HONG KONG SOCIETY OF ACCOUNTANTS
(Incorporated by the Professional Accountants Ordinance, Cap. 50)

香港會計師公會

香港金鐘道八十九號力寶中心二座四樓

BY FAX AND BY POST
(2861 1494)

Our Ref.: C/CGP, M24842 14 January 2004

Financial Services Branch,
Financial Services and the Treasury Bureau,
18/F Admiralty Centre Tower I,
18 Harcourt Road,
Hong Kong.

Attn: Proposals to Enhance the Regulation of Listing

Dear Sirs,

Consultation Paper on Proposals to Enhance the Regulation of Listing

The Hong Kong Society of Accountants ("the Society") has considered the above Consultation Paper ("the Paper"), which seeks comments on proposals for giving certain listing requirements statutory backing and ways to improve the regulatory structure governing the performance of the listing functions. However, there is not a complete consensus amongst our members on all of the issues raised in the Paper, in particular on the most suitable regulatory structure for Hong Kong's markets and the extent to which the Listing Rules should be given statutory backing, and where differing views have been expressed, we have reflected these in the submission.

A. Regulatory Structure Governing the Listing Functions

The Society believes that the key principle to consider is that the regulation of the securities markets in Hong Kong should be efficient, effective, transparent and accountable, and that there are adequate checks and balances in the system to ensure the integrity of listing functions, including independence and freedom from conflicts, both actual and perceived. We believe that any enhancements to the existing system that can provide a greater level of comfort in this respect to investors, issuers, and the domestic and international financial community generally, is worthy of consideration and support.

The Society has a large membership from diverse backgrounds and, on this issue, there is no one single view from amongst the representatives of these different sectors as to the most appropriate means of giving effect to the principle of independence, in the light of the four models of possible regulatory structures outlined in the Paper. As the issue is to a significant extent one of perception and the perception of the international financial and investment community will be an important part of this, the Society believes that the Government will be in a better position to make a judgment as to which approach will be best for Hong Kong in the future, taking account of the merits of the arguments for and against the various possible models. The four models outlined in the Paper are not of course the only options and they are not all mutually exclusive. We simply indicate below the preferences expressed by the representatives from different sectors of our membership that have an interest in the issues under consultation, and the reasons for their views.

4th Floor, Tower Two, Lippo Centre, 89 Queensway, Hong Kong.
Tel: 2287 7228 Fax: 2865 6603 / 2865 6776
Web: http://www.hksa.org.hk E-mail: hksa@hksa.org.hk

(1) Our members from the corporate finance sector consider that a combination of the proposed model B (i.e. transfer of the listing functions to a new subsidiary of the Hong Kong Exchanges and Clearing Limited ("HKEx")) and model D (i.e. expanding the "dual filing" system), would be workable and could achieve an acceptable level of independence, provided that the new HKEx subsidiary had a modus operandi that was fair, open and transparent, incorporating the following key features:

- To improve transparency, (i) the composition of and selection arrangements for the listing committee under an HKEx subsidiary should be looked at very closely, i.e. to consider giving the HKEx only a minority say in the selection; and (ii) the reasons and rationale behind important decisions on listing applications etc. should be published; and

- a Process Appeals Committee ("PAC") should be established under the new Listing Committee. Many of the problems practitioners have experienced with the Stock Exchange of Hong Kong Limited ("SEHK") appear to have resulted from what is perceived to be a degree of high-handedness in the approach to transaction vetting by the Listing Division and deviations from standard procedures. The PAC would therefore present a simple, quick and independent forum to resolve such complaints.

The reasons cited for favouring the combined model are:

- HKEx already has adequate resources and transferring them to a new subsidiary would help to strengthen the present "Chinese wall" arrangement within HKEx, as there would, for example, be a separate budget for the subsidiary.

- SEHK could continue to perform its existing listing functions, with possible modifications if and when certain fundamental listing requirements were given statutory backing.

- This proposal avoids the potential pitfall of over-regulation that could result from transferring the listing functions to a purely regulatory body, such as the Securities and Futures Commission ("SFC"), and thus avoids the concern that market innovation may be stifled.

- This proposal builds on the recently introduced "dual filing" system, which has been operating smoothly so far.

- The present system, although imperfect in some respects, has served Hong Kong's markets quite adequately. The advocates of this view believe that its imperfections could be remedied if the regulators and practitioners worked more closely together.

(2) However, there is a concern amongst some members in business and commerce that independence and the market's perception of independence need to be enhanced. The view held by our Professional Accountants in Business Committee ("PAIBC"), and also by the Corporate Governance Committee ("CGC"), is that, given the inherent conflicts in HKEx's position, genuine independence could be achieved only through transferring the listing functions away from the HKEx, and not simply by transferring the relevant functions to another subsidiary of the HKEx. They are also of the view that if statutory backing is given to the Listing Rules, it would be more appropriate for a statutory body to pursue and prosecute offences in relation to the statutorily backed Listing Rules, and thus the listing functions should be transferred to a statutory body.

This could be a new statutory authority independent of both the SFC and the HKEx, i.e. model C as proposed in the Paper. Our PAIBC members favour this approach, while noting that the practical and implementational side would need to be considered further. They also believe that if model C was regarded as too expensive and complex in the short term, a fall-back position would be to transfer the listing functions to the SFC for the time being, i.e. model A as proposed in the Paper, with a view to establishing an independent authority in the longer term.

There is support from the CGC for transferring the listing functions to an agency under the SFC (as opposed to a new division of the SFC) as a first option, i.e. model A with modifications. The supporters of this view consider that while the relevant functions should be placed "under the SFC", it may be better for them to be established on a more autonomous basis than suggested by model A. They do however acknowledge that there would be implementational considerations that would need to be addressed in order for the proposal to be workable in practice. These include:

- The need to avoid over-emphasising regulation at the expense of other aspects of the broader role.

- The need for SFC to be practical, investor friendly and commercially-minded in relation, for example, to market development.

- The importance of involving persons who reflect a diversity of disciplines in the new institutional set-up under the SFC.

It is, however, noted that any option involving transfer of the listing functions must ensure that Listing Rules issued by the SFC would not automatically have the status of subsidiary legislation under the Securities and Futures Ordinance ("SFO") and so be subject to the normal processes applicable to the enactment of subsidiary legislation, necessitating tabling in and vetting by the Legislative Council. Such an arrangement would undermine the flexibility inherent in the existing Listing Rules, which should be retained as far as possible, even if statutory backing is given to some of the fundamental requirements.

B. Statutory Backing for the Listing Rules

(1) Should statutory backing be given to the Listing Rules?

The Society supports the principle of giving statutory backing to certain fundamental requirements in the Listing Rules for the following reasons:

- About 80% of the listed companies in Hong Kong are incorporated off-shore and are governed primarily by laws in those jurisdictions. The Listing Rules, rather than the Companies Ordinance, have thus become the principal tool for regulating overseas-incorporated listed companies in Hong Kong (paragraph 2.1 of the Paper). As such, certain parts of the Listing Rules should be given more "teeth".

- The SEHK, as the administrator of the Listing Rules, faces constraints in enforcing the Listing Rules. It does not have any statutory investigative powers to delve into any suspected breaches of the Listing Rules. This restricts the SEHK's capacity to detect, pursue, or deter corporate misconduct (paragraph 2.2 of the Paper). In addition, the range of penalties that may be imposed by the SEHK in relation to any breaches is limited. It is therefore necessary to give statutory backing to certain fundamental requirements of the Listing Rules so that any breaches in respect of these requirements will be subject to a statutory regime of enforcement and sanctions, which will be applicable to all listed companies, whether or not they are incorporated in Hong Kong.

(2) Which part of the Listing Rules should be given statutory backing?

The Society considers that, first and foremost, connected transactions and directors' dealings should be given statutory backing because these two areas are of most concern to minority shareholders and the public interest.

Members on the Society's Expert Panel on Listing, who are mainly from the corporate finance sector, believe that other listing requirements are either covered by the "dual filing" system under the SFO, which allows the SFC to invoke its investigative powers in cases of intentional or reckless disclosure of false or misleading information, or they may not be suitable to be made statutory.

However, we also take the point that while dual filing would enable the SFC to take action in the event of significant irregularities in disclosure, it would not enable the SFC to act in the case of a total failure to file information.

In addition to the two areas referred to above, therefore, given also the importance of information disclosure, members of our CGC are of the view that the principal disclosure requirements in the Listing Rules, as outlined in paragraph 2.34 of the Paper, should also be given statutory backing. This includes disclosures in financial statements and the management discussion and analysis; in relation to price sensitive or material events and information; and disclosures in prospectuses and other listing documents.

(3) How should statutory backing be achieved?

The Society believes that statutory backing would best be achieved through a combination of all the available channels, comprising a mixture of primary legislation, subsidiary legislation, non-statutory codes and guidelines.

(4) What sanctions should be introduced for breaches of statutory listing requirements?

The Society considers that a mixture of both civil and criminal sanctions should be provided for, similar to the arrangements pertaining to the market misconduct regime under the SFO, which provides for a dual regime, i.e. parallel civil and criminal regimes, to deter market misconduct. However, no person should be subject to double jeopardy under a dual civil and criminal regime in the enforcement of statutory listing requirements. In addition, a right of appeal to the Court should always be available, as should the possibility of judicial review.

As to the types and levels of any civil and criminal sanctions for breaches of statutory listing requirements, the Society considers that further details of possible options should first be put forward to allow a more informed consultation to take place.

We hope that you find our comments to be helpful. If you have any questions on our submission or wish to discuss it further, please contact Peter Tisman, Technical Director (Business Members and Specialist Practices) at the Society on 2287 7084 in the first instance.

Yours faithfully,

WINNIE C.W. CHEUNG
CHIEF EXECUTIVE & REGISTRAR

WCC/PMT/cy