

**LegCo Panel on Financial Affairs**

**Extract from minutes of the special meeting  
held on 13 June 2003**

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**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).)*

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