

**BRITISH CHAMBER of COMMERCE**  
**in**  
**HONG KONG**

**SUBMISSION RE THE CONSULTATION PAPER**  
**ON**  
**AMENDMENTS TO LISTING PROCEDURES**

**December 29, 2003**

## EXECUTIVE SUMMARY

1. The HK Stock Exchange has an important role to play in bringing Chinese enterprises to market and providing those enterprises with a source of capital. It is vital for the SAR and for the nation that this be done in Hong Kong and not in other regional markets such as Singapore.
2. HK must provide a regulatory environment giving international investors confidence, and must offer a user-friendly listing process competitive with other rival centres in terms of costs, administrative requirements and the time taken to effect a listing.
3. The best way to meet these dual objectives seems to a strengthening of the existing model, not additional regulatory bodies or a greater involvement of regulators in the listing process.
4. Of the four alternative models, we feel that Model D should be used as a basis, since it:
  - presents the least disruption to the existing regulatory structure,
  - deals with the calls for the SFC to be granted a greater role in enforcing the more serious breaches of the Listing Rules.
  - preserves the Stock Exchange's position as a market regulator and the body in charge of administering and vetting new applicants for listing.
5. We also feel that additional statutory powers are necessary to ensure compliance with certain key investor protection provisions regarding:
  - regular financial reporting obligations of listed companies, which should be in line with the currently accepted international norm of quarterly reporting.
  - disclosure obligations in relation to corporate transactions (particularly connected transactions)
  - the obligation to disclose price-sensitive information.
6. There should be a move by the SFC to develop bilateral arrangements and protocols with the appropriate authorities in the jurisdictions where HK-listed companies are domiciled.
7. It is advisable to have some kind of "watchdog" to oversee the work of the SFC, and we would suggest that some form of "companies ombudsman" be considered.

**We feel that combining all of the above will reflect international norms, and maintain Hong Kong's position as a leading international centre, with world-standard regulation and compliance.**

## **The Expert Group - The View Last Time**

The view last time (the “Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure”, November 2002) seemed to be that the Listing function needed to be moved out from the Stock Exchange, and in fact that anything was better than the then-current system.

## **The Changes Since Then**

Since then, the Stock Exchange has a new chief executive, the SFO has come into force, and the dual filing system has been implemented. The staffing of the Listing Division of HKEx has also been upgraded substantially.

## **And How These Changes Translate in Practice**

Interviews with a wide cross-section of market participants suggest that these changes are generally working well, and seems to have circumvented or solved most of the problems of the old system. The system is still capable of improvement, but it appears that there is nothing fundamentally flawed with what is now in place.

## **Points to Bear in Mind**

- Rapid wholesale upheavals in financial markets and their regulation are neither positive nor desirable.
- Moreover, the whole Hong Kong success story is built on a philosophy of “positive non-interventionism”, and “benign laissez-faire”, and an excessively *dirigiste* system would be seen as a negative, and some might argue shows a slippage in the “one-country-two-systems” philosophy.
- However, the doctrine of *caveat emptor* is no longer acceptable in world markets, and Hong Kong must ensure that it maintains very high regulatory standards.

## **The Current Situation**

A unique feature of Hong Kong is that 80% of the companies listed on the Hong Kong Stock Exchange are incorporated overseas. As a result, the principal tool for regulating companies listed in Hong Kong is not the Companies Ordinance, but rather the Listing Rules (which are non-statutory). This is in contrast to other jurisdictions such as the U.S., the U.K., Australia and the PRC, where listed companies are regulated by reference to statutorily backed rules.

The bulk of the requirements applying to listed companies in Hong Kong are found in the non-statutory Listing Rules and non-statutory Code on Takeovers and Mergers. There

are some limited statutory requirements in the Securities and Futures Ordinance (“SFO”) including disclosure of interests and (of particular relevance) the “dual filing” arrangement introduced on April 1, 2003. The prospectus requirements in the Companies Ordinance apply to all companies, while the bulk of the Companies Ordinance only applies to the less than 20% of listed companies that are incorporated in Hong Kong.

The current regulatory framework relies heavily on the Exchange’s Listing Rules, due to the absence of the statutory ongoing disclosure requirements for listed companies and other issuers **which are a standard feature of the regulatory regimes in other major international markets.**

The Stock Exchange **can** use public sanctions or criticism of listed companies (and/or their directors) and, whilst it has the power to order a suspension of trading of a company’s shares or, in extreme cases, the delisting of a company’s shares, this power is highly unlikely to be used – for the simple reason that suspension or delisting serves only to hurt those whom the Stock Exchange is trying to protect (i.e. the shareholders of such companies) by removing their ability to protect themselves by selling their shares. **As a result, the Stock Exchange’s lack of ability to deal out effective sanctions for breach of the Listing Rules has been the subject of much criticism over the past few years.**

The Consultation Paper proposes giving statutory backing to certain fundamental requirements in the Hong Kong Listing Rules – the purpose being to create positive statutory obligations for compliance with those requirements and to allow a wider range of sanctions for breach – thereby promoting better compliance amongst Hong Kong’s listed companies. The creation of positive statutory obligations for compliance with these requirements is particularly important given the limited sanctions available to the stock Exchange to deal with breaches of the Listing Rules.

The principal disclosure requirements contained in the Listing Rules are:

- a) disclosure in prospectuses and other listing documents;
- b) disclosure in financial statements and in the management discussion and analysis section;
- c) disclosure of price sensitive information; and
- d) disclosure of particular transactions (eg. connected transactions)

### **Statutory Backing**

The Consultation Paper notes that with commencement of the Securities and Futures Ordinance on 1 April 2003 (SFO) and the introduction of the “dual-filing” regime a limited form of statutory backing to certain listing requirements has now been introduced. Under the “dual-filing” regime, applications for listing and also post-IPO continuing disclosure (eg. company announcements, circulars etc.) are filed with both the Stock Exchange and the SFC. This enables the SFC to object to a listing (at the application stage) or in the case of post-IPO continuing disclosure, to employ its statutory powers of investigation (under the SFO) in relation to any false or misleading information contained

in such disclosure. The SFO also introduces the possibility of criminal fines and imprisonment of offenders under certain circumstances.

Statutory backing of certain requirements of the Listing Rules would mean that breach of these requirements would attract statutory sanctions, including, for example, civil fines or orders for disqualification of directors or disgorgement of profit. The Consultation paper also raises the question whether severe breaches should be dealt with via criminal sanctions, for example, punitive fines or even imprisonment.

In fact this is actually the current situation – since the SFC does have the right to institute criminal prosecutions.

There are however problems with the existing regime, not least the fact that the criminal burden of proof is extremely high. In addition, the SFC can only take action in respect of disclosure which has been made and which is or may be false or misleading. This does not translate into a positive obligation on listed companies to disclose information. Accordingly, cases of non-disclosure or late disclosure of information, or selective disclosure of price-sensitive information – (i.e. exactly the arena where the most blatant abuses have occurred) fall to be dealt with by the Stock Exchange, not the SFC.

There is therefore a clear case to be made for making some of the Listing Rules statutory, and the Consultation Document raises the issue of the extent to which additional statutory “bite” is necessary to ensure compliance with certain key investor protection provisions which are presently contained only in the Stock Exchange Listing Rules.

These provisions are currently backed up only by the non-statutory and limited investigative and sanctioning powers of the Stock Exchange.

The situation on item (a), being the requirements for new listings, seem to be adequate as the rules stand, and does seem to be in line with international practice.

However, the “ongoing” aspects of listing rules (points (b)-(d) above) seem to be the area where there is most scope for abuse **and this is where statutory backing should be implemented.** Doing so would enable civil action and penalties such as fines, disgorgements etc, without involving the delays and onerous levels of proof which would be required by criminal sanctions. There should however still be no reason why criminal sanctions should not be brought in serious cases.

Fines etc should probably be set by some form of tribunal, which should be seen to be independent, so as the SFC itself would not be conflicted, and this would be perceived as being fairer.

Statutory backing should be brought in for:

- Financial reporting and its content
- Disclosure of connected transactions (it would be practical to set some form of “material level” above which disclosure would be mandatory). Voting procedures

should also be set out, namely allowing only independent shareholders to vote on such.

- Disclosure of price-sensitive information (this would bring Hong Kong into line with most other jurisdictions)

**These key provisions of regular financial reporting obligations of listed companies, disclosure obligations in relation to corporate and connected transactions and disclosure of price-sensitive information should be included in primary legislation.**

In order to achieve statutory backing, the Consultation paper envisages amending primary legislation with further requirements being contained in subsidiary legislation (and possibly also in related guidance notes). Presumably any amendments to primary legislation would be minimal, with the detail being contained in subsidiary legislation – due to the relative ease (and speed) of amending subsidiary legislation.

The Consultation Paper notes that with commencement of the Securities and Futures Ordinance on 1 April 2003 and the introduction of the “dual-filing” regime a limited form of statutory backing to certain listing requirements has now been introduced.

Under the “dual-filing” regime, applications for listing and also post-IPO continuing disclosure (eg. company announcements, circulars etc.) are filed with the Stock Exchange and thereby deemed to be filed with the SFC. This enables the SFC to object to a listing (at the application stage) or in the case of post-IPO continuing disclosure, to employ its statutory powers of investigation (under the SFO) in relation to any false or misleading information contained in such disclosure. The SFO also introduces the possibility of criminal fines and imprisonment of offenders under certain circumstances.

**This system has now been in force for nine months, and there seems little evidence that it is not working efficiently.**

#### **How is This Handled Overseas?**

“Shared Regulation” in relation to listing matters is a feature of securities markets in the vast majority of overseas jurisdictions (London is the only significant exception). The role of exchanges, being closer to their own markets, is to administer the listing rules on a day-to-day basis and, if breaches are detected, to conduct inquiries and take disciplinary action where non-statutory offences are found. Where the exchange’s inquiries reveal possible breaches of statutory provisions, the matter is reported to the statutory regulator. The primary role of the statutory regulator is to set key disclosure standards and to police statutory provisions. The exchange’s listing rules may well include requirements which go beyond those set out in or derived from statute. **“Shared regulation” (to a greater or lesser extent) of this kind is the international norm and has worked well in most jurisdictions. (see Appendix A)**

## **What Safeguards Are Built into the System?**

Extensive safeguards against potential conflicts of interest within HKEx are already built into Hong Kong law and the existing arrangements (see **Appendix C**). There has been no conclusive evidence that these safeguards are not working. Whilst some have argued that a natural desire by the Stock Exchange to maximise listing revenues has resulted in a failure to reject listing of companies whose shares have subsequently underperformed, in fact the Stock Exchange has no incentive to list companies that are likely to be a source of corporate irregularities or to damage its reputation. The Stock Exchange has a twelve year track record of devoting appropriate resources to listing regulation since the “three-tier system” was established in 1991. Numerous provisions are already built into the system to ensure that the listing function is adequately resourced.

The involvement of both the SEHK and SFC in regulation of listed companies (“shared regulation”) can and should produce net regulatory benefits, as happens in other jurisdictions. The present three-tier structure contains in-built checks and balances which prevent an excessive and unhealthy concentration of administrative power and are an important mechanism for ensuring regulatory oversight and accountability. If the “watchdog” becomes the maker and administrator of the Listing Rules, there is no more watchdog.

The principal listing requirements are set out in para 2.29 of the Consultation Document. **Appendix B** of this paper describes in more specific terms the matters covered in the Listing Rules of the Stock Exchange of Hong Kong.

Under Hong Kong’s “three-tier” regulatory structure, the SEHK is the front-line regulator of listed companies and the body which makes the Listing Rules. The SFC occupies the second “tier”, exercising a supervisory or “watchdog” role over the Exchange in the performance of its responsibility for administering the Listing Rules. Both HKEx and the SEHK have a statutory duty under the SFO to maintain an orderly, informed and fair market. The SFC must approve all SEHK Listing Rules before they can take effect; the SFC closely monitors HKEx’s work, receives monthly reports and holds monthly review meetings, conducts regular audits of the listing function and recommends changes of practice where it sees the need for these. As a “public body” under the Prevention of Bribery Ordinance, HKEx (including its listing function) is also audited periodically by the ICAC. The SFC is responsible for investigating and prosecuting breaches of statutory requirements by listed companies and their directors.

## **Is anything wrong with the existing system?**

HKEx does not have statutory powers of investigation (although it does have contractual powers) and the range of disciplinary measures available to HKEx in relation to Listing Rule breaches is confined to public censures, statements of criticism, disqualification of individuals as directors of Hong Kong-listed companies, denial of the Exchange’s facilities to issuers and the “cold shoulder” for professional advisers. The Listing Rules do not at present provide for fines, although there is no reason in principle why the SEHK

should not consider amending the rules to introduce a limited contractual fining power (as happens in some other markets). HKEx staff investigate potential breaches of the Listing Rules and take appropriate action (subject to the foregoing limitations on investigation power and sanctions). Whenever HKEx staff uncover a potential breach of statutory provisions, they immediately notify the SFC, who will decide whether to undertake an investigation under the SFO.

HKEx has an important role to play in bringing Chinese enterprises to market and providing those enterprises with a source of capital. It is important for the SAR and the nation that the role be discharged in Hong Kong and not in other regional markets such as Singapore.

If HKEx is to retain this role it must provide a regulatory environment in which international investors can have confidence and it must also offer a user-friendly listing process which is competitive with other rival exchanges in terms of costs, administrative requirements and the time taken to effect a listing.

**The best way to meet these dual objectives is a strengthening of the existing model, not additional regulatory bodies or a greater involvement of regulators in the listing process.**

These present powers and sanctions available to HKEx seem to have proved adequate to ensure compliance with the Rules by the vast majority of listed companies and directors in the vast majority of situations which arise. Most such companies and their directors and controllers value their reputations and their access to the Hong Kong Stock Exchange.

However, a small minority of unscrupulous directors and company controllers have not been deterred from activities designed to enrich themselves at the expense of public shareholders. Cases which have reached public attention frequently involved alleged fraud or theft (which already carry criminal sanctions). However, they also generally included misrepresentations in prospectuses, circulars and other listing documents. In a number of such cases, the relevant directors were resident outside Hong Kong, which exacerbates the difficulty of taking enforcement action.

The limited nature of the statutory obligations of listed companies results in excessive reliance being placed on the non-statutory Listing Rules and the limited investigative and sanctioning power of the SEHK. The current absence of statutory requirements for listed companies, particularly in the areas of financial reporting, continuous disclosure and connected transactions, has led to the perception that the Listing Rules need sharper “teeth” and to calls that “statutory backing” should be given to the Listing Rules. In fact, the weakness in Hong Kong’s regulatory framework does not lie in the content of the Listing Rules or the powers of the SEHK, but in the lack of relevant statutory provisions.

There are also perceived conflicts of interest which have repeatedly been cited as a reason why HKEx should relinquish administration of the Listing Rules. This was a recurrent

theme in the Expert Group report. Paras 3.9 to 3.14 of the Consultation Document deal with this subject and point out that **a very extensive set of safeguards exists in both the law and the MOU to address all different types of theoretical conflict which could arise.** These go well beyond the measures recommended in 2000 by the International Organisation of Securities Commissions (“IOSCO”) to deal with this issue in the context of exchange demutualization. They include a specific power in the SFO for the SFC to give directions to HKEx if it considers that a conflict of interest exists. (Interestingly, the existence of these safeguards was ignored in the Expert Group report and has been largely ignored in the public debate which has accompanied and followed it, although they are however mentioned in Consultation Document.)

Nevertheless, conflicts remain a constant theme of public discussion. They are still cited as a potential objection to Models B and D in the Consultation Document. It is therefore necessary to address this matter in some depth. **(refer to Appendix C in this connexion).**

The evidence is that these conflicts seem more perceived than actual. Prior to the events leading up to the appointment of the Expert Group, the issue of conflicts did not figure prominently in public debate. No evidence has been adduced at any time that the present safeguards are inadequate or are not working. None of the audits of HKEx’s listing function by the SFC or ICAC has identified any case of inappropriate decision-making by either the Listing Committee or the Listing Division as a result of any conflict. Nor has the SFC voiced informally concerns of this nature. If such concerns had arisen, the SFC has extensive powers to ensure corrective action.

The only allegation which has been made against HKEx is that contained in the Expert Group’s report to the effect that HKEx’s desire to maximize listing fee revenue has resulted in a failure by the Listing Committee and/or Listing Division to reject the applications of companies whose shares subsequently performed badly or attracted low liquidity or failed to interest international investors or which (in a few cases) became a source of corporate irregularities or alleged fraud after listing.

- (a) Listings are approved by the Listing Committee, whose 25 members (with the sole exception of the HKEx CEO) have no interest in HKEx’s profitability.
- (b) HKEx has no commercial interest to list poor-quality companies or companies that are likely to be a source of corporate irregularities. The opposite is the case. HKEx’s overriding concern is to maintain the quality of its market and its “brand”, which is what attracts investors, and therefore listings, to the Hong Kong market. HKEx’s financial interest (which in any case does not prevail over its statutory public interest duty) is in profitability, not revenue for its own sake. The listing of new companies, particularly small ones, and particularly if they end up causing regulatory problems, is not a profitable activity for HKEx.

A potential conflict is that between HKEx’s profit motive and the need to allocate sufficient resources to the listing regulatory function. However, again there is no

evidence that HKEx has failed to devote adequate resources to regulation. Numerous mechanisms exist to ensure that the regulatory function is properly resourced, including:

- (a) the overriding public interest duty of HKEx, backed up by the fact that half the Board of HKEx is appointed by Government;
- (b) a specific provision in the SFO requiring the SEHK to ensure that the listing function is staffed with competent personnel;
- (c) a provision in the MOU which requires that HKEx ensure that the staffing of the Listing Division is sufficient to discharge its responsibilities;
- (d) the leverage over HKEx enjoyed by the SFC by virtue of its extensive power to give directions.

**Conflicts do not seem to be the problem they have been made out to be, and the perception that conflicts of interest within HKEx either have prejudiced or could prejudice the regulatory process seems unjustified.**

### **Regulatory gaps**

Mention has been made of “regulatory gaps” which might exist. If any were to emerge as a result of the involvement of two bodies, that would certainly be undesirable, but in principle, the involvement of two bodies should make the emergence of gaps **less** likely rather than **more** likely, and there seems no evidence that such gaps exist. (The well publicised “penny stock” occurrence has often been cited as an example of this, but it was not a “regulatory gap” per se – it was just HKEX carrying out a normal consultancy, as any exchange would do from time to time.)

The involvement in monitoring listed company conduct of the body which owns and operates the market, with its generally more market-attuned personnel, should add value to that of the statutory regulator, with its sensitivity to the statutory framework and the law. This has certainly been the experience in other markets, where this kind of overlap is generally perceived to confer net regulatory benefits. There is an inherent “trade-off” between regulatory overlap and the maintenance of checks and balances to prevent the arbitrary exercise of power, and to ensure fairness in the administration of the Rules. A key feature of the “three-tier” system is the SFC’s role as “watchdog”, overseeing HKEx’s and the Listing Committee’s performance of their listing functions and ensuring that these are properly resourced and efficiently and fairly carried out.

If the watchdog became the administrator of the Rules, there would be no watchdog. Overlap might be eliminated (whether or not that is a good thing), but most of the checks and balances within the present three-tier structure would be lost.

Thus the present three-tier system would become in this area a two-tier system or, in effect, a one-tier system (unless Government acquired personnel with the necessary experience to perform a watchdog role analogous to that performed by the SFC over HKEx). History has repeatedly shown that any administrative institution which operates without strong structural checks and balances over its day-to-day operations has a

tendency to develop over time a control-centred and authoritarian style accompanied by a conviction of its own infallibility. The risk of corruption would also, inevitably, be greater if the SFC had unsupervised control over listed companies.

## **The Four Models**

The Consultation paper proposes four alternative models of regulatory structure and lists the perceived advantages and disadvantages for each, which can be summarized as follows:

### **Model A: Transfer of listing functions to a new division of the SFC**

This model removes the conflict of interest point and also the need for enforcement of disclosure and related matters by both the Stock Exchange and the SFC. However, it may create an over-concentration of powers in the SFC, and the potential for over-regulation, and cause delays which would affect the competitiveness of HKEx, and the effectiveness of HK as a financial centre.

### **Model B: Transfer of listing functions to a new subsidiary of Hong Kong Exchanges and clearing Limited (with a separate board of directors)**

The theory behind this model is clear enough, but in practice, it is doubtful whether this model goes far enough to convince the critics that the conflict of interest point is effectively laid to rest.

### **Model C: Transfer of listing functions to a new statutory authority independent of both the SFC and the stock Exchange**

The proposed independent authority will have a board appointed by the Government, with nominations from the SFC and the Stock Exchange. It is proposed to be funded by fees paid by companies listed on the Stock Exchange. However, establishment of the new authority would require a significant body of legislation, which would take time and cost money. There would also be a question as to whether the authority would have sufficient market knowledge to perform its functions to the standard expected.

### **Model D: Expand and enhance the “dual-filing” system**

Under this model, the SFC would continue to perform its existing functions, but would take on new functions as a result of statutory backing having been given to certain listing requirements. The result is that the SFC would handle the more serious cases of abuse of the Listing Rules (i.e. those involving breach of statutory provisions), with the Stock Exchange left to deal with the less serious cases, by way of public censure/criticism etc.

## **Our Choice and Recommendations:**

Of the four alternative models, we feel that **Model D should used as a basis**, since it:

- presents the least disruption to the existing regulatory structure,
- deals with the calls for the SFC to be granted a greater role in enforcing the more serious breaches of the Listing Rules.
- preserves the Stock Exchange's position as a market regulator and the body in charge of administering and vetting new applicants for listing.

However, this **must** be combined with **additional statutory powers** to ensure compliance with certain key **investor protection provisions** regarding:

- regular financial reporting obligations of listed companies, with a move towards the currently accepted international norm of quarterly reporting.
- disclosure obligations in relation to corporate transactions (particularly connected transactions)
- the obligation to disclose price-sensitive information.

At the same time, measures should be taken to **continue the process of strengthening the staffing of the Listing function in the Stock Exchange.**

The problems of disciplining of HK-listed companies who are domiciled overseas, who do no business in Hong Kong, and whose directors are non-HK resident can also be eased by **having the SFC develop bilateral arrangements and protocols with the appropriate authorities in the jurisdictions where HK-listed companies are domiciled.**

It is advisable to have some kind of “watchdog” to oversee the work of the SFC, and we would suggest that some form of “companies ombudsman” be considered.

**We feel that this will address the current situation, reflect international norms, and maintain Hong Kong's position as a leading international centre, with world-standard regulation and compliance.**

## **APPENDICES**

## **Appendix A**

### **International Comparisons**

#### **United States**

##### **New York Stock Exchange (NYSE)**

Mutual Exchange

Responsible for supervision of member firms

Enforces compliance with financial and operational regulations

Listing function vested in the exchange, although the exchange does not have the same kind of jurisdiction over its listed companies as it does have over its member firms

To maintain quality, the NYSE requires listed companies to meet the exchanges listing criteria and corporate governance standards

##### **Nasdaq Stock Market**

Run by a non-profit organisation – National Association of Securities Dealers

Membership includes 5,300 brokerage firms

Provides education to industry professionals and investors

Operates the world's largest securities dispute resolution forum with arbitration and mediation programmes

NASD was the sole owner of Nasdaq Stock Market until 2000, when it sold the exchange to concentrate on its core mission of ensuring market integrity and investor confidence

Role of the National Regulator – Securities and Exchange Commission (SEC) in the Listing Process

All traded securities must be registered with the regulator, the SEC before they are allowed to trade

Whilst the SEC does not set listing standards, they are however involved in the process of changing listing rules. All new rules and changes to existing rules must be approved by the SEC, which may amend rules as it deems necessary

SEC may also ask the exchange to review their rules

The SEC is essentially the dominant regulator of public companies. Moreover, the US regime – and the many others around the world that are based upon it – distinguishes the public offering (which is regarded as a heavy, statutory process) from the listing (which is regarded as a lighter, non-statutory) process

#### **Canada**

##### **Toronto Stock Exchange (TSX)**

Demutualised in 2000

Became listed public company in mid-November 2002

TSX Listings Committee Considers and approves all applications for listing on the TSX  
Listing requirements such as public distribution, management, sponsorship and financial conditions are issued by the TSX

May at any time temporarily halt or suspend trading, or even delist, a company's securities if it deems that the company has failed to comply with provisions of the Listing Agreement

#### **Role of TSX Market Regulation Services**

Similar to Australia, the TSX has established a separate subsidiary, Market Regulation Services Inc (MRS), to oversee exchange member regulation upon demutualisation. The subsidiary is independent of and structurally separated from the for-profit operations of TSX Group.

MRS is operated on a cost-recovery basis, to ensure that member regulation is not a for-profit activity and that trading operations do not subsidise regulation.

MRS has a separate committee that reports to the TSX board.

MRS has a segregated budget that is subject to the approval of the TSX board.

#### **Role of Regulator – Ontario Securities Commission (OSC)**

Regulation of Canada's securities industry is carried out by provinces and territories, each of which has its own securities regulator. These 13 regulators collaborate through the Canadian Securities Administrators, an informal body with no powers of enforcement.

The OSC's mandate is to protect investors from unfair, improper and fraudulent practices, foster fair and efficient capital markets and maintain public and investor confidence in these markets.

The OSC has statutory authority to make rules with binding legislative effect, subject to a process involving both public comment and review of the proposed rule by the Finance Minister.

Recognises self-regulatory organisations such as the stock exchange, with the authority to review any of the organisation's directions, decisions, orders or rulings.

The OSC also has the power to review and approve by-laws, hear appeal against decisions of a self-regulatory organisation, and ask an organisation to retain an auditor to conduct compliance reviews, etc.

#### **United Kingdom**

##### **London Stock Exchange (LSE)**

Demutualised in July 2001

The LSE transferred the listing authority responsibilities to the statutory regulator, the Financial Services Authority, in 2000.

The LSE has continued to set its own requirements for companies listed on its boards, including the right to decide whether or not to admit a listed security to trading and to make and enforce its own rules.

#### **Role of Regulator – Financial Services Authority (FSA)**

The single statutory regulator directly responsible for regulation of deposit-taking, insurance and investment businesses.

Independent non-governmental body accountable to the Treasury and, through that, to Parliament.

All responsibilities for primary market regulation in the UK rest with the UK Listing Authority, or UKLA, a division of the FSA, which is the competent authority responsible

for admission of securities to the official list [The UKLA is to be merged with a market regulation division of the FSA]

[By international standards, the UK is unusual or unique in merging taking the Listing process into the statutory framework. The normal alignment is more or less along the US lines, as mentioned above.

## **Singapore**

### **Singapore Exchange (SGX)**

Publicly listed company that was formed by the demutualisation and merger of the Stock Exchange of Singapore and the Singapore International Monetary Exchange Ltd under the Exchanges (Demutualisation and Merger) Act of 1999

Listed in November 2000

Provides, regulates and maintains facilities for conducting exchange business

The Singapore Exchange Securities Trading Ltd, or SGX-ST, is a wholly-owned subsidiary of the SGX, and is a stock exchange that is the front-line regulator for corporations listed on it

SGX-ST regulates listing matters by issuing the Listing Manual, which sets out requirements that apply to issuers, the manner in which securities are to be offered and the continuing obligations of issuers

SGX-ST is not vested with any statutory power but is responsible for front-line regulatory functions such as listing approval and market surveillance

SGX and SGX-ST signed a Deed of Undertaking with the Monetary Authority of Singapore for dealing with possible conflicts of interest that may arise from listing and quotation of SGX on an exchange

SGX's issuer regulatory role has been progressively transferred to the MAS.

### **Role of Regulator – Monetary Authority of Singapore (MAS)**

Final copies of listing prospectuses must be lodged with the MAS

Can issue stop orders to halt an offering and can require the return of moneys if there are problems

Authorised to make all decisions and take action in relation to the SGX that would be taken by the SGX-ST in the case of other listed corporations

Supervises SGX's compliance with listing rules, and has the power to delist SGX, or to stop/suspend its quotation

## **China**

### **Shanghai and Shenzhen Stock Exchange**

Both stock exchanges are non-profit institutions

Listing regime is controlled directly by the China Securities Regulatory Commission (CSRC)

Stock issuance is subject to CSRC approval

Prospectuses, listing applications, periodic reports and public announcements are filed with the CSRC

### **Role of Regulator – China Securities Regulatory Commission (CSRC)**

In April 1998, the CSRC became a ministry-rank unit under the State Council and the authorised department governing the securities and futures markets of mainland China. CSRC's responsibilities include supervising the securities and futures markets, overseeing issuance, trading, custody and settlement of equity shares, supervising listed companies and their shareholders who are liable for information disclosure in the market and supervising exchanges and their senior management in accordance with regulations

### **Australia**

#### **Australian Stock Exchange (ASX)**

Demutualised entity

ASX's supervisory activities are focused upon:

Supervising companies' compliance with the ASX Listing Rules

Supervising trading activity in the market

Supervising market participants such as stockbrokers and brokering firms

Helping meet the regulatory obligations of the ASX under the Corporations Act

#### **Role of ASX supervisory Review**

Subsidiary company established to enhance transparency and accountability of ASX's supervisory activities.

Aims to provide assurance that ASX Group adequately complies with its ongoing responsibilities as a market and clearing house operator; that it is conducting its supervisory activities ethically and responsibly and is maintaining appropriate controls preventing employee conflict of interest.

The board of ASX Supervisory Review is comprised of a majority of non-executive independent persons with complementary skills

#### **Role of Regulator – Australian Securities & Investment Commission (ASIC)**

The Corporations Act confers a range of specific functions and powers to ASIC in respect of its oversight role of market supervision, e.g. review compliance report by exchanges suspend trading of securities, pursue enforcement action, etc

Have an active role in any changes to the listing rules as all amendments to listing rules must be lodge with ASIC

Responsible for the licensing of traders

(ASX is an interesting case, in that it takes the "brand/quality" argument to its logical conclusion by locating the listing function squarely within the business process, ie rather than trying to isolate it. Listing regulation becomes explicitly a business quality control function.)

## **Appendix B**

### **BRIEF SUMMARY OF THE CONTENT OF THE SEHK LISTING RULES**

The Listing Rules of the Stock Exchange of Hong Kong (“SEHK”) cover a wide range of matters, including

- listing and de-listing criteria and procedures,
- Listing Committee and appeal procedures,
- contents of the Listing Agreement between HKEx and each listed company,
- methods of listing
- different types of product which can be listed (including options, warrants, convertibles and collective investment vehicles),
- the rules governing share option schemes,
- the standards and procedures required of IPO sponsors,
- the contents of accountants’ and valuers’ reports,
- reporting and shareholder approval requirements for different types and sizes of corporate transaction (including “disclosable”, “major” and “connected transactions” and “very substantial acquisitions”),
- the post-IPO disclosure obligations of listed companies and their directors (including disclosure obligations in relation to price-sensitive information),
- corporate governance requirements for listed companies.

The Listing Rules have been developed and adapted over a long period of time to address many investor protection issues which have arisen as markets have evolved.

## Appendix C

### **SAFEGUARDS AGAINST CONFLICTS OF INTEREST**

1. **Existing Safeguards** – One of Government’s main objectives in promoting demutualization of the exchanges three years ago was to eliminate conflict between the interests of the owners of the Exchange and those of investors and the general public. It was recognized by Government at the time that (despite the high degree of congruence between the public interest and the interest of public shareholders in HKEx), situations involving new types of conflict could arise. The same issue was faced by regulators in other markets where exchanges had demutualized. Various ways to deal with this issue were considered, including the transfer of the listing function to the SFC. After careful consideration, the SFC recommended, and Government endorsed, a decision to retain the so-called “three-tier” structure which we have today.

2. **Statutory Safeguards** – To address any possible conflicts of interest and to ensure that HKEx’s interests coincide with those of the public, a comprehensive set of safeguards was put in place by Government, Legco and the SFC. These included the following provisions in the Merger Ordinance:

- (a) A statutory duty for HKEx to give precedence to the public interest over any other of its interests;
- (b) An initial majority of public interest directors, followed in 2003 by parity between appointed and elected directors;
- (c) Appointment of the HKEx Chairman by the Chief Executive of the SAR;
- (d) Approval by SFC of the CEO and COO of HKEx;
- (e) Approval by SFC of all fees and charges related to HKEx’s regulated activities, including listing fees;
- (f) Power for SFC to give directions to HKEx if it considers a conflict of interest has arisen;
- (g) Provision that HKEx, as a listed company, would be regulated by SFC, not by SEHK.

Hong Kong safeguards follow closely suggestions from IOSCO for dealing with the issue of conflicts in the context of exchange demutualization.

3. **Memorandum of Understanding** – In addition to these statutory provisions, the 1991 Memorandum of Understanding (“MOU”) between the SFC and HKEx was updated and extended in a new MOU in 2000. This provided (among other things) for decision-making power on listing matters to be delegated by the Board of HKEx to the Listing Committee, whose members have no interest in HKEx’s revenue or profitability, and over whose appointment the SFC has a large measure of control. This delegation was also entrenched in the Listing Rules. In early 2003 (in anticipation of the “dual filing” regime) a further MOU was signed which modified to some extent the responsibility carried by the Listing Committee and also gave the SFC power to object to any particular listing if it wishes to do so.

4. **SFC Oversight of HKEx** – On top of these structural safeguards against potential conflicts, there is a statutory requirement that the Exchange’s Listing Rules (and any amendments to them) must be approved by the SFC. In addition, there is continuous

close oversight by SFC of HKEx's performance of its listing functions, including monthly reports and regular audits. At no time have these suggested that any of HKEx's decisions were influenced by conflicts of interest.