IFPHK’s Response to the Join Consultation Paper on Proposed Enhancements to The Stock Exchange of Hong Kong Limited’s Decision-making and Governance Structure for Listing Regulation Issued by the Securities and Futures Commission and the Stock Exchange of Hong Kong Limited

September 2016

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IFPHK's Profile

Background

The Institute of Financial Planners of Hong Kong ("IFPHK") was established in June 2000 as a non-profit organization for the fast-growing financial industry. It aims to be recognized in the region as the premier professional body representing those financial planners that uphold the highest standards for the benefit of the public.

The IFPHK is the sole licensing body in Hong Kong authorized by Financial Planning Standards Board Limited to grant the much-coveted and internationally-recognized CFP^{CM} Certification and AFP^{TM} Certification to qualified financial planning professionals in Hong Kong and Macau.

It represents more than 6,800 financial planning practitioners in Hong Kong from such diverse professional backgrounds as banking, insurance, independent financial advisory, stockbroking, accounting, and legal services.

Currently there are more than 147,000 CFP certificants in 25 countries/regions; the majority of these professionals are in the U.S., Canada, China, Australia and Japan, with more than 4,800 CFP certificants in Hong Kong.

CFP^{CM}, CERTIFIED FINANCIAL PLANNER^{CM}, CFP^{CM}, CERTIFIED FINANCIAL PLANNER™, AFP^{TM}, ASSOCIATE FINANCIAL PLANNER^{TM}, AFP and ASSOCIATE FINANCIAL PLANNER® are certification marks and/or trademarks owned outside the U.S. by Financial Planning Standards Board Ltd. The Institute of Financial Planners of Hong Kong is the marks licensing authority for the CFP marks and AFP marks in Hong Kong and Macau, through agreement with FPSB.

IFPHK's interest in this consultation

The mission and vision of the IFPHK is to promote the importance of financial planning[1]. The IFPHK is the sole licensing body in Hong Kong authorized by the FPSB to grant the internationally recognized CFP^{CM} Certification and AFP^{TM} Certification to qualified financial planning professionals in Hong Kong and Macau.

Since the IFPHK is the leading professional body for the welfare of the financial planning industry, we have been active in responding to policy changes that will affect the industry or the financial system as a whole. In 2009, we provided our comments to the proposal to enhance the protection of the investing public. The proposal was put forward by the SFC as a result of the aftermath of the Lehman Brothers Minibond Saga. In 2010, the IFPHK submitted a response to the consultation paper on the proposed establishment of an Investor Education Council and a Financial Dispute Resolution Centre. In 2014, we responded to the Consultation Document on having an effective resolution regime in Hong Kong. Last year, we provided comments on Hong Kong's Financial Competency Framework and Hong Kong's Strategy for Financial Literacy. The

[1] www.fpsb.org. Financial planning refers to the process of setting, planning, achieving and reviewing life goals through the proper management of finances.

list of the IFPHK's responses to the various consultation papers can be found on our website (http://www.ifphk.org/ee/importance-of-advocacy).

In light of the above, the IFPHK has a vested interest in the Consultation Paper and wishes to express its views on the proposed changes.

<u>IFPHK's representation</u>

The IFPHK was founded by 30 members (the "Founding Members") in order to raise the standards of financial planners and highlight the importance of sound financial planning advice.

The IFPHK currently has 47 Corporate Members including banks, independent financial advisors, insurance companies, and securities brokerages. With its Corporate Members providing a full spectrum of client services and products, the IFPHK is well positioned to understand the needs, concerns and aspirations of the financial planning community.

Executive Summary

On 22 June 2016, the Securities and Futures Commission ("SFC") and the Hong Kong Stock Exchange ("Stock Exchange" or "HKEx") jointly published a consultation paper on the proposed revamp of the regulatory structure for making decisions in listing-related matters (the "Consultation Paper"). Under the Proposals, the listing function will remain within the Stock Exchange, and the Listing Committee and Listing Department will continue to decide on the majority of IPO applications and post-IPO matters. Two committees will be established – the Listing Policy Committee and the Listing Regulatory Committee. These two committees, on which the SFC and the Stock Exchange will be equally represented, will decide listing policy and policy-related listing matters with advice from the Listing Committee.

Although financial planners are not directly affected by the proposed resolution regime, publicly listed securities are one of the major investment vehicles in a financial plan. Thus, the IFPHK would like to provide general comments on the proposals of the Consultation Paper.

The IFPHK's submission is based upon the following principles that we consider important for the capital market and the financial system as a whole:

- **Aligning with international best practice**
  Globalization and financial market integration have increased rapidly in the past decade. As an international financial centre, Hong Kong is not immune from international financial market and regulatory development. As Ashley Alder, CEO of the Securities and Futures Commission ("SFC"), said in the 3rd Pan-Asian Regulatory Summit: "Because Hong Kong is a host city to international investors and companies, things that happen outside our borders really matter and that's why we have to be involved to shape the agenda"[2]. For many years, major stock markets have moved the responsibility for listing matters entirely to the securities regulator, as we have seen with the Securities and Exchange Commission in the US and the UK Listing Authority in the UK. The Stock Exchanges of Hong Kong and Singapore have dual roles as profit-making companies and regulators of listed companies. Both cities have put forward a reform plan at a similar time to address the conflicts of interest.

- **Assuring the quality of listed companies**
  The IFPHK regards that Hong Kong's position as a key IPO destination is reliant on the quality of its listed companies rather than on the amount of funds raised or the number of new listings. The heightened concern over the deteriorating quality of listed companies appears to have pushed the SFC to review and reform the listing process, and take a more proactive role in regulating IPO applications and listed companies.

- **Enhancing investor protection**
  As financial products get more complex and sophisticated, it is of utmost importance that investors/consumers are provided with proper and adequate protection under a sound and effective regulatory system. The IFPHK supports a regulatory system that would facilitate delivering better financial products and services to the benefit of the investing public, as well

[2] The 3rd Pan-Asian Regulatory Summit was hosted by Thomson Reuters Accelus on 27 & 28 November 2012.

as protecting them. Hence, the effectiveness of consumer protection and a healthy balance of robust regulations and market development were the areas of focus for the IFPHK.

- **Enhancing retail investor engagement**
  The London Stock Exchange has established an independent body consisting of representatives from the regulator, professionals and the investing public to vet IPO applications. The engagement of retail investors in Hong Kong is almost nonexistent. Retail investors hardly ever vote, despite the advances of technology and the emergence of online brokers. To keep abreast with the demand for enhanced corporate governance standards, the Government and regulators should consider increasing the engagement of retail investors in the listing process.

Since its publication, the industry has been split on the Consultation Paper. Many have criticized that the proposals give the SFC excessive power. The IFPHK conforms to the views of the SFC that the SFO has already given the SFC power to regulate the capital market. At present, the SFC can reject new listings or listing policies. The proposal is an attempt to address the conflicts of interest of the Stock Exchange as both a listed company and a frontline regulator of listed companies. Whilst we agree that the proposals match with the abovementioned principles and consider it a step in the right direction, the proposed reform on the whole involves no major change and is far from revolutionary.

Hence, the IFPHK thinks that Hong Kong is behind the curve in aligning with international best practice. Even the Singapore Stock Exchange has taken a further step by establishing a separate subsidiary company to undertake all the frontline regulatory functions it currently performs. The IFPHK thus suggests the following for the consideration of the SFC and the Stock Exchange in the long run:

- A complete segregation of the exchange's regulatory functions from its commercial and operating activities is needed so as to align with international best practice.

- The SFC should retain the function of reviewing every listing application in order to be a gatekeeper of the capital market.

- There should be increased involvement of retail investors on the Board of the HKEx and the management committees.

The SFC & Stock Exchange Consultation

On 22 June 2016, the Securities and Futures Commission ("SFC") and the Hong Kong Stock Exchange ("Stock Exchange" or "HKEx") jointly published a consultation paper on the proposed revamp of the regulatory structure for making decisions in listing-related matters (the "Consultation Paper"). Under the Proposals, the listing function will remain within the Stock Exchange, and the Listing Committee and Listing Department will continue to decide on the majority of IPO applications and post-IPO matters. Two committees will be established – the Listing Policy Committee and the Listing Regulatory Committee. These two committees, on which the SFC and the Stock Exchange will be equally represented, will decide listing policy and policy-related listing matters with advice from the Listing Committee.

The Listing Policy Committee will be responsible for the listing policy. The aim of this committee is to facilitate coordination and collaboration between the regulators to enable effective joint development of the listing policy in response to market developments. The Listing Regulatory Committee will be responsible for making decisions and providing guidance on listing applications and on matters relating to listed companies where: (i) there are issues as to suitability; (ii) there are novel, potentially controversial or sensitive aspects; (iii) there may be policy implications; and (iv) where the decision is intended to have a general effect. The Listing Regulatory Committee will also replace the Listing (Review) Committee to review decisions of the Listing Committee. The Listing Regulatory (Review) Committee will replace the existing Listing Appeals Committee[3].

The Listing Department and Listing Committee will still handle most of the routine IPO applications. Only about 10%, those with policy implications, will be handled by the new Committees. The composition of the Listing Committee will remain largely unchanged, except that the HKEx's Chief Executive will no longer be a member.

The Consultation Paper contains 48 pages and has sought comments from the public on the proposals in the following areas:

(a) Policy development
(b) Listing applications by new applicants
(c) Matters involving listed issuers
(d) Reviews of listing decisions
(e) Disciplinary matters
(f) Oversight of the listing function
(g) Publication of decisions
(h) Composition and procedures of the Listing Policy Committee
(i) Composition and procedures of the Listing Regulatory Committee
(j) Composition and procedures of the Listing Regulatory (Review) Committee
(k) Composition and procedures of the Listing (Disciplinary) Committee, the Listing (Disciplinary Review) Committee and the Listing Disciplinary Chairperson Group
(l) Other matters

[3] "Proposed revamp of Hong Kong's regulatory structure for decision making in listing related matters", Herbert Smith Freehills LLP, 22 June 2016

IFPHK's Submission

At present, the Stock Exchange and the Listing Committee approve new listings and set policies, while the SFC grants approval during the final stage. Since it listed in 2000, the Stock Exchange has had a dual role as a profit-making listed company and a frontline regulator. To address the resulting conflicts of interest, two new committees will be established under the proposals in the Consultation Paper – the Listing Policy Committee and the Listing Regulatory Committee. The SFC and the Stock Exchange are equally represented in these two new committees. The aim of establishing the Listing Policy Committee is to facilitate coordination and collaboration between the regulators to enable effective joint development of listing policy in response to market developments. The Listing Regulatory Committee, meanwhile, is responsible for making decisions and providing guidance on listing applications that have policy concerns. There is no major change to the existing Listing Committee, except that the HKEx's Chief Executive will no longer be a member.

In addition, the Listing Regulatory (Review) Committee will replace the existing Listing Appeals Committee as the final review body within the Stock Exchange. The Consultation Paper also includes enhancements to the regime for conducing disciplinary proceedings. A Listing Disciplinary Chairperson Group has been proposed, comprising at least five such persons who will chair the disciplinary hearings. In the first instance, the Listing (Disciplinary) Committee will determine whether a person has breached the Listing Rules and, if so, deliver the appropriate sanction. Any appeals can be made to the Listing (Disciplinary Review) Committee.

Since its publication in June, the proposed reforms to the governance structure of the Listing Regime have been hotly debated by the industry. There are bi-polar views towards the proposed changes. Some industry practitioners and listed-company directors have criticized the proposals for giving the SFC extensive power. They worry that the SFC may over-regulate and kill off the IPO market as a result. Others have even said that raising the listing threshold may put Hong Kong's reputation as a financial hub in jeopardy. SFC Chief Executive Ashley Alder has openly rejected criticism of the proposals. He has said that the SFC already has the authority to reject new listing or listing policies, thus the proposed changes are not aimed at extending the power of the SFC. Alder has also said that the reforms are aimed at creating an efficient, focused and publicly accountable one-stop shop to quickly get on top of and pursue complex listing policy options, so as to set the right conditions for a flourishing, competitive and healthy market. Alder has further said that the two new committees with smaller memberships – one will have six members and the other eight – could work more effectively to resolve complex listing matters. Moreover, he has reservations about suggestions that Hong Kong should widen the door to allow more new listings and let the SFC handle enforcement in problematic cases. Enforcement is an SFC priority, but no enforcement system in the world is able to right all wrongs and compensate all investor losses[4].

IFPHK's Principles

The IFPHK's submission to this Consultation Paper is based upon several principles that we consider important for the health of the financial system and the capital market in general:

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[4] Enoch Yiu, "Turf war over Hong Kong's stock market regulation: watchdog chief attacks critics of reform", 5 August 2016, South China Morning Post

Aligning with international best practice

Globalization and financial market integration have increased rapidly in the past decade. As an international financial centre, Hong Kong is not immune from international financial market and regulatory development. As Ashley Alder, CEO of the Securities and Futures Commission ("SFC"), said in the 3rd Pan-Asian Regulatory Summit: "Because Hong Kong is a host city to international investors and companies, things that happen outside our borders really matter and that's why we have to be involved to shape the agenda"[5].

For many years, major stock markets have moved the responsibility for listing matters entirely to the securities regulator, as we have seen with the Securities and Exchange Commission in the US and the UK Listing Authority in the UK. The London Stock Exchange was stripped of the power to grant listing approvals in 2000, with the Financial Service Authority, an independent non-governmental body (later Financial Conduct Authority, or "FCA"), taking up the role. The FCA, acting as the competent authority for listing, is referred to as the UK Listing Authority ("UKLA"). The UKLA monitors market disclosures, reviews and approves prospectuses, and operates the UK listing regime. In the US, IPOs are regulated by the United States Securities and Exchange Commission under the Securities Act of 1933. The New York Stock Exchange has a not-for-profit subsidiary responsible for the surveillance, investigation and enforcement of listed companies and listing applications.

Since 2003, proposals have been made to follow international best practice by moving the listing function of the Stock Exchange to the SFC, but the proposals have failed. Thus, the Stock Exchange's dual role as a profit-making company and a regulator of listed companies continues. As a regulator, the Stock Exchange can reprimand, suspend or delist companies that breach the rules, compel companies to take specific remedial actions, censure directors, and revoke trading and listing authorizations.

Similar to Hong Kong, Singapore's local exchange, SGX, act as a frontline regulator, meaning that it polices the same companies that provide its revenue and shareholder dividends. In July, a little while after the publication of the Consultation Paper, the SGX announced that it will establish a separate subsidiary company to undertake all the frontline regulatory functions it currently performs. This new company will be governed by a board of directors who are separate from those of the SGX. Its chairman and a majority of its directors will also be independent of the SFX and its regulated subsidiaries. The SGX's move echoes the arrangement at the New York Stock Exchange, where a not-for-profit subsidiary is responsible for surveillance, investigation and enforcement. Tan Boon Gin, Chief Regulatory Officer of the SGX, will head the new unit.[6]

Assuring the quality of listed companies

In the past two decades, the unacceptably large proportion of newly listed companies that have later been deemed unfit for public listing reflect the shortcomings of the current voluntary-disclosure system in protecting investors' interests[7]. In 2010, the Chief Executive of China Forestry was arrested. The SFC asked the court to freeze about HK$400 million of his assets as potential reparation to investors. Another company, Chinese fabric maker Hontex, was accused

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[5] The 3rd Pan-Asian Regulatory Summit was hosted by Thomson Reuters Accelus on 27 & 28 November 2012.

[6] Jeevan Vasagar, "Singapore exchange overhauls governance after trading outage", Financial Times, 18 July 2016

[7] Peter Liang, "Opinion: IPO reform – stockbrokers need to look at both sides of the coin, China Daily, 3 August 2016

by the SFC of issuing a prospectus containing false and misleading information. Hontex agreed in June 2012 to repay more than HK$1 billion to investors. In 2015, China Metals Recycling Holdings' seven-year-old listing was cancelled by the Stock Exchange. According to the HKEx, the company obtained its initial listing by fraud and so was no longer suitable for listing[8]. In view of the seriousness of the IPO fraud, the SFC immediately reformed the IPO sponsor regime.

Hong Kong's position as a key IPO destination does not lie with the amount of funds raised or the number of new listings. Rather, the sustainable growth of the local stock market is reliant on the quality of listed companies. Heightened concerns over growing IPO fraud and the deteriorating quality of listed companies appear to have pushed the SFC to review and reform the listing process, and take a more proactive role in regulating IPO applications and listed companies.

The IFPHK agrees with what SFC Chairman Carlson Tong has said with regard to this: basically, that the major priority for the SFC is to take on broader, more proactive oversight of listed companies as a corporate regulator. By actively detecting misconduct and following up on suspicious activity, the SFC hopes to identify red flags and enhance its role in maintaining quality markets and high corporate governance standards, as well as protecting investors.[9]

Enhancing investor protection

As financial products get more complex and sophisticated, it is of utmost importance that investors/consumers are provided with proper and adequate protection under a sound and effective regulatory system. The IFPHK supports a regulatory system that would facilitate delivering better financial products and services to the benefit of the investing public, as well as protecting them. The IFPHK thinks that many overseas companies are seeking a listing in Hong Kong to tap into the market for long-term institutional investment funds. To attract these companies, Hong Kong must maintain a transparent and well-regulated market. Hence, the effectiveness of consumer protection and a healthy balance of robust regulations and market development are our areas of focus.

Whilst the Stock Exchange has a statutory duty to act in the interest of the investing public, the HKEx is a listed company and polices the same companies that provide its revenue and shareholder dividends. Such a dual role is not ideal and gives rise to conflicts of interest.

Some observers have said that there are adequate checks and balances within the Stock Exchange to avoid conflicts of interest. However, with increasing demand for better corporate governance, the IFPHK thinks that criticism of the Stock Exchange for putting too much emphasis on advancing the interests of its shareholders and members as a publicly listed company and too little on fulfilling its fiduciary duty to the public as a monopoly[10] is inevitable and continuously growing. To better protect retail investors, measures should be taken to address the conflicting roles of the Stock Exchange.

Enhancing retail investor engagement

The London Stock Exchange has established an independent body consisting of representatives from the regulator, professionals and the investing public to vet IPO applications. The

[8] Peter Guy, "Mainland Chinese define fraud differently, and Hong Kong regulators should wake up", SCMP, 14 January 2016
[9] Lianna Brinded, "Hong Kong Cracks Down on Accounting Scandals with Corporate Fraud Taskforce", 20 December 2013, ibtimes
[10] Peter Liang, "Opinion: IPO reform – stockbrokers need to look at both sides of the coin", 3 August 2016, China Daily

engagement of retail investors in Hong Kong, however, is almost nonexistent. Retail investors hardly ever vote, despite the advances of technology and emergence of online brokers. The Board of the Stock Exchange is effectively dominated by the Hong Kong Government. It appoints 6 of the Board's 13 directors, and also includes the Stock Exchange's CEO as an ex-officio member.[11] To keep abreast with the demand for enhanced corporate governance standards, the Government and regulator should consider increasing the engagement of retail investors in the listing process.

IFPHK's Comments on the Proposals

The IFPHK regards that the proposed changes match with our abovementioned principles. We also view the suggestion that Hong Kong should widen the door to allow more new listings and let the SFC handle enforcement in problematic cases as irresponsible. A few rotten deals could affect the pricing and public perception of all listings in Hong Kong, and threaten Hong Kong's attraction for foreign companies[12]. As a securities market independent regulator, the IFPHK agrees that the SFC should act as a gatekeeper. In effect, the SFO has already given the SFC the power, the proposed changes just change the way the SFC will be able to exercise and perform those powers. As such, the IFPHK regards the proposed reforms as far from revolutionary. We consider them to be minor and proposed so as to streamline the decision-making process of listing policy. The impact on the whole listing process and the quality of listed companies are not substantial.

Hong Kong is behind the curve in terms of aligning with the international best practice of having an independent regulator to vet listing applications and regulate listed companies. Singapore put forward a more advanced reform in July, when the SGX announced that it will spin off its regulatory functions into an independently governed subsidiary.

In addition to the above general comments, the IFPHK has specific comments on the following areas:

Policy development

Under the new proposals, the Listing Policy Committee will be responsible for listing policy. Its role will include initiating policy proposals. It will also replace the function of the Listing Committee in terms of overseeing the Listing Department. Other matters may also be referred to the Listing Policy Committee by the Listing Regulatory Committee, Listing Committee, Listing (Disciplinary Review) Committee or the Head of Listing.

Though the proposed reforms try to address the conflicts of interest of the Stock Exchange, the IFPHK is not sure these alone can significantly improve the quality of listed companies. Hence, the IFPHK thinks in the long run that a complete segregation of the exchange's regulatory functions from its commercial and operating activities is needed so as to align with international best practice.

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[11] Philippe Espinasse Global Capital, "Small steps on a long journey", 20 July 2016, Asia Money
[12] Heda Bayron, "All that glitters – fraudulent IPOs threaten to stain the Hong Kong market's reputation as the goose that lays the golden eggs", HKICPA, April 2011

Listing applications by new applicants

At present, the Stock Exchange and a committee approve new listings and set policies, while the SFC grants approvals during the final stage. Under the new proposals, the functions of the Listing Department and the Listing Committee will remain largely unchanged. On the other hand, with the setup of the new committees, the SFC will no longer look at every single IPO application but only focus on cases that have larger policy and market implications. It is estimated that only about 10% of all listing applications under the proposed reforms would be handled by the newly setup listing regulatory committee.

The IFPHK disagrees with the view that the SFC is raising the bar by only concentrating on listing applications with controversial policy issues. With most advanced markets having an independent regulator overseeing the listing regime and vetting each listing application, the IFPHK thinks that it only makes sense for the SFC to continue to vet every single application.

Composition of the Committees

The Board of the Stock Exchange is effectively dominated by the Hong Kong Government. It appoints 6 of the Board's 13 directors, and also includes the Chief Executive of the HKEx as an ex-officio member.[13] Also, the Listing Committee does not include representatives from the investing public and is dominated by professionals from the investment, legal and accounting sectors. Apart from this lack of diversity, these professionals may also have potential conflicts of interest.

The proposed reforms neither address this lack of diversity nor enhance measures to address the potential conflicts of interest of the members of the Listing Committee. The proposed composition of the new committees also does not engage retail investors as representatives. Thus, the IFPHK suggests inviting investor-protection advocates and/or representatives from the Consumer Council onto the Board of the HKEx and the management committees.

[13] Philippe Espinasse Global Capital, "Small steps on a long journey", 20 July 2016, Asia Money