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Dispute between Hong Kong regulator and exchange highlights difficulties with listing changes

Aug 15 2016 Ajay Shamdasani, Regulatory Intelligence

Proposed amendments to Hong Kong's listing rules and a difference of opinion between regulators and the stock exchange over how to proceed have highlighted the challenges that must be resolved before finalizing such reforms. While some have characterized the amendments as a power grab by the Securities and Futures Commission (SFC), others said the SFC already has the power to reject new listings. The amendments were rather intended to increase the operational efficiency between the SFC and the Hong Kong Exchanges & Clearing (HKEx), which runs the local stock exchange, they said.

The proposals to amend the listing process were outlined in a public consultation issued on June 17. Under the proposals, a listing regulatory committee and a listing policy committee would be established, with equal representation from the SFC and HKEx. The regulatory committee would handle applications deemed complicated by the exchange's listing division; the other panel would decide on policies.

Both committees would require a majority vote in decision making. The reforms would replace the current system in which the HKEx's in-house listing division gives preliminary approval to a listing and then submits it to the listing committee, comprised of 28 members including accountants, lawyers, listed companies executives and fund managers, for approval. The SFC is not directly involved in the discussion process but has veto power to reject any application or listing policies.

In late July, Vincent Lee, an independent non-executive director at HKEx, publicly opposed the reforms and said the exchange board had neither approved nor endorsed them. Such an early involvement of the SFC in the listing process could give it too much power too soon and lead to a reduction in the number of initial public offerings, he said.

A local lawyer, speaking on condition of anonymity, said the proposals were only known about by the HKEx chairman and deputy chairman before they were announced.

"There was no consultation with the board of the exchange or the listing committee before the proposed reforms were announced," he said.

"There absolutely is a turf war going on between HKEx and the SFC," he said. "What is happening is that power is being moved from the industry to the regulator."

The territory's dual-filing regime, which involves both the exchange and the SFC, worked well, he said.

Following Lee's public disapproval, the Chamber of Hong Kong Listed Companies' vice-chairman, Lo Ka-shui, also criticised the initiative as giving too much power to the SFC, and warned it could kill the city's IPO market.

In defence of the proposals, SFC chief executive Ashley Alder told the media such attacks were misinformed, as the SFC would get no new powers since it already had the authority to reject new listings or listing policies.

Turf war maybe too strong a term

Different views exist within HKEx and the SFC as to the implied scope and appropriateness of the proposed reforms. Yet, to label it a turf war may be too strong a term, some said.

"We need to stay focused on what works best for the market in the long term. Calling it a 'turf war' does not help progress a rational discussion about the proposed reform," said Syren Johnstone, adjunct associate professor at the University of Hong Kong's (HKU) Faculty of Law.

"There seems to be some sort of misplaced understanding in some quarters that HKEx and SFC are always at loggerheads. That patently is not the case," he said, given the SFC's overarching powers under the law.

Others noted the SFC's existing power in such matters to eschew the characterisation the row is a turf war.

"I would not say that there is a turf war between the SFC and the HKEx. The SFC has clear authority in regulatory matters and will always have the final say," said Dr Sir David Kwok-po Li, chairman and chief executive of the Bank of East Asia in Hong Kong. "Furthermore, the consultation paper was jointly issued by the SFC and HKEx."

Boundary disputes occasionally occur between regulators and other government agencies, even in developed markets. Differences over substantive rules and regulations will, periodically, see regulators differ in terms of their interpretation and application.

"The SFC does not really have 'turf' to defend because they do not have any financial incentive to gain new powers. The desire to add more staff to the SFC is a weak incentive indeed," said Dr. Bryane Michael, a senior fellow at HKU's Asian Institute of International Financial Law. "Instead, all governments are strengthening market oversight and Hong Kong is no exception," he said.

Those opposing the reforms fear that the new structure will enable the SFC to step into the approval process of a new listing application at an earlier stage, which would lead to more rejections of applications and impede the growth of the local IPO market. There are also concerns the SFC will step into the arena of the Listing Committee, which makes decisions on listing applications based on the existing regime.

"Whether or not this is a 'turf' war between SFC and HKEx depends on how you interpret the rationale behind the reform proposal: whether the new regime's real purpose is to allow the SFC to formally participate in the listing process or whether the existing regime can achieve the same outcome without the need to have such reform," said Wing On Chui, partner at law firm Bird & Bird in Hong Kong.

Concerns that such reforms threatened the local IPO market were overblown, said Anthony Neoh, a former chairman of the SFC.

"I do not believe that the proposals will kill off the IPO market in the light of its incremental nature. I think international investors will appreciate the better co-ordination between the front and second line regulators intrinsic in the proposals. Potentially, if the workflow is properly designed, that could quicken the IPO process," Neoh said.

Neoh urged all stakeholders to collaborate to work out a solution beneficial to the markets and investors.

SFC already has the power

"Alternatively, the SFC can impose the present structure as part of the licensing conditions of the exchange, rather than proceeding by a consultation paper. As the SFC is by law entitled to do this, proceeding by a consultation paper cannot be properly characterised as a turf war," Neoh said.

From a compliance perspective, the SFC and HKEx seem to have somewhat different views on the qualities of companies that should be allowed to participate in Hong Kong's capital market, as well as the regulatory approach.

One way of looking at the proposed reform was that it merely provided a proper forum for HKEx and SFC to discuss difficult or unusual cases.

"There is often a patella-like reflex in the market that opposes change and precludes a more rational assessment of its real impact in practice," Johnstone said.

An HKEx spokesman said the reforms were needed as the market has become increasingly large and complex, and carries a greater variety of risks. "Coordinated regulatory efforts on different fronts, strategic foresight in policy formulation and constant vigilance are required to address emerging market developments," he said.

It was now the right time to revisit this decision-making structure and adopt enhancements that would enable the SFC and the exchange to better coordinate and address future regulatory needs, he said.

Compliance concerns

From a compliance perspective, it did not matter whether the existing regime prevailed or was amended, one lawyer said.

"From a compliance standpoint, whatever system is adopted is fine so long as it possesses transparency of process, certainty as to results and reliable timing [for decision making]," he said. "IPOs are important when they get listed or are spun off, but you do not deal with them all the time, so compliance is not that big of an issue so long as policies are consistent, comprehensible and palatable."

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