

Hong Kong's Listing Regulation Reforms- The Way Forward

September 2017

1. Summary

1.1 Just over a year on from releasing a [joint consultation paper on listing regulation reform](#), The Stock Exchange of Hong Kong Limited (the **Exchange**) and the Securities and Futures Commission (the **SFC**) have released their [consultation conclusions](#).

1.2 The two regulators have abandoned the idea of establishing a joint committee to vet the trickier listing applications and listing decisions, but will establish a joint panel to steer and advise on listing policies. The Exchange's Listing Committee will continue to make decisions under its Listing Rules (including decisions on suitability for listing) and the SFC will intervene in a more direct and front-loaded manner in more "serious" listing matters that fall within the Securities and Futures (Stock Market Listing) Rules (**SMLR**) or the Securities and Futures Ordinance (**SFO**).

1.3 Some have characterised this as a "backing down" by the SFC, whilst some may consider it as quite the opposite. Much will depend on how the SFC will in practice interpret what is a sufficiently serious listing matter falling within its domain. As described below, there is an overlap between suitability concerns which fall within the Listing Committee's purview and the statutory grounds for SFC intervention - it remains to be seen how this overlap will be handled going forward. It is also of note that there will be a "materially enhanced" audit of the

Exchange's performance by the SFC, the results of which will be published.

1.4 The separate consultation regarding a New Board - containing a strawman proposal for certain companies with dual class shares to be listed in Hong Kong - has not yet been concluded. It will be interesting to see whether the new listing policy panel (with equal representation from the SFC and the Exchange) will have a significant impact on the dual class shares debate despite the panel not having formal rule-making powers.

2. Consultation Paper

2.1 There is a certain overlap in the functions and powers of the Exchange and the SFC, both in terms of listing policy matters and in regulatory decision-making. It was felt the decision-making structure should be reformed so the two bodies can consensus-build in a more efficient manner.

2.2 The Exchange is the front-line regulator in listing matters, and up until recently, the SFC raised any comments it had via the Exchange. Under the proposals, the SFC would have had earlier and more direct input in the form of committees with equal representation from the Exchange and the SFC - a joint listing policy committee (**LPC**) to steer and decide listing policy, and a joint listing regulatory committee (**LRC**) to decide listing applications and post-IPO matters where the case raises suitability concerns

or wider policy implications. The Listing Committee would have decided on the more “vanilla” listing applications and post-IPO matters.

3. Market Response to Consultation Paper

3.1 The consultation paper generated over 8,700 responses from market participants.

3.2 Very broadly speaking, it prompted, on the one hand, many companies and their professional advisers to raise concerns with what they viewed as a shift of power in favour of the SFC (which may stifle market development and slow down processes) and, on the other, investment managers and academics who supported greater oversight by the SFC (which they thought would enhance market quality).

4. Recent SFC Practice

4.1 Around two months before the consultation conclusions were released, an [SFC bulletin](#) (the **Bulletin**) explained the SFC had started to adopt a revised approach to listing applications and post-IPO matters. It clarified the SFC, in the performance of its statutory functions, had the power to:

- (A) object to listing applications (both on IPOs and follow-on equity offerings) on certain grounds under the SMLRⁱ - for example, where it appears to the SFC that it would not be in the interest of the investing public or in the public interest for the securities to be listed; and
- (B) direct the Exchange to suspend trading of a company’s shares on certain grounds under the SMLRⁱⁱ - for example, where it appears to the SFC that it would be in the interest of the investing public or in the public interest to direct a suspension.

4.2 The Bulletin clarified the SFC’s new approach is to intervene in serious cases falling under the SMLR by liaising directly with the applicant (rather than via the Exchange) and at an earlier stage than before.

5. Consultation Conclusions

5.1 The consultation conclusions confirmed the following key changes will be implemented:

IPO Applications and Post-IPO Listing Decisions

- (A) The LRC will not be adopted. Instead, the Exchange will continue to make decisions under its Listing Rules (including decisions on suitability for listing) but the SFC will intervene in more serious listing matters that fall within the SMLR or the SFO.
- (B) For IPO applications, the above means the dual-filing regime will remain but the SFC will stop vetting an application once it determines the case does not raise SMLR concerns. For such non-SMLR cases, the Exchange will be the contact point for listing applicants. For SMLR cases, the SFC will communicate any concerns it has with the applicant directly and at an earlier stage than before - this would be in addition to the Exchange, which will have discretion to suspend, resume or continue its own vetting. The SFC will be available for pre-IPO enquiries relating to potential SMLR concerns.

If the SFC forms the view it is more likely than not to raise an objection under the SMLR, it will issue a Letter of Mindedness to Object (LOM) at the first reasonable opportunity. If an applicant’s response to the LOM is

considered inadequate, the SFC will issue a final decision notice within the specified time period to object to the listing application. The SFC and the Exchange will update and copy each other on all correspondence with the applicant to avoid duplication. The revised IPO application process is summarised in a diagram set out in Appendix 1 to this paper.

- (C) In relation to post-IPO matters, the SFC will adopt the same approach as outlined above for IPOs to any post-IPO equity offerings, as well as use its existing powers (such as the power to direct a suspension of dealings) to discharge its statutory functions where appropriate in relation to post-IPO matters. The Exchange will continue to make its decisions under its own Listing Rules in relation to post-IPO matters.
- (D) Where an LOM would serve as useful guidance to the market, it will be published on an anonymous basis. Final decision notices will be published on a named basis (unless the applicant can demonstrate to the SFC that disclosure of its name will be unduly prejudicial to its interests or the decision is price sensitive).

Listing Policy

- (E) There will be a more watered-down version of the LPC called the Listing Policy Panel (LPP) to discuss listing policy with broader regulatory or market development implications. It will still have equal representation from the SFC and the Exchangeⁱⁱⁱ, but will have no rule-making powers.
- (F) Recommendations of the LPP will be fed to the Listing Department which will formulate proposals for the approval of, first, the Listing

Committee, then the Exchange's board, and finally the SFC's board.

Other Matters

- (G) The SFC will exercise its powers under the 2003 Listing MOU to conduct audits of the Exchange's performance of its listing function, but such audits will be "materially enhanced", focusing on whether the Listing Committee and Listing Department have discharged their duties under the SFO. The audit report will be published.
- (H) The CEO of Hong Kong Exchanges and Clearing Limited (HKEX) (who attends as an ex officio member) will only attend Listing Committee meetings where listing policy matters are discussed.
- (I) Reforms to the review of listing decisions and disciplinary matters will be the subject of a separate consultation next year.

6. Implications

IPO applications

- 6.1 For most IPO applicants, the main takeaway from the consultation conclusions is that the SFC will no longer routinely issue comments on listing applications. However, for companies whose listing application may raise suitability concerns, there is a degree of uncertainty as to whether the application will be considered a sufficiently serious SMLR case to be vetted by both the SFC and the Exchange, or a suitability case to be vetted solely by the Exchange.
- 6.2 On the one hand, the consultation paper itself recognised that, "in practice, the Exchange's consideration of suitability under [Listing] rule 8.04 often overlaps with the SFC's consideration of the public interest and the interest of the investing

public” under the SMLR. On the other hand, the conclusions state “interpretations of the Listing Rules including “suitability” for listing is determined solely by the Exchange, whereas the SFC’s focus is upon the grounds for objection under the SMLR, which have a distinct and unique function as a part of listing regulation”. The Bulletin recently issued by the SFC contained examples of the SFC intervening under SMLR grounds that arguably involved consideration of suitability (for example, over-reliance on a director of a listing applicant).

- 6.3 Given the uncertainty, it may be that listing applicants should assume (until it is told otherwise) that an application involving a potential suitability concern could be a potential SMLR case. Applicants can now raise any potential SMLR concerns with the SFC directly as a pre-IPO enquiry. Where the SFC considers it not to relate to an SMLR issue, it will refer the enquiry to the Exchange’s Listing Department.
- 6.4 Where it is considered an SMLR case, applicants will now have the opportunity to liaise directly (and at an earlier stage)

with the SFC, as well as with the Exchange which has discretion to continue to vet even if an LOM has been issued by the SFC.

Listing Policy

- 6.5 The LPP will not have any rule-making powers and will not limit the SFC’s existing powers to object to policy changes or direct the Exchange to make or amend the Listing Rules. It acts as a single forum for the relevant parties from the SFC and the Exchange to discuss broader policy matters and should help the regulators present a united front on policy matters.
- 6.6 Whether it will have a significant impact on the course of the current consultation on the New Board and dual class shares remains to be seen, but perhaps it will help avoid a repeat of the divergence in views between the SFC and the Exchange that played out on a public stage during the previous consultation on dual class shares in 2015.

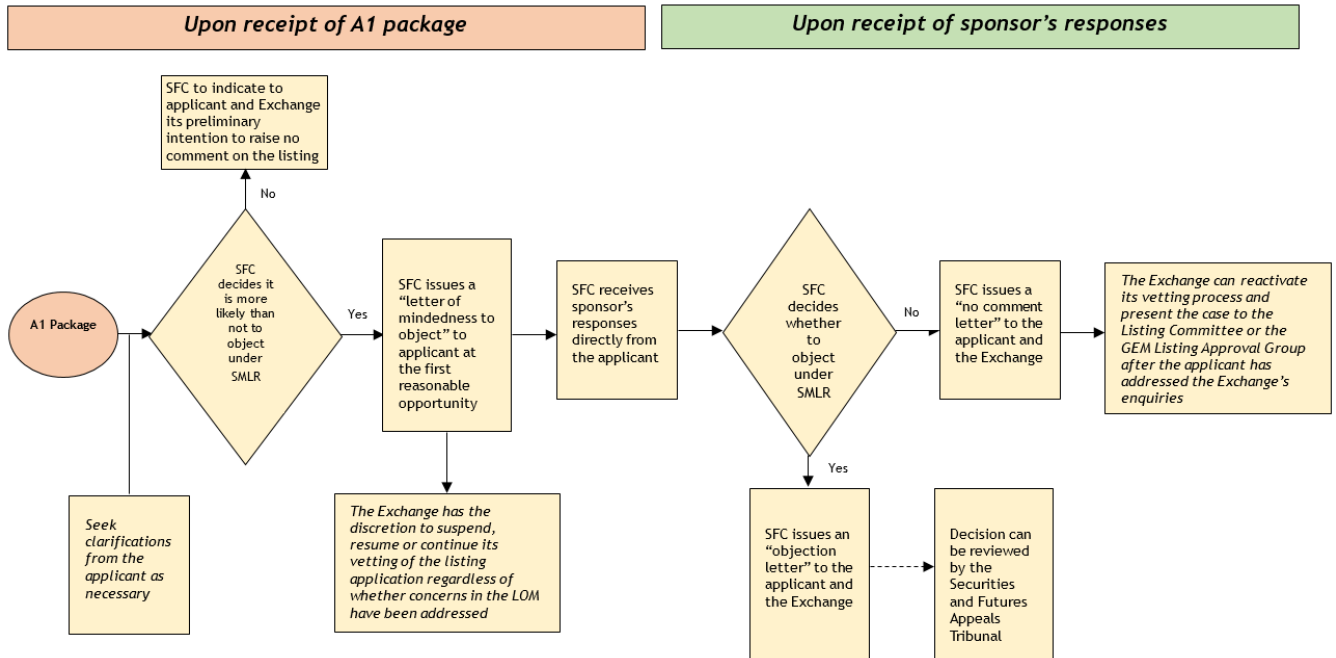
ⁱ Broadly, section 6(2) of the SMLR allows the SFC to object to a listing application on one or more of the following grounds: (i) non-compliance with the Listing Rules or applicable law; (ii) failure to disclose information necessary to enable investors to make an informed assessment of the applicant; (iii) the application being false or misleading as to a material fact (or through omission of a material fact); (iv) failure to provide information as the SFC reasonably requires or providing false or misleading information to the SFC; and (v) it would not be in the interest of the investing public or in the public interest for the securities to be listed.

ⁱⁱ Section 8(1) of the SMLR allows the SFC to direct the Exchange to suspend trading in a company’s shares on one or more of the following grounds: (i) disclosure of materially false, incomplete or misleading information; (ii) it is necessary or expedient in the interest of maintaining an orderly and fair market; (iii) it is in the interest of the investing public or in the public interest or appropriate for the protection of investors generally; and (iv) failure to comply with conditions imposed by the SFC.

ⁱⁱⁱ The LPP’s twelve members will comprise: (i) the chair of the Listing Committee; (ii) the two Deputy Chairs of the Listing Committee; (iii) the Chief Executive of the HKEX; (iv) two Non-Executive Directors from HKEX’s board; (v) the Chair of the Takeovers Panel; (vi) CEO of the SFC; (vii) Executive Director of the Corporate Finance Division of the SFC; (viii) Senior Director of the Corporate Finance Division of the SFC; and (ix) two Non-Executive Directors from the SFC’s board.

Appendix 1

Diagram summarising the SFC’s new approach to processing IPO applications



* Source: <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201606cc.pdf>



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