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## **CHAPTER 5**

# **PROCEDURES FOR THE PREPARATION AND RELEASE OF LISTING RULES AND AMENDMENT THERETO BY THE HKEX**

### **INTRODUCTION**

5.1 This chapter describes the existing procedures for the preparation and release of new or amended Listing Rules of the HKEx.

### **LISTING**

5.2 Listing is the process whereby a security of a public company is admitted for trade on an exchange. For the Hong Kong Exchange, the listing process is regulated by the “Rules Governing the Listing of Securities (the Listing Rules)”<sup>39</sup>. The Listing Rules set out, among other things:-

- (a) the qualifications that must be met in order to obtain a listing;
- (b) the continuing obligations public companies have to comply with as a condition for the listing of their securities; and
- (c) sanctions against non-compliance, including suspension and cancellation of listing.

### **AUTHORITY FOR MAKING OR AMENDING LISTING RULES**

#### **Transfer of Authority from the SFC to the Exchange and from the HKEx Board to the Listing Committee**

5.3 Until the end of 1991, both the SFC and the Stock Exchange of Hong Kong (SEHK) were responsible for overseeing the listing of securities. To avoid duplication between the SFC and the SEHK, the SFC transferred

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<sup>39</sup> Further rules and ordinances regulating the initial listing and continued listing of securities on the Hong Kong Exchange are found in the Securities (Stock Exchange Listing) Rules and the Companies Ordinance(Cap. 32).

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its listing functions to the SEHK in 1991, subject to systematic checks and balances within the SEHK. The SEHK became the so-called front-line regulator of the listing process in Hong Kong. The arrangements are contained in the Memorandum of Understanding (MOU) Governing Listing Matters between the SFC and the SEHK first signed in 1991 which was overtaken by the Amended and Restated MOU in March 2000 following the merger and listing of the HKEx.

5.4 Within the HKEx, the HKEx Board has delegated to the Listing Committee<sup>40</sup> its functions and powers in relation to listing matters over which it does not exercise any concurrent jurisdiction. The Listing Committee is thus the constituted authority on all matters related to listing, including the approval of consultation papers, and thereafter, the endorsement of any new and amended Listing Rules before they go for final approval of the HKEx's Executive Committee, the Board of the SEHK and then lastly, the SFC. The Listing Division<sup>41</sup>, which forms part of the executive structure of the HKEx, underpins and supports the Listing Committee in discharging its functions.

5.5 While the SFC has the ultimate authority over the final promulgation of any listing rule, which would likely have been formulated by the HKEx after consultation with the market, the MOU contains no provision which mandates the SFC's approval over the HKEx's consultation papers before they are allowed to be published. In practice, the SFC and the HKEx work closely on proposals once these have been fashioned, even at the general principle stage, by the HKEx.

## **PROCEDURES FOR AMENDMENTS TO THE LISTING RULES**

### **Four Stages**

5.6 The procedures adopted by the Exchange for the preparation and release of new and amended Listing Rules have been in place since 1991. The detailed procedures are set out in the following paragraphs. Broadly speaking, the process can be divided into four stages: initiation, preparation and release of proposals, market consultation and, lastly, approval.

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<sup>40</sup> Please also refer to paragraphs 4.9 to 4.11.

<sup>41</sup> The Listing Division is one of the three divisions in the Listing, Regulations and Risk Management Unit. See paragraph 4.7 and **Annex 4.7**.

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## **Initiation**

5.7 The HKEx initiates action on changes to the Listing Rules under the following circumstances:-

- (a) Where there are market comments and feedback, whether by direct representation to the HKEx or through views expressed in the media, that the Listing Rules need to be amended in the light of market developments, the Listing Division of the HKEx will consider whether amendments are necessary.
- (b) The HKEx monitors developments in other leading security markets and considers whether its own rules need to be amended in the light of current international trends.
- (c) In the course of administering the Listing Rules, executives of the Listing Division identify areas which need to be amended to clarify grey areas and to remove loopholes.
- (d) When the SFC points to the need for specific rule amendments, the HKEx has to consider and follow up.

5.8 The HKEx adopts different approaches in preparing amendments to the Listing Rules depending on the importance of the proposals. For significant changes, the HKEx issues a formal consultation paper to seek market views on the proposed amendments. For less significant changes, the HKEx publishes a paid announcement of the proposed changes in the press and invite comments on such proposed changes. For insignificant changes such as administrative matters, no formal consultation is made. The HKEx informs the market of the changes when they are implemented also by way of paid announcements in the press. These are usually not matters of substance. They may involve drafting or other minor clarification.

5.9 Since the merger in early 2000, the HKEx has made 33 amendments to the Listing Rules. A breakdown is provided below:-

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<b>Types of Amendments</b>	<b>Number</b>
Significant Changes with consultation papers	8
Less significant changes with paid announcements, inviting comments on proposed changes	2
Insignificant changes with paid announcements upon implementation	23

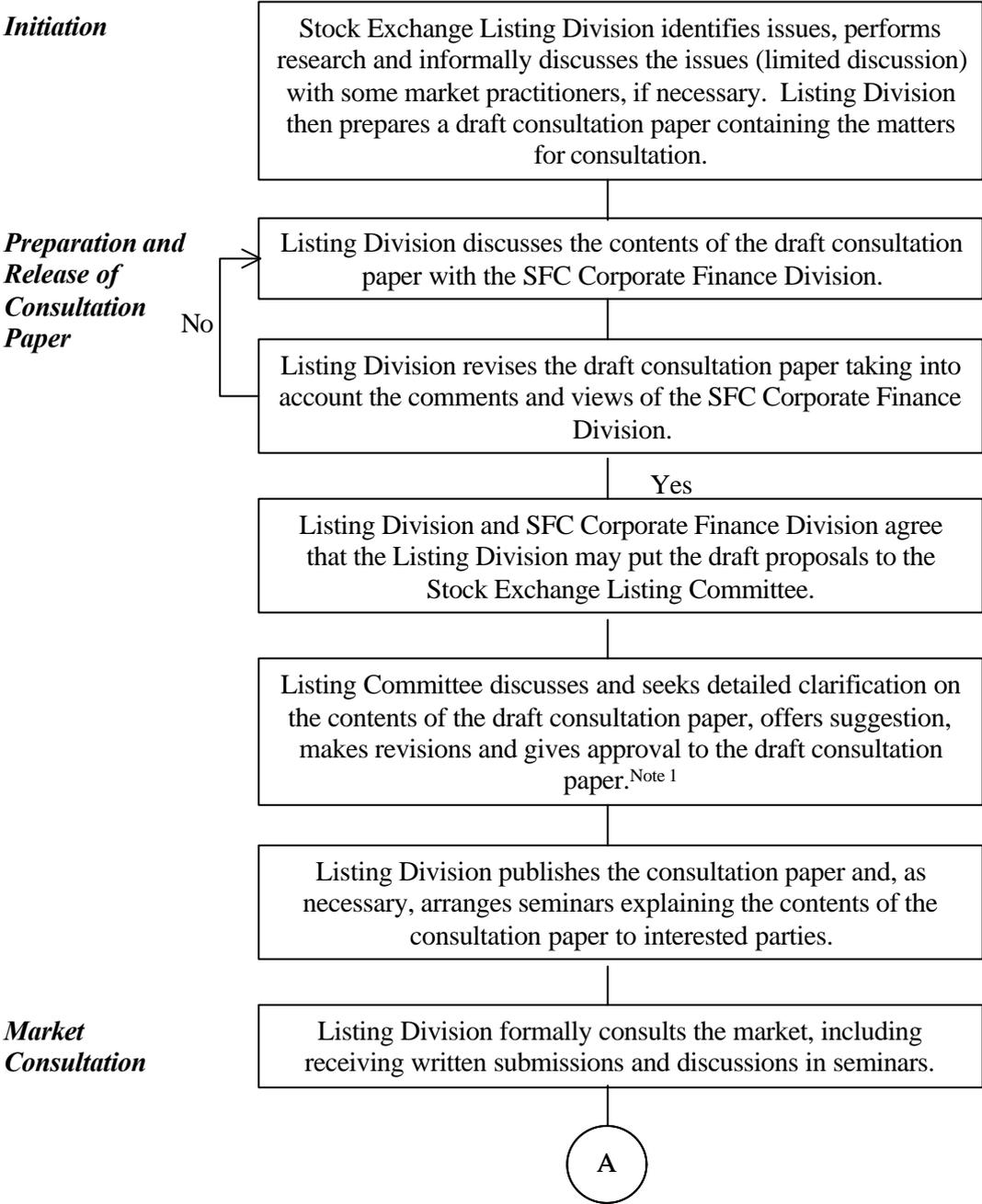
### **Preparation and Release of Consultation Papers**

5.10 For significant changes which would be the subject of a consultation paper, the Listing Division follows the procedures as illustrated in the Flow Chart in **Figure 5.1**. First, the Listing Division formulates detailed proposals after analyzing the issues, studies the relevant listing rules of other major markets, prepares any relevant statistics to assess the impact of the proposals, and notes any relevant market comments in the media. Where necessary, the Listing Division seeks independent views, especially on technical issues.

5.11 Under the MOU between the SEHK and the SFC, the HKEx need not consult the SFC on draft consultation papers before releasing them to the public. However, as a matter of practice, the Listing Division prepares discussion papers and seeks comments from the Corporate Finance Division of the SFC. The Listing Division revises these papers taking into account the views of the SFC. Depending on the significance of the matters to be consulted, the Listing Division may arrange meetings with the SFC to discuss the contents of draft papers. The review and revision process tends to continue until the SFC indicates that it has no further comments or that it agrees with the contents of the draft paper.

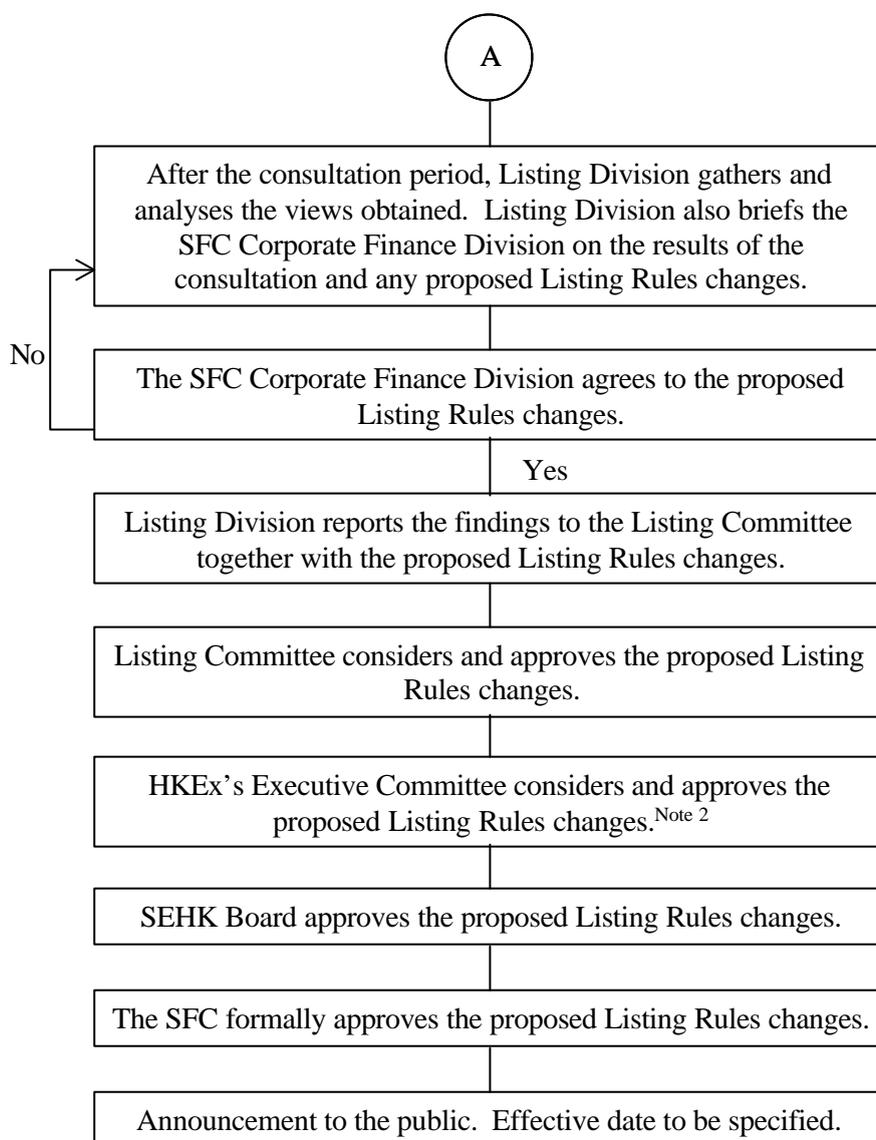
Figure 5.1

**Flowchart for Issuing Consultation Papers and Approving Proposed Listing Rules Changes**



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*Approval*



Note 1 : Listing Committee comprises members from exchange participants, listed company representatives or market practitioners. Listing Rule 2A.01 states that, inter alia, SEHK Board has arranged for all of its powers and functions in respect of all listing matters to be discharged by the Listing Committee.

Note 2 : Since the merger of the exchanges and the clearing houses, any Listing Rules changes have to be approved by HKEx's Executive Committee prior to their approval by SEHK Board.

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5.12 While the SFC and the HKEx do not necessarily agree on all issues even after prolonged discussion, it is usual, in practice, for some compromise solution to be worked out, especially since the proposals go for public consultation anyway. The parties tend to be pragmatic about this and some acceptable formulation is usually arrived at for the proposals to go forward.

5.13 After consultation with the Corporate Finance Division of the SFC, the Listing Division finalizes the paper and circulates it to all Listing Committee members for discussion. The Listing Committee meets almost every Thursday. In general, the Listing Division dispatches the agenda and papers to members of the Listing Committee on Monday afternoons or Tuesday mornings for the Thursday meeting. For policy matters including consultation papers, the Listing Division normally dispatches the papers the week before, so that committee members will have at least a weekend to review the relevant papers.

5.14 Listing Committee members' views and suggestions are incorporated in the consultation paper before issue. Where the Listing Committee has made significant changes to the proposals, such changes are usually communicated to the SFC before they are incorporated into the consultation paper, which the Listing Division then arranges for publication.

5.15 The Listing Committee is regarded as the final authority for the approval and release of consultation papers on listing matters. Without its approval, no proposal can go for consultation.

### **Market Consultation**

5.16 The duration of consultations varies. It has ranged from three weeks to three months<sup>42</sup>. As a general practice, the HKEx announces the release of the consultation paper in a press release or a press briefing. The HKEx's publicity arrangements depend on the significance of the

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<sup>42</sup> The consultation period for the Paper on corporate governance was originally three months but was subsequently extended to four months.

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proposal. For major proposals, such as the Consultation Paper on Proposed Amendments to the Listing Rules relating to Corporate Governance in January 2002, after its release, the HKEx held three seminars (in English, Putonghua and Cantonese) for listed issuers with about 560 attendees. The HKEx also gave nine presentations at meetings with professional bodies to discuss the proposals and hosted nine luncheon meetings with 54 representatives from listed issuers. The HKEx also provided a telephone enquiry service for those interested parties who might have queries on the contents of the consultation paper. The HKEx received 503 responses to the Consultation Paper on Corporate Governance. Of these 503 responses, 110 were from listed issuers, 12 were from trade or professional associations and the remainder from market practitioners and the investing public.

### **Approval**

5.17 After the consultation period, the Listing Division gathers and analyzes the views obtained and, if necessary, revises the proposed amendments. The revised amendments go through the following five steps before obtaining final approval:-

- (a) The Listing Division discusses the proposed amendments with the Corporate Finance Division of the SFC. The discussion continues until the SFC indicates that it has no further comments and is in agreement with the proposed amendments.
- (b) The Listing Division then reports the findings, together with the revised proposed amendments, to the Listing Committee for approval.
- (c) The Listing Division next submits the proposed amendments approved by the Listing Committee to the HKEx's Executive Committee for authorization. (The Executive Committee comprises four HKEx Non-Executive Directors and the Chief Executive of the HKEx.)
- (d) After authorization, the proposed amendments go to the SEHK Board for final approval within the HKEx. (The SEHK Board comprises only the executives of the HKEx. See **Annex 4.8.**)

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- (e) The SFC is then asked to approve the new and amended Listing Rules.

5.18 After approval, the HKEx issues a paid announcement setting out brief details of the amended rules and informing the market of the effective date of such rules. Depending on the complexity of the subject matter, the whole amendment process may take many months. In certain instances, the HKEx also allows a reasonable transitional period for listing companies to comply with the new rules.

## **OBSERVATIONS**

### **No Pre-consultation Sounding Exercise by the HKEx**

5.19 Whilst the HKEx takes into account market views in initiating changes to the Listing Rules, it has been its standard practice not to sound out different segments of the market on the details of its proposed changes before public consultation. The HKEx's four main concerns are as follows:-

- (a) Sounding out prior to public consultation would result in the uneven dissemination of information, leading to certain segments acquiring knowledge of some of the issues before the market in general.
- (b) Any proposed amendments should be considered in their proper contexts with detailed analysis and arguments. Informal sounding out of segments of the market on detailed rule changes without a properly formulated consultation paper may lead to misunderstanding and hence less reliable feedback.
- (c) Prior consultation may result in pre-consultation lobbying and unnecessary pressure being exerted on the SFC or members of the Listing Committee, seeking to influence the content of any consultation proposals.
- (d) A formal consultation paper should be taken as only the beginning of a market wide consultation with detailed proposals on specific amendments.

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## **Involvement of the Listing Committee**

5.20 Whilst the Listing Committee is the authority for approving the issue of consultation papers on listing matters and the main gatekeeper for amendments to the Listing Rules, it is noted that:-

- (a) The Listing Committee is not involved until the draft consultation paper is almost finalized for consultation. In other words, the Listing Committee is not normally involved in earlier debates or discussion on the underlying philosophy, objectives and principles to be covered in the consultation paper.
- (b) Members of the Listing Committee, who are usually busy commercial people, and working on a voluntary basis, have only a few days to read the agenda and papers. Even for consultation papers containing detailed proposals with far-reaching implications, such as the one under consideration, members are accorded no more than a week or so to examine the proposals.
- (c) In some instances, and the current one is an example, consultation papers are not accompanied by detailed statistical data or impact analyses conducted by the Listing Division to facilitate the consideration by the Listing Committee, even though they are available and would have been produced if asked at the actual meeting when the paper is being considered.
- (d) There may be differences of perception and expectation of staff of the HKEx and those of the Listing Committee regarding the role of the latter. The terms of reference for the Listing Committee are expressed in very general terms<sup>43</sup>. The Listing Committee perceives its role as “technical” in nature. Even for policy matters, the role is seen as one of improving the Listing Rules in terms of their practicability and workability. Members of the Listing Committee do not consider that their role is to determine market reaction unless they are specifically asked and they were not on this occasion. On the other hand,

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<sup>43</sup> See [Annex 4.9](#).

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the HKEx staff appear to expect the Listing Committee to advise on all issues which may arise of any of the proposals, including technical issues and market impact, even if the latter has not been raised as an issue for consideration. The Listing Committee, all conscientious people, will consider any issue flagged for their attention as well as any other matters which occur to them. By the time of their involvement, however, it is usually considered too late to make radical changes or to question underlying assumptions meaningfully. (See further paragraphs 7.45(d), 11.51 to 11.55.)

- (e) At present, the Chief Executive of the HKEx is the only bridge between the Board and the Listing Committee. The Listing Committee operates independently, and has no ready access, as such, to the pool of expertise on the HKEx Board except through the Chief Executive.

5.21 In view of these considerations, there are questions over whether the existing structure, roles and operation of the Listing Committee needs to be fine-tuned so that it can fully perform its role as the body on the HKEx with final responsibility over listing matters.

### **Role of the SFC**

5.22 As shown in **Figure 5.1**, the procedures involve the interaction of the HKEx and the SFC, particularly between the Listing Division of the HKEx and the Corporate Finance Division of the SFC. There are three points worth noting.

5.23 The first is whether certain important policies with far-reaching implications for the market should be the subject of joint consultations by the SFC and the HKEx. Under Section 7 of the Amended and Restated MOU in March 2000, the SFC and the SEHK agreed to work together on future policy development, particularly regarding the introduction of statutory obligations for listed companies in respect of certain “agreed areas”. These “agreed areas” include the listing document, supplementary information, accounts, liability of advisers and penalties. The SFC and the SEHK have pledged to consult each other or issue joint consultation documents on these areas. The list of “agreed areas” does not appear to have been revised. Between 1990 and 1997, the SFC and the HKEx issued three joint

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consultation documents<sup>44</sup>. There is no formal mechanism to determine when a joint consultation paper should be issued. It is for consideration that there should be.

5.24 Secondly, there are no clear agreements between the HKEx and the SFC on whether and to what extent the SFC should engage its consultation network, both formal and informal, in scrutinizing the concept and details of the HKEx's draft proposals before they are released to the public by the HKEx. For the SFC's own amendments, the SFC usually adopts a two-stage approach. It conducts informal sounding on the broad concepts and then consults further on the details. (See paragraph 4.21.) When dealing with the HKEx's proposed amendments to its Listing Rules, the SFC does not consult informally. On an occasion in December 2001 when the SFC had discussed in general terms the HKEx's preliminary proposals with its Shareholders Group, the HKEx staff had expressed grave reservations. The SFC has since taken the view, not without justification, that it has to be careful not to be seen to be treading on the HKEx's turf. As befits the relationship between regulator and the regulated, there is an abiding tension in their co-existence even when they are in the co-operation mode. To say that this is inevitable may be pessimistic, but it would not be too far from the truth. A lot more tact (and understanding) is needed to assuage sensibilities which may at times be delicate. (See further details in paragraphs 7.71 to 7.76.)

5.25 Thirdly, there are differences of understanding of the role of the SFC as perceived by the SFC and by the HKEx. The SFC considers its role as "a sounding board" to the HKEx's proposals whereas the HKEx considers the SFC as having the "final say" over the HKEx's proposals. This point will be covered in greater detail in Chapters 7 and 11. Suffice it to say that both points of view appear to us to be incomplete, not to say inaccurate. (See further paragraphs 7.8(a), 7.10, 7.45 and 7.83.)

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<sup>44</sup> There were three SFC/HKEx joint consultations in June 1990, June 1995 and June 1997:-

- (a) June 1990: joint consultation on the ability of a Hong Kong company to purchase its own shares; the project was launched in response to a request by the Standing Committee on Company Law Reform and covered issues under the Companies Ordinance;
- (b) June 1995: joint consultation on suitability of persons serving as directors of listed companies; the project arose from concerns about nondisclosure of directors' criminal records; and
- (c) June 1997: joint consultation on offer mechanisms; the SFC was involved because the issues of price stabilization and market manipulation were within SFC's regulatory role.