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Financial Services Branch
Financial Services and The Treasury Bureau
18/F Admiralty Centre I
18 Harcourt Road
Admiralty
Hong Kong

Attn : Proposal to Enhance the Regulation of Listing

Dear Sir,

As one of the largest investors in Hong Kong, we have a vested interest in the market's development as the leading capital formation center for mainland issuers. We also strongly believe that Hong Kong is uniquely positioned because of its regulatory and market infrastructure to capitalize on the growth of newly listed companies from China.

The recent consultation paper published by Hong Kong's Financial Services and Treasury Bureau is an encouraging step towards improving capital markets and enhancing the regulatory regime.

While Hong Kong is one of the better-regulated centers in Asia, and even the world, recent financial scandals have had an impact on investors' standards and expectations. The regulatory foundation provided by the three-tier regulatory structure of the securities and futures industry needs to be reviewed and upgraded.

Need for Statutory Laws

As 80% of the listed companies in Hong Kong are incorporated off-shore and are primarily governed by the laws in those jurisdictions, the Listing Rules of the Stock Exchange of Hong Kong, (SEHK) are the primary tool for regulating overseas-incorporated listed companies in Hong Kong, giving them a greater significance than their equivalent in other major markets.

However, our understanding is that SEHK does not have any statutory investigative powers to investigate suspected breaches of its listing rules. If it discovers a company has violated the listing rules, it can only use public censures, public statements and private reprimands to discipline the company, having no enforcement powers. The SEHK does have the power to delist a company, but this would be detrimental to minority shareholders who would then be unable to dispose of their shares.



In April, Hong Kong introduced the “dual filing” system, which provided a limited form of statutory backing. Copies of listing applications and public disclosure materials must be filed with the Securities and Futures Commission, in addition to the Stock Exchange of Hong Kong, giving the SFC the authority to comment and object to a listing application. It can then also exercise statutory powers to take action against false or intentionally misleading disclosures.

We recognize in recent years the efforts of HKEx to be an advocate for new statutory remedies that would allow investors to take legal action when they believe their interests have been abused. We also noted that a review found that in certain circumstances, conflicts of interest could arise between the roles of HKEx and the SEHK as a commercial market operator and service provider on one hand, and regulator and enforcer of the listing rules on the other. It also found that sufficient safeguards did exist against possible compromise of investors’ interests by the business pursuits of HKEx. However, there is no document that clearly defines the roles, powers and responsibilities of the listing committee, its chairman or its members, and their relationship with staff of the listing division. In addition, perception of potential conflict of interest will always exist, possibly undermining the credibility of capital markets in Hong Kong.

In our opinion, the main goal of any reforms is twofold:

1. To give statutory backing for all principal disclosures obligations, timeliness of disclosures and non-disclosure, duties of directors, duties of sponsors and financial advisers and corporate governance issues. In addition it should allow for appropriate sanctions if statutory listing requirements are breached, such as civil fines, in addition to disgorgement and cost orders.
2. To ensure that no perceived or real conflict of interest exists in the regulatory environment of Hong Kong that could undermine the quality and efficiency of its capital market.

The first proposal on Model A

This model calls for the HKEx to retain certain regulatory functions with respect to listings. It would, for instance, still have the authority to decide which issuers should be allowed to use its trading platform. This model allows the exchange to do what it does best – to get new listings in Hong Kong. It also has the benefit of clear accountability. Removing co-ownership of key regulatory functions minimizes the problem of shared regulation, and makes for an effective choice. Putting the regulation of listed companies and intermediaries under the same jurisdiction would also eliminate the potential for conflict within the different agencies. It would remove the “dual process” under which disclosure and related requirements are enforced by both the SFC and SEHK.

And while the HKEx operates a relatively transparent business and is one of the most efficient exchanges in the world, as a for profit public listed company, it does expose itself to potential and/or perceived conflicts of interest. This model would minimize that risk. The proposal includes a new division staffed by the former employees of the HKEx, which means -- another plus -- all market knowledge would be maintained. Finally, we believe this model could enhance cross-border cooperation. The SFC is already well positioned to be an effective single point of contact with its counterpart in China -- the China Securities Regulatory Commission (CSRC).

The second proposal on Model B

In this model, the board members would be appointed by the HKEx with input from the SFC. They would be drawn from a wide spectrum of market users. If this option is deemed to be preferable, we would recommend that the board should consist of at least 50% of the ultimate buyers of listed companies investors. We don't believe this is an effective and optimal model. Even if a separate department was created within the stock exchange to perform the listing function, a perceived conflict of interest would still exist, and that could hurt Hong Kong's credibility as a financial center. Moreover, we believe this arrangement has the potential to create some areas of overlap in regard to the SFC's and SEHK's work on shared administration of statutory listing requirements.

The third proposal on Model C

In this model the SFC would no longer have the authority to make and enforce any statutory public offering requirements and ongoing obligations. This model also eliminates its power to approve the requirements governing admission to SEHK's platform.

This new authority would effectively be a fourth tier in the three-tier regulatory system, or co-exist with the SFC as a new entity on the second tier of the regulatory structure, potentially creating more gaps and overlaps in regulating listed companies with multiple ownership of regulatory functions.

The fourth proposal on Model D

The SFC would continue to perform its existing listing function, but would also take on new roles surrounding the statutory backing of certain fundamental listing requirements. Under this proposal, we believe that all principal disclosures obligations, timeliness of disclosures, non disclosures, duties of directors, duties of sponsors and financial advisers and corporate governance issues should be included. There may be some modification to the HKEx's existing listing functions if and when certain fundamental listing requirements are supported by statute. On the positive side, this model is already familiar to regulators and market practitioners, and would cause minimal disruption to the existing structure. In addition, it would help preserve market savvy of the listing process and thus facilitate market development.

However, this model might not be optimal because it does not remove the HKex's perceived conflicts of interest. As such, it may add to public confusion and uncertainty regarding the accountability and responsibility of the SFC and SEHK.

In conclusion, it is very clear to us that Model B and C are not desirable in the present environment. Model A is the most appealing and straight forward to implement while Model D is a more gradual evolution as long as it is combined with the necessary revisions of roles.

Yours sincerely,

Vincent Duhamel
Chief Executive - Asia