed company, the Expert Group considered it more appropriate to share its tentative findings with the Government only but not any other parties. In explaining the recommendations of the Expert Group, he drew members' attention to the following:

- (a) There was concern that the decline in the quality of new listings on both the Main Board and the Growth Enterprise Market would affect the standing of Hong Kong's securities market as a whole and could lead to lower valuations, reduced liquidity and a higher cost of capital in the long term.
- (b) About 80% of the companies listed in Hong Kong were incorporated overseas and were governed primarily by laws in those jurisdictions. This had made corporate regulation difficult. There was general support for providing the necessary statutory backing to the Listing Rules so as to ensure their regulatory effectiveness. The Expert Group however kept an open mind on how to give "teeth" to the Listing Rules.
- (c) The recommendation to allow the listing function to be performed by a new division of SFC, to be known as the Hong Kong Listing Authority (HKLA), would free HKEx from its existing listing function and allow it to concentrate on its core commercial activities as a listed company. HKEx could charge fees for admission to trading on the stock exchange, as a commercial service, at levels that should render the transfer of the listing function bottom line neutral to the company.

19. Mr CAMERON said that while the recommendations of the Expert Group would not be the only solution to the problem of the present listing regime, the Expert Group considered this feasible having regard to the findings of its study and views of the respondents. He also pointed out that the perceived problem of concentration of regulatory power in SFC could be addressed by putting in place adequate checks and balances. Members might also recommend additional checks and balances to the power of SFC in overseeing the listing function.

#### Discussion with members

##### *Public consultation on regulation of listing matters*

20. Mr Jame TIEN said that the Liberal Party was of the view that the regulation of listing matters was important to Hong Kong's role as a major financial centre in the region. He was disappointed with FS's immediate endorsement of the Expert Group's recommendations shortly upon the publication of its Report and opined that public consultation on the implementation was necessary.

21. Mr Henry WU, however, doubted whether the Administration had a pre-determined stance on the regulatory structure governing listing matters as FS announced on the same day of the publication of the Expert Group Report that the

direction recommended was appropriate. He opined that the proposed public consultation would not be a genuine one if the Administration had in fact decided to take forward the recommendations of the Expert Group.

22. Ms Emily LAU criticized the Administration for handling the recommendations of the Expert Group in an indecisive manner, with FS announcing endorsement of the recommendations immediately upon the publication of the Report but subsequently slowing down the implementation for public consultation. Ms LAU considered the delayed implementation of measures to improve the listing regime undesirable for the development of corporate governance in Hong Kong. As there was an overwhelming support for the removal of the listing function from HKEx, Ms LAU urged the Administration to expedite the consultation process for early implementation of the recommendation.

23. In response, SFST said that though the general direction recommended by the Expert Group was considered appropriate, the Administration recognized that public consultation was necessary in view of the far-reaching implications of the recommendations. In this connection, the Administration had outlined a proposed framework for consultation and invited members' views in this regard. SFST stressed that the Administration kept an open mind on measures to be taken to improve the listing regime. The Administration's objective was to improve market quality with a view to enhancing the competitiveness of Hong Kong as an international financial centre and to strengthen its position as the premier capital formation centre of China. He assured members that consultation did not imply inaction, and would in no way impede the on-going measures to improve the listing regime.

24. Mr CHAN Kam-lam noted that the introduction of legislative amendments to LegCo was scheduled for end 2004. He considered the consultation process too long and urged the Administration to complete the consultation process and implement the improvement measures within 18 to 24 months. SFST advised that the present timetable was still tentative and subject to revision. He undertook to relay Mr CHAN's view to FS for expediting the consultation work.

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25. Mr SIN Chung-kai, however, opined that given the far-reaching implications of the recommendations by the Expert Group, ample time should be allowed for the community and relevant stakeholders to give their views on the specific implementation during the consultation. He therefore did not agree with Mr CHAN Kam-lam's view of expediting the consultation and sought the view of SFC and HKEx on the timetable for consultation. In response, Mr Ashley ALDER, the Executive Director of SFC, said that SFC supported the consultation for determination of the implementation details for improvement measures to the listing regime. SFC would be committed to doing all the necessary work to ensure that the reform measures implemented after the consultation would help improve the quality of the market. Mr Paul CHOW, the Chief Executive of HKEx, said that

HKEx endeavoured to cooperate with the Government to facilitate the smooth completion of the consultation within the set time frame.

*Work of the Expert Group*

26. Mr Henry WU expressed grave concern about the personal comments made by Mr Peter CLARKE, a member of the Expert Group, in his letter dated 1 June 2003 to the Panel Chairman. He opined that certain points in the letter involved unfair criticisms of various parties and sought the view of the Expert Group Chairman in this regard. In reply, Mr Alan CAMERON said that while he had seen the letter before it was released, it did not imply that he shared all of Mr CLARKE's opinions, and he would not give his endorsement to all of the comments made in this letter. However, he would be happy to respond to members' concern on particular points raised in the letter.

27. Responding to Mr Henry WU's enquiry on the Expert Group's communication with the FS in the course of its work, Mr Alan CAMERON said that he met with FS and other Government officials on several occasions when he was in Hong Kong to update the Administration on the Expert Group's work progress. When the Expert Group met with the FS in December 2002, there was not yet any draft report. It was only in March 2003 that the Expert Group had a draft. The remarks made in Mr CLARKE's letter only recorded the fact that the Expert Group conveyed to the Government the message of the overwhelming support for the removal of the listing function from HKEx and strong support for its transfer to SFC in December 2002, as part of a progress update on the Expert Group's work. He said that while the Government provided written submission as well as secretariat support to the Expert Group, it did not give any directive to the Expert Group. Mr CAMERON advised that since the Expert Group had disbanded upon submission of its Report in March, members of the Group had no access to any documents relating to its work and he was only briefing the Panel on the basis of the Report.

28. In reply to Mr Henry WU's enquiry on whether all respondents' views had been considered in a fair manner by the Expert Group, Mr CAMERON explained that the Expert Group Report had not provided the details of all the views and proposals considered as it would become too lengthy if they had decided to do so. He pointed out that the Expert Group was not engaged in a judicial process to deliberate a judgement on the issues concerned. Its major task was to identify the problems in the current regulatory structure and make recommendations for improvement which it considered appropriate for Hong Kong.

29. Mr SIN Chung-kai also expressed concern about the extent of influence the Financial Services and the Treasury Bureau (FSTB) had on the work of the Expert Group. SFST reiterated that FSTB was obliged to provide information on the three-tier regulatory structure to the Expert Group, but it had never in any way directed or set a pre-determined stance for the Expert Group. The work of the

Expert Group was independent. As to the request of Mr SIN for a copy of the written submission from FSTB to the Expert Group, SFST undertook to consider this after the meeting.

*(Post-meeting note: A copy of the written submission from FSTB to the Expert Group was circulated to members vide LC Paper No. CB(1)2146/02-03 on 4 July 2003.)*

30. Pointing out that the securities and futures market of Hong Kong was unique in that majority of the listed companies were incorporated in overseas jurisdictions, Mr James TIEN opined that direct adoption of regulatory models from overseas markets would be impracticable. He suggested that the committee/authority responsible for listing approval should be composed of both SFC and HKEx representatives, with the Chairman appointed by FS or CE. It would not be a matter of concern whether the committee/authority was formed under SFC or HKEx.

31. Dr Raymond CH'IEN responded that the work of the Expert Group was to examine all the relevant issues, identify the problems and recommend the optimal solutions to the problems. Nevertheless, the Expert Group appreciated that in implementation, compromise might be necessary having regard to the relevant factors involved. The Expert Group was not in a position to give weightings to these factors and the decision should be made by the community of Hong Kong as a whole. Mr Alan CAMERON added that the Expert Group had completed its mission and the extent of involvement of HKEx in listing matters would be decided through the process of public consultation. Mr James TIEN commented that compromise was commonly made for achieving the best arrangements having regard to the circumstances in Hong Kong.

#### *Proposal of HKEx*

32. Responding to Ms Emily LAU's concern about the engagement of consultants by HKEx for preparation of submissions to the Expert Group and the involvement of the HKEx Board of Directors (BoD) in the process, Mr Paul CHOW explained that BoD convened a number of meetings to deliberate on the submissions to be provided to the Expert Group and each of these submissions were endorsed by BoD. Mr Paul CHOW clarified the view of HKEx on the improvement of the listing regime, as follows:

- (a) HKEx agreed with the observation of the Expert Group that the quality of the market should be improved. This would require the joint effort of all parties involved, including the regulator, intermediaries, sponsors and HKEx. HKEx had been working towards this goal through strengthening staffing support for the listing division and improving the listing procedures etc. Nevertheless, HKEx's enforcement efforts were constrained by the

limited power for sanctions it could impose on the companies which had committed misconduct.

- (b) To encourage on-going compliance, making the part of the Listing Rules relating to on-going disclosure statutory obligation would be more effective than the Expert Group's suggestion of giving statutory backing for all the Listing Rules. The statutory part of the Listing Rules on disclosure requirements could be administered by SFC as the statutory enforcement agent.
- (c) HKEx believed that a statutory regulator was by nature less well-equipped to perform the market development and marketing functions than an exchange. The present Listing Committee of HKEx worked entirely independently and did not consider HKEx's commercial interest. There was not one single case that had proved the existence of the Listing Rules had been compromised because of HKEx's commercial interest. The present arrangement preserved the operational interface between listed companies and the operator of the market, i.e. HKEx, as well as providing flexibility and responsiveness of the Listing Rules to changes in market practice and regulatory needs. The same arrangement was adopted in majority of the markets overseas except for the United Kingdom (UK) which the Expert Group chose to follow.
- (d) The current three-tier regulatory structure for listing matters had worked effectively in the past decade and one of the advantages of the current structure was that it provided an extra layer of checks and balances. The proposed transfer of the listing function from HKEx to SFC would give rise to the concern of power concentration in SFC, which would be empowered to make rules for listing, perform listing function, take enforcement actions and deal with appeal cases.
- (e) The perceived conflict of interests of HKEx in performing the listing function as a commercial entity was not a material one as the listing approvals were given by the Listing Committee, comprising 25 members among which 24 were independent market-experienced professionals. Nevertheless, HKEx recognized the perception problem and proposed to the Expert Group the formation of a HKEx subsidiary company to take up the listing function. HKEx believed that this proposal could address the concerns for improvement in the regulatory structure for listing matters while at the same time preserving the merit of a market-based regulation framework for the long-term development of the market.

33. Dr David CHU sought the view of the Expert Group on HKEx's proposal of providing statutory backing to part of the Listing Rules as set out in

paragraph 32 (b) and (c) above. In reply, Mr Alan CAMERON advised that the principle for providing statutory backing to the Listing Rules was to enhance the effectiveness and enforcement of the rules. The proposal of HKEx would be an alternative to be further considered during the upcoming consultation for implementation of the Expert Group's recommendations.

*Conflict of interests*

34. Ms Emily LAU did not agree with HKEx that the formation of a subsidiary company could adequately address the concerns about conflict of interests in HKEx in performing the listing function. Ms LAU also sought clarification from the Expert Group as to how it considered the overwhelming support for making significant changes to the listing regime from its respondents mentioned in paragraph 51 of its Report would logically converge into the set of propositions in paragraph 53. She questioned whether all respondents except HKEx were concerned about the conflict of interests in HKEx's performance of the listing function and agreed with the Expert Group's recommendation of removing the function from HKEx.

35. In response, Mr Alan CAMERON said that while there was overwhelming support for making significant changes to the listing regime, the recommendations of the Expert Group were what it considered appropriate in addressing the concerns and problems of the current listing regime. He advised that he did not recall any respondents explicitly commenting that there were no conflict of interests in the current regime yet it was the fact that some respondents supported the continuation of the present arrangements for listing.

36. Dr Raymond CH'IEN added that the perceived conflict of interests, even not material, coupled with the increasing trend of listed companies with short history causing regulatory concerns, would have adverse impact on the credibility and the long-term development of Hong Kong as the premier financial centre in the region. The Expert Group's recommendation to transfer the listing function to SFC would remove the perceived conflict of interests while at the same time maintain efficiency of the listing regime as SFC was considered equally competent to take up the responsibilities. Dr CH'IEN said that the Expert Group fully recognized the need of consensus for reform but was equally aware of the fact that sometimes a consensus would be impossible when stakeholders' interests would be affected in the reform and under such circumstances, the majority view of the community should be taken.

37. Dr David CHU remarked that in addressing conflict of interests, it was necessary to note that in addition to commercial interests, other interests such as power would be equally attractive to market participants. Mr Alan CAMERON responded that the Expert Group was not looking into individual conflict of interests in the technical sense but rather the conflict of interests which existed as a result of the inappropriate regulatory structure and system that was fundamentally

flawed.

*Quality of market*

38. Dr Philip WONG supported the Administration's determination to improve market quality. However, he was disappointed with the Expert Group Report which did not give a clear definition of market quality. Referring to paragraph 11 of the Report, Dr WONG said that he did not agree that the large number of new listings in Hong Kong in contrary to the global trend in 2002 implied problems in market quality. He did not agree with the point in paragraph 12 of the Report that relatively small number of listings sponsored by global investment banks represented low quality of the listings in Hong Kong. In this connection, Dr WONG sought information from the Expert Group on how it would assess the quality of a market. Dr WONG also doubted the propriety of the recommendation of transferring the listing function from the HKEx to SFC.

39. In reply, Mr Alan CAMERON clarified that the Expert Group was not commenting that Hong Kong had a poor quality market nor was it of the view that the current regulatory regime would have adverse impact on the credibility of the market. However, given the Government's objective to enhance the role of Hong Kong as a leading financial centre, the standard which ought to be required was relatively high and the quality of listings coming to HKEx in recent years was not consistent with such a high standard as they were of little interest to international sponsors or investors. He explained that the quality of market was assessed through examining factors such as market liquidity, genuineness of the listed companies in raising funds through listing and spread of shareholdings of the listed companies. There was rising concern about the quality of listings in Hong Kong as the recent development in listings was different from the rest of the world. Mr CAMERON pointed out that if a large number of listings in a market failed to attract trading interest, the market liquidity would be low and it would not be a competitive market.

40. Mr LEE Cheuk-yan sought the Expert Group's view on the reasons for the declining trend of the quality of new listings in recent years and in what way this could be improved if the listing function was transferred from HKEx to SFC. Mr LEE opined that measures to ensure on-going compliance after listing would be more effective in quality control than those to strengthen the gate-keeping mechanism for listing.

41. Dr Raymond CH'IEN responded that continuous quality control of new listings would depend on the incentives for these companies to exercise self-discipline. He pointed out that the provision of statutory backing to the Listing Rules would be one feasible way of providing such incentives. SFC as a statutory body would be in a better position than HKEx, which was a commercial entity, to administer these statutory provisions for listing. Furthermore, as more Mainland companies were seeking for listing in Hong Kong, the relationship

between SFC and the China Securities Regulatory Commission (CSRC) would become increasingly important. It was not possible for HKEx, as a commercial entity, to establish the same kind of close working relationship and information sharing with CSRC as it was for SFC as a statutory regulator. Dr CH'IEN also pointed out that despite the undoubted quality and integrity of the members of the Listing Committee, the present system of their service as part-time volunteers working under considerable time constraints to handle the voluminous cases seeking listing was undesirable as the resources allocated to listing approvals were inadequate.

42. In response to Mr LEE's further comment on the need for giving adequate power to the Listing Rules, Dr Raymond CH'IEN said that the decision would be in the hands of the Legislative Council and the Government. SFST pointed out that the effective roll out of SFO on 1 April 2003 had strengthened the enforcement capability of SFC over corporate misconduct and rules to deter false and misleading disclosure.

*Checks and balances to the power of SFC*

43. Dr Eric LI was concerned about the checks and balances to the power of SFC if it took up the listing function from HKEx. Noting that the recommendations of the Expert Group modeled on the UK regulatory structure, Dr LI pointed out that there was strong parliamentary oversight of the regulatory body in the UK, which was very different from the circumstances in Hong Kong where the Legislature had no power to monitor the work of SFC. He opined that the Expert Group's recommendation of transferring the listing function to SFC would lead to concentration of power in SFC and was unacceptable unless proper checks and balances to the power similar to that in the UK were in place. Dr David CHU also expressed similar concern about the concentration of power in SFC.

44. In response, Mr Alan CAMERON referred members to paragraph 3.33 and 3.34 of the Report setting out the set of external checks and balances on SFC's exercise of its powers in the current system, which was considered effective by the Expert Group. In addition, if the listing function was transferred to SFC, parties aggrieved by HKLA's decisions on listing matters could appeal to the Listing Panel, and had further recourse by means of judicial review. He said that additional checks and balances might be introduced if members considered appropriate. Dr Raymond CH'IEN supplemented that while the Expert Group had seen a worrying trend of deterioration in the quality of the new companies listed and had thus recommended what it considered as the optimal solution to the problem, the decision on implementation of the recommendations would be made by the Government in consultation with the community.

Way forward

45. Ms Emily LAU suggested that the Administration should update the Panel on the progress of the public consultation in September 2003. The Chairman directed the Secretariat to follow up Ms LAU's request with the Administration after the meeting. The Panel would schedule the item for discussion at a later meeting subject to the advice of the Administration.

*(Post-meeting note: The Administration's response to Ms Emily LAU's request was circulated to members vide LC Paper Nos. CB(1)2146/02-03 and CB(1)2172/02-03 on 4 and 7 July 2003 respectively (the English and Chinese versions were issued under separate covers).)*



**Extract from the minutes of meeting  
of the Panel on Financial Affairs on 2 April 2004**

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**IV. Regulation of listing**

(LC Paper No. CB(1)1393/03-04(03) — Information note on “Consultation conclusions on proposals to enhance the regulation of listing”

LC Paper No. CB(1)2545/02-03 — Consultation paper on proposals to enhance the regulation of listing

LC Paper No. CB(1)1393/03-04(04) — Extract of the minutes (Item II) of the special meeting of the Panel on 13 June 2003

LC Paper No. CB(1)1199/02-03 — Report by the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure

LC Paper No. CB(1)1908/02-03(03) — Information paper provided by the Administration)

Briefing by the Administration

6. The Chairman informed members that at the Panel meeting on 13 June 2003, the Administration had briefed members on its plan to conduct public consultation on the major recommendations concerning regulation of listing in the Report by the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure. On 3 October 2003, the Administration published a consultation paper to invite public views on the proposals to enhance the regulation of listing (the Consultation Paper). The Administration then released the Consultation Conclusions on 26 March 2004.

7. Upon invitation by the Chairman, the Secretary for Financial Services and the Treasury (SFST) briefed members on the recommendations in the Consultation Conclusions and the Administration’s proposed way forward. He pointed out that there had been support from the market and the public for upgrading market quality,

in particular the recommendation to give the more important listing requirements statutory backing. He also highlighted the major recommendations in the Consultation Conclusions and the implementation roadmap, as follows:

- (a) To give the more important listing requirements statutory backing  
This proposal included those important listing requirements relating to financial reporting and other periodic disclosure, disclosure of price-sensitive information and shareholders' approval for notifiable transactions. This would be achieved by subsidiary legislation to be made by the Securities and Futures Commission (SFC) under section 36 of the Securities and Futures Ordinance (SFO) (Cap. 571).
- (b) To make breaches of statutory listing requirements a new type of market misconduct under SFO  
Any persons who breached the statutory listing requirements could either be subject to civil sanctions imposed by the Market Misconduct Tribunal (MMT) under Part XIII of SFO, or criminal sanctions under Part XIV of SFO following prosecution. The SFC would be empowered to impose direct civil sanctions, namely reprimands and disqualification orders, on issuers, directors and corporate officers who were primarily accountable for corporate disclosure and other corporate activities under the listing regime. The Administration would take forward the proposals by introducing a Securities and Futures (Amendment) Bill (the Amendment Bill) into LegCo in early 2005. To facilitate consideration of the Amendment Bill by LegCo and to gauge the views of the public, SFC would endeavour to consult the market and the public on the draft rules on the more important listing requirements before end of 2004.
- (c) To expand the existing dual filing system  
The Stock Exchange of Hong Kong (SEHK) would continue to receive listing applications at the frontline, and no securities would be listed on SEHK unless they were approved by the SEHK Listing Committee. SFC would detect any non-compliance with the statutory listing requirements and assess whether it should exercise its statutory power to object to the listing applications.
- (d) To enhance the transparency and accountability of the performance of listing functions of SFC and the Hong Kong Exchange and Clearing Limited (HKEx) through a series of measures  
The measures included enhancing disclosure of decisions relating to listing, articulating in a public statement the division of responsibilities between SFC and HKEx relating to listing, publication of SFC's reports on annual audit of HKEx's performance of listing functions, and inviting the Independent Commission Against Corruption to study respective procedures and practices of SFC and HKEx for the

performance of listing functions under the dual filing system. SFC and HKEx had been invited to implement these measures by phases from the second quarter of 2004 onwards.

8. SFST pointed out that the above proposed improvement measures would contribute to the enhancement of the quality of the market and further strengthen Hong Kong's position as the premier capital formation centre for the Mainland and a major international financial centre. The Administration would work closely with SFC, HKEx and all market users in taking forward the proposals with a view to achieving these common goals.

### Discussion

#### *Proposals for enhancing the regulation of listing*

9. Mr Henry WU said that while market participants welcomed the major recommendations in the Consultation Conclusions, they urged that implementation of the proposals should cater for the needs of the local market and be conducive to its future development. As details of the proposals had yet to be worked out, Mr WU stressed the importance for the Administration to consult the market on the draft rules and the Amendment Bill before presenting them to LegCo. On improving the regulatory structure for listing, Mr WU conveyed the market's support for expanding the dual filing system but he stressed that there should be a clear division of responsibilities between SFC and HKEx in administering the listing functions so as to avoid possible regulatory overlaps or gaps.

10. In response, SFST pointed out that there would be a clear division of responsibilities between SFC and HKEx in administering the listing functions and dual filing system. Under the proposal, SFC would be responsible for enforcing the new statutory listing requirements while HKEx would continue to enforce the non-statutory listing rules. SEHK would continue to receive initial public offer applications at the frontline and be responsible for administering the listing process. All documents filed with SEHK were also to be filed with SFC. In this way, SFC would be in a position to detect any breaches of the statutory listing requirements and to exercise its statutory power to object to listing applications. All applications remained to be approved by the SEHK Listing Committee. As regards the monitoring of the ongoing compliance by listed companies, the same division of labour would apply. SFC would be able to exercise statutory enforcement powers where it had reasons to believe that there were breaches of the statutory listing requirements.

11. 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, Mr Henry WU opined that there should be a limit on the period within which these relevant persons should be held liable for corporate disclosure. He further suggested that consideration be given to providing appropriate exemption for independent non-executive directors because they were not closely

involved in decision making and management of the company. In this connection, Mr WU expressed concern about whether there would be different treatment for government officials or their representatives who were appointed as directors of listed companies. In particular, he was concerned whether they would be subject to the same sanctions for breaching of the statutory requirements as other directors, including civil sanctions imposed by SFC, and the criminal and civil sanctions under SFO.

12. SFST took note of Mr Henry WU's view and responded that there would be opportunities for members to study the draft rules and the Amendment Bill in detail when they were submitted to LegCo. As regards the question on the liability of government officials appointed as directors to listed companies, SFST agreed to provide a written response after the meeting.

*(Post-meeting note: The Administration's written response was circulated to members vide LC Paper No. CB(1)1639/03-04(02) on 27 April 2004.)*

*Monitoring of the operation of SFC and HKEx*

13. Mr Henry WU recalled that when discussing the SFC budget for 2004-05 at the Panel meeting on 1 March 2004, members had expressed concern about the proposed increase in the staff establishment of SFC despite the general trend of downsizing in the public and private sectors. Members had also noted that the Administration had expressed the same concern to SFC but it finally accepted SFC's view that the proposed increase in staff establishment was necessary to cope with the increase in workload from dual filing, and to cope with new market and product developments. Mr WU enquired how SFC would recover the additional cost. He also pointed out the need to strengthen the existing monitoring system over SFC to ensure the cost-effective deployment of its resources and to enhance checks on its powers.

14. In reply, SFST said that it remained the Administration's position that public funded bodies should, same as Government departments, exercise stringent control on their expenditure and explore measures to cut costs. As such, the Administration had urged SFC to be more vigilant in managing its staff resources. He also pointed out that under the existing arrangement, HKEx provided \$20 million per year to SFC for implementing the work relating to the dual filing system. As regards monitoring of SFC, SFST informed members that SFC consisted of executive and non-executive directors, the latter being members from the market, the business community, the academies or members of the public appointed by the Government. Hence, there was adequate public scrutiny over the operation of SFC. Moreover, SFC presented its annual budget to the Panel for information before presenting it to the Financial Secretary (FS) for approval and tabling it at LegCo. In examining SFC's budget, the Administration had sought to find out the reasons for any increases in expenditure and to ensure that SFC would carry out its functions in a cost-effective manner.

15. The Deputy Secretary for Financial Services and the Treasury (Financial Services) (DS/FST(FS)) stressed that the Administration attached great importance to enhancing the transparency of the operation of SFC and HKEx. Building on the existing administrative arrangement for SFC to conduct regular reviews on HKEx's performance of listing functions, it was recommended in the Consultation Conclusions that SFC should prepare and submit these annual audit reports to FS, who should cause the reports to be published. Moreover, in order to ensure the procedural fairness and reasonableness in conducting the audit reviews, it was also recommended in the Consultation Conclusions that SFC's regulatory oversight of HKEx's performance of listing functions, including the conduct of annual audits, be a subject of regular review by the Process Review Panel (PRP). Through the publication of PRP reports and SFC's audit review reports on HKEx, the public would be better able to judge SFC's performance in overseeing and supervising HKEx's performance of listing-related functions.

16. Mr Henry WU pointed out that PRP's terms of reference was only limited to conducting review of SFC's internal operational procedures to ensure that the procedures were fair and reasonable, and examining whether SFC had followed the procedures in making its decisions. PRP was not empowered to take actions on any unfair decisions made by SFC. DS/FST(FS) advised that any persons who were aggrieved by SFC's decisions might apply to the Securities and Futures Appeals Tribunal (SFAT) for a review of the decisions.

17. Whilst expressing support for the recommendations for improving regulation of listing, Mr Albert HO saw the need to strengthen the oversight of SFC's regulatory power. In this connection, he enquired about the mechanism for lodging appeals against SFC's decisions to object listings under the dual filing system and to impose civil sanctions directly on the issuers, directors and corporate officers, i.e. the "primary targets", who had breached the statutory listing requirements.

18. DS/FST(FS) advised that persons who were aggrieved by SFC's decisions to object to listings under the dual filing system might apply to SFAT for a review of the decisions. As regards the appeal mechanism for persons who had breached the statutory listing requirements, the Permanent Secretary for Financial Services and the Treasury (Financial Services) (PS/FST(FS)) referred members to the three-pronged approach outlined in paragraphs 3.30 to 3.35 of the Consultation Conclusions. In brief, the first prong involved civil sanctions imposed by SFC on the "primary targets" and the SFC's decisions were subject to review by SFAT. The second prong involved civil sanctions imposed by MMT on any persons who engaged in market misconduct including, but not limited to, the "primary targets". MMT's decisions were subject to appeal to the Court of Appeal. The third prong involved criminal sanctions imposed by the Court of First Instance on persons who had committed market misconduct including, but not limited to, the "primary targets". Such decisions were also subject to appeal to the Court of Appeal.

19. Given the increase in duties and responsibilities of SFC, Mr Albert HO

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suggested that the Administration should consider expanding the membership of PRP. PS/FST(FS) undertook to consider the suggestion.

*Improvement of the operation of the Listing Committee*

20. Mr SIN Chung-kai expressed support for the recommendations in the Consultation Conclusions. Referring to the suggestions for improving the operation of the SEHK Listing Committee outlined in paragraphs 4.30 to 4.33 of the Consultation Conclusions, Mr SIN opined that the Administration should proactively work out concrete proposals to strengthen the listing regime rather than leaving it to SFC and HKEx to decide how to take forward the suggestions. For example, in order to address the concern about the need to avoid possible conflict of interests on the part of the members of the Listing Committee so that the listing process could be, and was seen to be, done in a fair and independent manner, the Administration should review the existing system for appointing members to the Listing Committee.

21. In reply, SFST stressed that the Administration kept an open mind on the suggestions put forward in the public consultation to improve the operation of the Listing Committee. He assured members that SFC, as the regulator of the securities market, and HKEx, as the operator of the market, would study the suggestions carefully and work out improvement proposals. SFST also pointed out that a number of changes initiated by SFC and HKEx, had already been introduced to the Listing Committee in the past ten years. For example, its composition had changed over time with more members from the investing public. Moreover, common membership for the main board and the growth enterprises market Listing Committees had been introduced a year before with the aim to achieving greater consistencies in the decisions relating to listings. SFC and HKEx should continue to work out concrete proposals for improving the listing regime.

22. Whilst appreciating that a number of changes had been introduced to the Listing Committee in the past, Mr SIN Chung-kai considered that there was room for further improvement, such as in the system for appointing its members. He reiterated that the Administration should review the appointment system. In this connection, he suggested that reference be made to the appointment systems adopted by other jurisdictions. For example, members of the Financial Services Authority in the United Kingdom (UK) were appointed through self-nomination and formal selection processes. SFST undertook to convey Mr SIN's views to SFC and HKEx.

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## Proposal to give statutory backing to major listing requirements

### List of relevant papers (Position as at 30 March 2005)

Paper/Report	LC Paper No.
Report by the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure	CB(1)1199/02-03 <i>(discussed at the FA Panel meeting on 13 June 2003)</i>
Administration's paper on "Proposed Framework for Consultation on the Regulation of Listing Matters"	CB(1)1908/02-03(03) <i>(discussed at the FA Panel meeting on 13 June 2003)</i>
Minutes of the FA Panel meeting on 13 June 2003	CB(1)2543/02-03
Consultation Paper on Proposal to Enhance the Regulation of Listing	CB(1)2545/02-03 <i>(discussed at the FA Panel meeting on 2 April 2004)</i>
Administration's paper on "Consultation Conclusions on Proposals to Enhance the Regulation of Listing" (with the Consultation Conclusions)	CB(1)1393/03-04(03) <i>(discussed at the FA Panel meeting on 2 April 2004)</i>
Minutes of the FA Panel meeting on 2 April 2004	CB(1)2084/03-04
<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>	CB(1)670/04-05 <i>(issued on 7 January 2005)</i>