



## **Response to the Consultation Paper on Proposals to Enhance the Regulation of Listing**

The Hong Kong Institute of Company Secretaries (“HKICS”) unequivocally supports the proposals to improve the quality of Hong Kong’s equity market by adjusting the regulatory regime for listing through statutorily backing certain fundamental requirements in the Listing Rules so as (a) to create a positive statutory obligation for compliance with those requirements; (b) to allow more effective investigation of a suspected breach of the statutory requirements; and (c) to enable the imposition of more effective sanctions for any proven breach of statutory requirements.

### **Statutory backing**

#### **HKICS position**

HKICS considers statutory backing for some aspects of the Listing Rules, together with tougher statutory sanctions including civil fines against non-compliance, to be long overdue and is fully in favour of this step forward.

In response to the Standing Committee on Company Law Reform *Consultation Paper on Proposals made in Phase II of the Corporate Governance Review* issued in June 2003, HKICS stated that as a matter of principle, it “takes the view that the listed related elements in the Companies Ordinance are a matter for the Listing Rules, not legislation. Listed companies impact directly on the investing public with both economic and social consequences in a swiftly changing environment. For this reason, they should be regulated to the maximum extent possible by the Listing Rules which offer adaptability and flexibility. Both these characteristics are lacking in legislation: (a) the legislative process for primary and secondary legislation takes 12 to 24 months and 9 to 15 months respectively; and (b) the courts cannot waive the law whereas the SFC or HKEx is empowered with discretion to waive the Listing Rules in warranted cases... HKICS is of the opinion that the move to statutory backing of the Listing Rules should be considered in the context of a broader reform of corporate regulation in Hong Kong, including...simplifying the provisions of the Companies Ordinance by transferring... the prospectus provisions to the Securities and Futures Ordinance given that they only apply to some 7,000 (as of 31 August 2003) of the more than 500,000 companies that are incorporated in Hong Kong”.

HKICS reaffirms its view that regulation of listed issuers should continue to be governed by the Listing Rules. However, it is beyond dispute that there is a dire need for greater sanctions to be available for breaches of the Listing Rules and that statutory backing for some aspects of the Listing Rules is the best solution.

#### **Provisions requiring statutory backing**

As the real abuses which need to be heavily sanctioned are those where listed issuers (in particular, controlling shareholders and their representatives on the Board and in management) (a) lie to shareholders, regulators and the market place; and (b) in the case of connected transactions, unlawfully extract value from a listed vehicle in favour of their

private interests, the provisions relating to disclosure and continuing obligations are the ones requiring statutory backing.

HKICS is of the opinion that the regulators are in a better position to identify in detail the areas in the Listing Rules which so far suffer from inadequate sanctions, and therefore suggests the identifying process be jointly undertaken by the SFC and HKEx in the first instance. In determining the relevant provisions to be statutorily backed, exclusion should be made (or mechanism designed) for those which provide for, or allow the grant of, exemptions or waivers by SEHK for reasons stated earlier.

#### The way to extend statutory backing

In relation to the structures by which statutory backing might be extended, HKICS favours a “balanced mix” of instruments as envisaged in Paragraph 2.25 of the Consultation Paper “to achieve a reasonable balance between enforceability and flexibility”. If it was decided that this is the way to proceed, then a consultation paper on the proposed “balanced mix” of instruments in the pre-drafting stage would be necessary to obtain the input of both market users and market practitioners.

#### Sanctions for breaches of statutory listing requirements

Apart from “the difficulties in securing criminal conviction for ‘white collar’ crimes” as explained in Paragraph 2.46 of the Consultation Paper, HKICS is not convinced that criminal sanctions can in fact be a more effective deterrent for breaches of statutorily backed provisions.

HKICS favours civil sanctions as being the more appropriate measure for such breaches but holds no particular views on the types and levels of such sanctions save to point out that these (a) should be structured so as to be enforced by the SFC itself rather than being routed through the Department of Justice; and (b) should allow for a wide range of penalties (as opposed to being defined within narrow bands) to reflect the wide variety in breaches of the provisions and the divergent practical consequences of such breaches. In this connection, HKICS supports the plan of detailed legal research indicated in Paragraph 2.44 of the Consultation Paper and suggests that this be conducted in consultation with the SFC, HKEx and market practitioners.

### **Regulatory structure governing the performance of listing functions**

#### Conflict of interest

Based on reports from some HKICS members who are company secretaries of major listed issuers, HKICS concludes that conflict of interests within HKEx is perceived rather than real as none of those members has experienced any occasion whereby SEHK as the primary regulator of entry to the market has acted partially. In view of this, HKICS appreciates a number of valid points made by HKEx (including those relating to its ability to impartially discharge its regulatory role) in its letter dated 1 April 2003 (“HKEx letter”) to the Financial Secretary in response to the recommendations of the Expert Group that listing responsibility be transferred to the SFC.

In view of the criticism of HKEx's dual commercial and regulatory roles have been focused on the poor quality of certain new listings, and to the extent that the "disclosure-based" approach was taken, HKICS believes that a different decision on approving those listings might not have been made by the SFC, or indeed by yet another regulator if such existed. Moreover, in relation to the gate-keeping mechanism for the securities market in respect of disclosure at IPOs, the operation of the "dual filing" system in place since 1 April 2003 with greater SFC involvement is stated at Paragraph 2.14 of the Consultation Paper to be running "smooth so far".

It needs to be borne in mind that, in the final analysis, listed issuers are not concerned with the identity of the regulator, whether it is the SFC or HKEx matters little to them. However, of paramount importance to them is impartial, pragmatic and efficient regulation devoid of confusion and capable of being complied with by them.

HKICS supports the suggestion, as indicated in Paragraph 3.14 of the Consultation Paper, that there should be documentation clearly defining the roles, powers and responsibilities of the Listing Committee, its Chairman or its members, and their relationship with the staff of the Listing Division. Furthermore, to minimise potential confusion in the market, it would be advisable to consolidate various existing memoranda of understanding between the SFC and HKEx in one master document to clarify their respective roles.

#### Four possible models of regulatory structure

##### Model A: Transfer of listing functions to a new division set up under SFC

This model is premised on the grant of the entire regulatory authority over Hong Kong's listed issuers to a single statutory body. Over-concentration of power is unwholesome for the securities market and therefore undesirable. HKICS notes, and agrees with, the concerns expressed in the HKEx letter over the combining roles and powers of such a body as the policy-maker, adjudication body and enforcement agency. Moreover, HKICS takes the view that the exposure and experience as the "frontline regulator" of the HKEx staff in confronting the day-to-day practical problems and needs of the market place are beneficial to the effective and smooth operation of the market. Accordingly, HKICS is not in favour of this model.

##### Model B: Transfer of listing functions to a new HKEx subsidiary

Although this model offers an improvement, at least in perception, of the current "Chinese Wall" arrangements, HKICS considers it to be of no substantial merit as it fails to accommodate statutory backing of the Listing Rules.

##### Model C: Transfer of listing functions to a new statutory authority independent of both SFC and HKEx

HKICS takes the view that the disadvantages outlined in Paragraph 3.35 of the Consultation Paper far outweigh any benefits that this model might bring and therefore does not support this model.

Model D: Expanding the “dual filing” system

HKICS is in favour of this model for the following reasons:

- (a) absence of over-concentration of power in a single statutory body;
- (b) the continuation of the “dual filing” system, which has been in smooth operation since 1 April 2003, will avoid undue disruption to the existing regulatory structure; and
- (c) improving on an existent system with known limitations is far less risky than any radical changes that all other models would entail.

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