



## JOINT CONSULTATION PAPER

### PROPOSED ENHANCEMENTS TO THE STOCK EXCHANGE OF HONG KONG LIMITED'S DECISION-MAKING AND GOVERNANCE STRUCTURE FOR LISTING REGULATION

The Law Society has reviewed the Joint Consultation Paper published in June 2016 by The Securities and Futures Commission (“SFC”) and The Stock Exchange of Hong Kong Limited (“the Exchange”), with the captioned title (“the Joint Consultation Paper”). Without expressing a position for or against those proposals contained in the Joint Consultation Paper, the Law Society wishes to set out its comments on the feasibility and workability of those proposals, in the following.

#### **Objectives of the Proposals**

1. We note the objectives summarised in the introductory section of the Executive Summary of the Joint Consultation Paper. Broadly put, the proposals are meant to achieve closer collaboration between the SFC and the Exchange, enable the SFC to give “earlier and more direct input on listing policy matters and listing regulation” (emphasis supplied), and to enhance efficiency as well as accountability.
2. The proposals will essentially involve the establishment of two new committees. The Listing Policy Committee (“LPC”) will be responsible for overall policy development (including rules changes and oversight of the Listing Department) and the Listing Regulatory Committee (“LRC”) will deal with listing matters involving listing suitability concerns, other policy issues which are novel, potentially controversial or sensitive in nature, as well as any decision which will have the general effect within the meaning of Rule 2.04 of the Listing Rules in respect of waivers from the Listing Rules (“LRC Matters”).
3. The Joint Consultation Paper does not discuss details of the problems or perceived problems with the existing decision-making and governance structure of the Exchange for listing matters. The proposals have been put forward basically as enhancements rather than solutions to any specific

existing concerns or issues. The proposal to establish the LPC and the LRC is also premised on further developing the concept of establishing a “High-Level Group” to review systemic and policy issues concerning listing related matters as contemplated in paragraph 5.1 of the Memorandum of Understanding Governing Listing Matters concluded between the Exchange and the SFC dated 28 January 2003.

#### **Enhancement of efficiency**

4. Insofar as the proposals are aimed at enhancing efficiency, it is not entirely apparent from the Joint Consultation Paper as to how this will necessarily be achieved.
5. While the Listing Department may designate a transaction or an IPO as involving LRC Matters and should hence be determined by the LRC, the transaction or IPO will still be required to go through the Listing Committee in the normal way so as to enable the Listing Committee to provide its non-binding comments to the LRC.
6. Although certain paragraphs of the Joint Consultation Paper would seem to indicate the contrary, the position is clearly explained in Appendix B of the Joint Consultation Paper. Paragraph 7 of said Appendix B states that the Listing Department will present a LRC IPO case to the LRC “after the Listing Committee has given its comments on the case”. Similarly, paragraph 11 of the Appendix B, in the context of pre-IPO enquiries, states that the Listing Department “will arrange for the Listing Committee to provide its non-binding views on the relevant LRC Matters before it is considered by the Listing Regulatory Committee”. For non-IPO matters, paragraph 16 of the Appendix B states that the Listing Department will refer a matter to the LRC “after obtaining the non-binding views of the Listing Committee”.
7. Hence, in terms of timeline, the LRC does represent an additional layer of compliance and deliberations. The Joint Consultation Paper does not explain how the proposed decision process will be streamlined to make it more efficient to issuers and other users. This should be explained and, if the proposals are to be implemented, the Exchange and the SFC should publish an indicative timetable for LRC hearings.
8. Either the Listing Department or the Listing Committee may refer a matter to the LRC because it takes the view that a LRC Matter is involved. Such decisions are not reviewable. It is important for early identification and referral to be made at the beginning rather than near the end of the process. The Joint Consultation Paper states that a decision to refer will be made

known to the applicant/issuer “as soon as reasonably practicable”. While we appreciate the difficulty of prescribing fixed time limits, if the proposals are to be implemented, users should be appraised of their legitimate expectations so that they may make necessary preparations in advance for any likely delay, not least because transactions are often required to be executed within a tight timetable and third party reports may become stale if the relevant transactions cannot be implemented within a certain timeframe.

9. It is also important for the types of referral triggers and the basis of their implementation to be clear to the market. Although the Joint Consultation Paper describes in general terms as to what constitutes LRC Matters, it does not discuss or give any concrete examples of the factors involved in making such determinations. If the Listing Department errs on the safe side, this could potentially result in a considerable number of referrals to the LRC. The market needs to be informed and, where appropriate, consulted on how the proposals will work in practice. If the proposals are to be implemented, these concerns would need to be addressed at least by the publication of relevant practice guidelines in advance.
10. We note that the SFC will no longer as a matter of routine issue a separate set of comments on statutory filings made by new IPO applicants and the Listing Department will seek to resolve the matter with staff of the SFC. This implies that the SFC will continue to make comments through the Exchange. However, the Joint Consultation Paper does not explain how the listing application process will be streamlined in this respect.

### **Enhancement of governance**

11. We note that the SFC and the Exchange will be equally represented on the LRC and the LPC. Although only certain cases will be referred to the LRC and the LPC, such referrals relate to the most important decisions. In addition, not only will the LPC assume oversight of the Listing Department, it will also be commenting on the remuneration of the Listing Department staff. The proposals will hence have the practical effect of placing the SFC one step towards the frontline. This does not fit in entirely well with the Exchange being held out as the frontline regulator.
12. The respective chairmen of the LPC and the LRC will not have a casting vote. Hence, delegates of the SFC will be able to block a decision by the LRC and the LPC through a deadlock. This means that relevant powers of the SFC may be exercised through its delegates in their capacity as members the LPC and the LRC of the Exchange without the SFC itself having to exercise such powers.

13. In this connection, the statutory powers of the SFC to object to a listing are set out in Rule 6 of the Securities and Futures (Stock Market Listing) Rules. Such powers may only be exercised within particular time frames (basically within 10 business days from the later of the filing of the listing application or provision of the further information requisitioned by the SFC in respect of the listing application). However, if the proposals are implemented, the SFC delegates may veto a listing at any meetings of the LRC or LPC even when the SFC is no longer able to exercise its statutory powers to object to the listing. Hence, the proposals will have the practical effect of enabling the SFC to exercise additional powers through its delegates on the LRC and the LPC. If the proposals are to be implemented, consideration should be given to the need to align the SFC's statutory powers with such additional powers.
14. The Joint Consultation Paper contemplates that a deadlock will be equivalent to a decision against a transaction or a listing application. Although a deadlock is probably unlikely to arise in practice, from a structural perspective, this would not appear to be the most ideal governance structure. It also raises issues as to how judicial reviews may be conducted because the court will not be asked to review the reasonableness or fairness of a decision made by the LPC or LRC. Instead, the court will be asked to intervene because of the inability of the LPC or the LRC to reach a decision due to deadlock.
15. The Joint Consultation Paper does not address whether the LRC may on its own initiative designate a transaction or an IPO application as involving LRC Matters. We assume that the LRC is not intended to have such a power as that may undermine the Listing Committee's ability to consider and approve cases which does not involve any LRC Matter.
16. We note that the LRC will assume an appellate role and it will replace the current Listing (Review) Committee. A new Listing Regulatory (Review) Committee ("LRRC") will replace the existing Listing Appeals Committee. As a result, the LRC and the LRRC will assume review jurisdiction over non-LRC Matters. This aspect needs to be conveyed clearly to the market, including overseas investors. The current listing regulatory structure in Hong Kong is already by no means straightforward, and the market may not readily understand why the LRC will be dealing with non-LRC Matters.
17. We welcome the routine publication of various decisions with reasons as contemplated in the Joint Consultation Paper.
18. In respect of disciplinary matters, specific reference is made in the context of the Listing Disciplinary Chairperson Group to the inclusion of at least 5 practising or retired senior counsel "or other individuals of equivalent qualification". While the latter expression probably covers retired judges,

solicitors who are very experienced with disciplinary or related litigious matters and/or how the Listing Rules operate in practice should also qualify for inclusion and that should be made clear.

**Other related comments**

19. In line with the objectives of the proposals under the Joint Consultation Paper to enhance efficiency, transparency and accountability for decision-making within the Exchange, it would be helpful to the market for both regulators (the SFC and the Exchange) to rationalise not only the process aspects of the interplay between them, but also the relative powers and areas of oversight vested in the two regulators. For the SFC to maintain its "powers and functions in relation to listing matters" which shall remain unchanged (as per paragraph 14 of the Joint Consultation Paper) notwithstanding the implementation of the various proposals, the market will continue to have no certainty or clarity as to whether the SFC may decide to exercise its powers after going through the proposed new processes.

**The Law Society of Hong Kong  
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