



**SECURITIES AND  
FUTURES COMMISSION**  
證券及期貨事務監察委員會

## **Report on the Securities and Futures Commission's review of the Exchange's performance in its regulation of listing matters**

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June 2020

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## Section 1

### Introduction

1. This report summarises the key findings and recommendations of the Securities and Futures Commission's (SFC) 2019 review regarding the performance of The Stock Exchange of Hong Kong Limited (**Exchange**<sup>1</sup> or **SEHK** as the case may be) in its regulation of listing matters.

### Objectives of our review

2. The SFC has a statutory duty under section 5(1)(b) of the SFO to supervise, monitor and regulate the activities carried on by the Exchange. Under the Listing MOU<sup>2</sup>, it was agreed that the SFC would conduct periodic audits or reviews of the Exchange's performance in its regulation of listing-related matters as a means to discharge the SFC's statutory function to supervise and monitor the Exchange.
3. The First Addendum to the Listing MOU dated 9 March 2018 provides that in conducting these periodic audits or reviews the SFC will focus on:
  - (a) whether the Exchange, in carrying out its listing regulatory function, has discharged and is discharging its duties under the SFO; this will include assessing its work in developing, administering and implementing its Listing Rules<sup>3</sup> as well as the monitoring and enforcement of compliance with those rules;
  - (b) the adequacy of the Exchange's systems, processes, procedures and resources for performing its listing function; and
  - (c) the effective management of conflicts of interest within the Exchange as a regulator and as part of a for-profit organisation, including the supervisory functions performed by the Listing Committee.
4. Our review is based on the parameters set out in the SFO, the Listing MOU and the First Addendum to the Listing MOU. In this report, unless otherwise specified, "**conflicts of interest**" refers generally to perceived, potential and actual conflicts that may exist or arise either (a) between the Hong Kong Exchanges and Clearing Limited's (HKEX) duties<sup>4</sup> and commercial interests as a listed public corporation and its duties as an organisation that performs a public service function, or (b) between the personal interests of Listing Department personnel and their duties as regulators performing a public function.

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<sup>1</sup> The use of the term "Exchange" in this report refers to the listing regulatory function within the SEHK which is a recognized exchange company under the SFO.

<sup>2</sup> The Memorandum of Understanding between the Exchange and the SFC dated 28 January 2003 (**Listing MOU**).

<sup>3</sup> Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

<sup>4</sup> Such as the legal duties that it owes to its shareholders.

## Scope of the 2019 review

5. Our 2019 review covered the Exchange's regulation of listing matters in 2018 and focused on the following areas:
  - (a) HKEX's management of potential conflicts of interest and the interactions between the Listing Department and the HKEX business units<sup>5</sup> in pre-IPO enquiries;
  - (b) the oversight of the Listing Department and the Listing Committee's supervisory role;
  - (c) the Exchange's handling of share option schemes under Chapter 17; and
  - (d) the Exchange's handling of complaints relating to listing applicants and listed issuers.

## How we conducted the assessment

6. In conducting our assessment, we considered:
  - (a) relevant internal documents, written policies, procedures and processes of the Listing Department's operational teams;
  - (b) sample cases, including the relevant operational teams' internal reports and case files;
  - (c) information received from the Listing Department in the ordinary course of our supervisory work, including its monthly reports, internal reports and case data;
  - (d) HKEX's 2018 annual report, the 2018 Listing Committee Report and the 2018 Report on the Exchange's Review of Issuers' Annual Report Disclosure;
  - (e) the Exchange's published disciplinary procedures, listing decisions, rejection letters, guidance letters and other related documents on the HKEX website;
  - (f) minutes of meetings of the Listing Committee and the respective boards of directors of SEHK and HKEX and other relevant internal documents relating to the activities of the Listing Committee and the Listing Department;
  - (g) relevant internal documents submitted to the Listing Committee by the Listing Department in relation to the activities of the Listing Department;
  - (h) relevant internal documents relating to the interaction between HKEX and the Listing Department in listing-related matters;
  - (i) our discussions with the Chairman and Deputy Chairmen of the Listing Committee;

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<sup>5</sup> See footnote 13.

- (j) our discussions with the former Head of Listing<sup>6</sup>, the heads of the operational teams and other senior personnel of the Listing Department;
- (k) our discussions with the heads of the relevant HKEX business units; and
- (l) our discussions with relevant case officers of the Listing Department.

## Our findings

- 7. Below is a summary of our findings and recommendations following the 2019 review. In arriving at our recommendations, we have taken into account the Exchange's initiatives and proposals undertaken after the completion of the review period. Our findings and recommendations are set out in more detail in Section 2 of this report.
- 8. The incumbent Head of Listing and the Chairman of the Listing Committee have reviewed this report. The Exchange's responses are also set out in this report. We wish to thank members of the Listing Committee and the staff of the Listing Department and HKEX for their assistance in the review process.

## Summary of recommendations

- 9. The SFC's recommendations are as follows:

### ***HKEX's management of potential conflicts of interest: Interactions between the Listing Department and HKEX business units in pre-IPO enquiries***

- (a) In 2018, the HKEX business side referred 10 pre-IPO enquiries to the Listing Department. We selected six of these 10 referrals to conduct a study of the interactions between the Listing Department and the HKEX business side in this context. Summaries of our findings are set out in Appendix A. Our recommendations are:
  - i. Listing Department personnel should not attend introductory meetings with prospective listing applicants alongside HKEX business executives which may give an impression that the Listing Department is assisting the HKEX business side to win business or to service issuers and applicants. It is inadvisable for the HKEX Chief Executive and the HKEX business side to invite the Head of Listing and other Listing Department executives to join business meetings with prospective listing applicants (paragraph 28);
  - ii. internal procedures should be reviewed to ensure that HKEX business executives do not and are not seen to pressurise the Listing Department to respond more swiftly to particular applicants (for example, by repeatedly referring to the desirability of those applicants or by copying the Chief Executive to whom the Head of Listing reports on an e-mail). HKEX should consider ways to further promote and reinforce compliance amongst its business executives with the "Chinese Wall" (paragraphs 29 and 30);
  - iii. the HKEX business side should avoid responding to *specific* questions

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<sup>6</sup> Discussions relating to our review were held in December 2019 with the former Head of Listing who retired at the end of 2019.

raised by prospective listing applicants on the Listing Rules and other regulatory-related questions even on a general, non-committal basis (paragraph 32).

*The Exchange's response: the HKEX business side would make it clear to potential applicants that issues requiring Rule interpretation should be directed to Listing.*

- (b) We recommend that the Exchange tighten the protocols regarding the following areas to enhance the independence of the regulatory function:
- i. the Listing Department sharing non-case specific information that is not public with the HKEX business side (paragraph 42);
  - ii. the Listing Department relying primarily on market data and research provided by the HKEX business side to develop listing policies that affect the commercial interests of HKEX (it is our recommendation that the Department should, as a general rule, either conduct its own research and data gathering, or obtain information from an independent source, to ensure the objectivity and independence of the data and research used and reach a balanced view (taking into account business input as well as the regulatory (e.g. investor protection) perspective) (paragraph 40);
  - iii. while the HKEX business side should be consulted on the development of listing rules and policies that have both regulatory and commercial implications, the Exchange must ensure that listing policy development by the regulatory function remains independent; views and comments provided by the HKEX business side should be considered and assessed independently and objectively by the regulatory function, taking into account section 21 of the SFO; HKEX business executives should not be directly involved in drafting a listing rule or guidance (paragraph 41);
  - iv. HKEX's business staff providing input in the "360°" performance review of any Listing Department staff even where the HKEX business executive has worked closely with the Department executive on listing policy development or other matters (paragraph 34).
- (c) The Listing Department's Chinese Wall Protocol contains numerous ambiguities, does not fully address key aspects of the Chinese Wall and may be difficult for Department staff to interpret and follow (paragraphs 46 to 50). We recommend that the Exchange promptly conduct a thorough and comprehensive study to clarify and develop written rules, practices, policies, guidelines and procedures that are necessary and appropriate to give effect to the Chinese Wall, taking into account the listing regulatory function's role as a public authority and its statutory duty under section 21 of the SFO, including making provisions for, *amongst other things*:
- i. the policy objectives and the general principles that should be followed in identifying, avoiding and managing actual, potential and perceived conflicts of interest;
  - ii. highlighting that the Chinese Wall Protocol applies to all HKEX and

- SEHK executives and staff (not just those of the Listing Department);
- iii. common scenarios where actual, potential or perceived conflicts of interest may arise in HKEX's and SEHK's day-to-day commercial and regulatory operations (including the handling of pre-IPO enquiries from potential applicants) and how these situations should be handled;
  - iv. the circumstances under which exceptions to the "Chinese Wall" are permitted, along with (1) appropriate safeguards and guidelines to ensure that any potential conflicts of interest are promptly identified and appropriately managed and handled; and (2) the necessary systems, processes and procedures to ensure compliance;
  - v. the internal organisational structure(s) for supervising, reporting and resolving "Chinese Wall" questions or issues.
- (d) HKEX should consider whether the following procedural enhancements should be adopted (paragraph 51):
- i. to introduce systems or procedures for better monitoring compliance with the "Chinese Wall";
  - ii. to introduce more comprehensive and regular "Chinese Wall" training for the Listing Department and all HKEX business executives who interact with the Listing Department (not just new joiners).
- (e) Given the central importance of the "Chinese Wall" to the Exchange's organisation, the discharge of its statutory duty and the independent operation of the regulatory function, the Chinese Wall protocol should be reviewed and approved by the Listing Committee and the boards of HKEX and SEHK after it is amended and supplemented to address the SFC's recommendations in this report (paragraph 52).

### ***The oversight of the Listing Department and the Listing Committee's supervisory role***

#### ***Administration and interpretation of the Listing Rules***

- (f) The Listing Committee should explore further avenues in addition to its review function and the existing oversight processes to ensure that the Listing Department is exercising the delegated powers and carrying out the delegated functions as specified in the Listing Rules given that the proportion of the Department's decisions for which a review is sought in any given year is very small (paragraphs 57 and 65).
- (g) To reduce the extent of the Listing Committee's reliance on the Department (its supervisee) to identify matters that are relevant to the discharge of its oversight function, we recommend that the Listing Department, after consulting the Listing Committee, expand its regular reporting of matters and decisions handled and made by the Department during the period to include, *amongst others*, notable waiver approvals and rejections; reasons for notable decisions not to take disciplinary or other further action against an issuer or director; and notable complaints received against listed issuers. We recommend that these reports

be made at least on a monthly (if not a weekly) basis. To manage potential conflicts of interest on the part of Committee members, the report on waiver and other applications by listed companies can be limited to completed matters. The reports should contain sufficient information for Committee members to understand the issues and raise necessary or appropriate enquiries, and Listing Committee members should be given an opportunity to raise questions regarding these reports and these discussions should be properly recorded (paragraphs 67(a) and 69 to 71).

- (h) In our review of pre-IPO enquiry cases, which were primarily cases under the Chapter 18A (biotech) listing regime, which was new at the time, we noted that extensive discussions of certain policy and interpretation issues, which were arguably novel, sensitive or difficult, took place between potential applicants and the Listing Department during the preliminary oral consultation stage without the involvement of the Listing Committee (see Cases 1 to 5 of [Appendix A](#)). The pre-IPO enquiries were presented to the Listing Committee for endorsement only after an informal consensus position was reached with the potential applicant. The Listing Committee should review the decision-making process for pre-IPO consultations and consider whether it is necessary to provide clearer guidelines for the Department and/or to the market as to when pre-IPO enquiries should be referred to the Committee (paragraphs 67(c) and 68).

*The Exchange's response: the purpose of pre-IPO enquiries is to allow prospective applicants to obtain a certain level of comfort on specific novel elements or policy considerations regarding the potential listing before committing significant resources in the listing preparation. Where a pre-IPO enquiry is straightforward and does not involve any novel issues, the Listing Department may give a view on its own. In cases where novel issues or threshold issues (e.g. suitability) are involved, the Listing Department may ask for more information from the enquirer and after assessment, may decide to escalate to the Listing Committee for its guidance. For cases where the enquirer requests to receive the Listing Committee's guidance, the Listing Department will seek the Listing Committee's guidance depending on the complexity and circumstances of the enquiry. When the Listing Department presents the enquiry to the Listing Committee, its analysis is also presented and the Listing Committee will have an opportunity to review the decision-making process. The letters to the enquirer on the pre-IPO guidance will also state that the Listing Department's views are based on the information provided, and may be altered during handling the application if there is additional information or any change in information, and that such views may also be endorsed, modified or varied by the Listing Committee.*

#### *Management and operations of the listing regulatory function*

- (i) The Listing Committee's oversight of the listing regulatory function is largely confined to listing policy and the handling of cases (paragraphs 72 to 74). The board of directors of HKEX (**HKEX Board**) itself receives only high-level briefings and reports regarding the listing regulatory function (see paragraphs 61 to 63) and has limited oversight due to the "Chinese Wall". We recommend that the Exchange review the existing organisational structure and reporting lines for the listing regulatory function to enhance oversight by the HKEX Board,

or its delegates, while maintaining the independence required to discharge the requirements of the SFO (see paragraph 75).

*The Exchange's response: HKEX has been actively considering and reviewing, amongst others, the controls relating to the organisation and the operation of the Listing Department with an aim to implement measures to enhance the oversight of the Listing Department (including implementation of "Chinese Wall" and complaints handling).*

- (j) We noted that the Listing Liaison Forum and the Listing Committee have sought to enhance their oversight of the Department. We recommend that the Listing Committee, together with the Listing Department, continue to review the scope of the powers and functions delegated to the Department to interpret and administer the Listing Rules to ensure that decisions are being made in accordance with the policy and directions of the Committee (paragraphs 72 and 78).
- (k) The Exchange should continue to enhance the minutes and other records made of discussions by the Listing Committee and its sub-committees; minutes should fully, fairly and accurately reflect all significant comments made by members at the Listing Committee and sub-committee meetings, including the reasons for any decisions or recommendations (paragraph 85).
- (l) The minutes of sub-committee discussions should be circulated as early as practicable to the Listing Committee to enhance the full committee's appreciation of the issues and nuances that arose during the policy development process. Meeting minutes should be finalised as soon as possible, and in any event no more than three months after the date of a meeting (paragraphs 86 and 87).

*The Exchange's response: views of the sub-committees will be captured in the reports to the Listing Committee and the subject matter will be discussed by the Listing Committee.*

#### ***The Exchange's handling of share option schemes under Chapter 17***

- (m) The Listing Department discussed a review of its policy relating to share option schemes with the Listing Committee in late 2019 following a study on the grant of share options by listed issuers. We understand that the Exchange will seek preliminary views from stakeholders on the issues and the proposals with a view to conducting a formal consultation in due course (paragraph 103).

#### ***The Exchange's handling of complaints relating to listing applicants and listed issuers***

- (n) In handling complaints against listing applicants, the Listing Department should amend its protocol that no further regulatory action is required when the relevant listing application has been withdrawn or terminated (paragraph 111).

*The Exchange's response: for complaints relating to a listing application that has been withdrawn or lapsed, there is practical difficulty for the IPO Vetting team to proceed further with the sponsor/applicant given the application has been withdrawn/lapsed. Going forward, the IPO Vetting team will consider*

*whether to refer such complaints to the SFC on a case-by-case basis.*

- (o) In the cases where the Listing Department found that no breach of the Listing Rules had occurred, the Exchange's standard reply to complainants stated that, "the complaint appears unrelated to *serious breaches* of the Listing Rules...". There have been complaints from the public that this reply suggests that the Exchange accepts rule breaches that are not considered "serious". We recommend that the Exchange revise its replies to complainants to accurately reflect its findings and to avoid misunderstanding (paragraph 112).
- (p) The Exchange should continue to promote staff compliance with the complaint handling policy and procedures through training, supervision, management's reinforcement of the importance of this work and technology (such as automatic reminders to staff of impending deadlines) (paragraph 116).
- (q) For complaints received against a listing applicant after the Listing Committee hearing, we recommend that all decisions by the Department not to report the complaint back to the Listing Committee be properly recorded along with the reasons for the decision, that the IPO Vetting team's staff manual be updated to include this requirement, and that the Committee be regularly provided with an overview or summary of the complaints that were not reported to the Committee when they were received (paragraphs 117 and 118).

#### ***Follow up from 2018 review***

- (r) From our review of 2018 IPO cases, we noted a few instances where the Listing Department did not address or identify material suitability or eligibility issues in its report to the Listing Committee. There were also instances where the discussions by the Listing Committee, Listing (Review) Committee and the GEM Listing Approval Group (**GLAG**), as reflected in the relevant minutes, did not address, analyse or otherwise respond to the "suitability" issues raised by the Listing Department. We recommend that the Listing Department continue to take steps to enhance the analysis of "suitability" issues included in its reports to the Listing Committee and its recording of the related discussions at Listing Committee meetings (including through the provision of appropriate staff guidelines and training). Minutes of Listing Committee meetings should fully, accurately and fairly reflect the discussions; if any material issue, fact or observation is not discussed, the reasons for not considering it should be recorded (paragraphs 123 to 126).
- (s) In one case referred by the Listed Issuer Regulation (**LIR**) team to Listing Enforcement, we noted that the Enforcement team rejected the referral notwithstanding the issuer's own submission that the due diligence conducted was limited and its non-executive directors and independent non-executive directors had not been given relevant information for their assessment or prior approval of the relevant transaction. The reason recorded on file for the Enforcement team's decision was inadequate to explain the decision. We recommend that the Exchange review how this particular case referral was handled and consider whether any changes are required to avoid a recurrence (paragraphs 135 to 138).

***Review of the operations of the Listing Department in 2018***

- (t) We noted that in one complaint handled by the Listing Department, some of the issues raised by the complainant and subsequent possible regulatory action in that incident could have been avoided if there had been better communication within the Department. The Listing Department should review its processes and procedures for information sharing to avoid a recurrence in the future (paragraphs 156 to 158).

*The Exchange's response: the procedures have been revised to inform the LIR team when a listed issuer is a cornerstone investor/pre-IPO investor.*

## Section 2

### HKEX's management of potential conflicts of interest: Interactions between the Listing Department and HKEX business units in pre-IPO enquiries

#### Introduction

10. SEHK is a recognized exchange company under the SFO and a wholly-owned subsidiary of HKEX, a recognized exchange controller under the SFO. SEHK is responsible for, *amongst other things*, making and administering the Listing Rules and regulating the companies listed or seeking to list on its markets. These responsibilities are public in nature, and SEHK and HKEX are considered as public bodies and certain of their personnel are considered public servants for some purposes<sup>7</sup>.
11. Section 21 of the SFO imposes certain obligations on SEHK, as a recognized exchange company, to:
  - (a) act in the interest of the public, having particular regard to the interest of the investing public; and
  - (b) ensure that the interest of the public prevails where it conflicts with the interest of the recognized exchange company.

As a recognized exchange controller, HKEX is also subject to similar obligations under section 63(2)<sup>8</sup> of the SFO.

12. It is accepted that actual, potential and perceived conflicts of interest will arise from time to time between the duties owed by HKEX as a listed public corporation to its shareholders and other stakeholders, on one hand, and its duties and obligations as an organisation that performs a public function.
13. To mitigate actual, potential and perceived conflicts of interest, the board of directors of the SEHK (**SEHK Board**) has delegated all of its powers and functions in respect of all listing matters to the Listing Committee<sup>9</sup>. The Listing Committee has in turn delegated most of its functions and powers to the Listing Department<sup>10</sup> (which is headed by the Head of Listing) except for certain reserved matters<sup>11</sup>.

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<sup>7</sup> For example, they are designated as public bodies under Schedule 1 and Schedule 2 to the Prevention of Bribery Ordinance.

<sup>8</sup> Section 63(2) provides that, “[i]n discharging its duty under subsection (1)(a), (b) or (c), a recognized exchange controller shall—(a) act in the interest of the public, having particular regard to the interest of the investing public; and (b) ensure that the interest of the public prevails where it conflicts with the interest of the recognized exchange controller.”

<sup>9</sup> Rule 2A.01. The equivalent GEM rule is rule 3.01. For simplicity, references are made to a particular Rule or Chapter in the Main Board Listing Rules only. The GEM Listing Rules contain broadly equivalent rules. Our observations and comments in this report apply equally to GEM.

<sup>10</sup> Rule 2A.02.

<sup>11</sup> Reserved matters mainly comprise the approval of new listing applications, the cancellations of listings and disciplinary proceedings.

14. As stated in the First Addendum to the Listing MOU<sup>12</sup>, in reviewing the Exchange's performance in its regulation of listing-related matters, the SFC would, *amongst other things*, focus on the effective management of conflicts of interest within the Exchange as a regulator and as part of a for-profit organisation.
15. For this aspect of our 2019 review, we examined the interactions between the Listing Department and the HKEX business side<sup>13</sup> on pre-IPO enquiries made by potential listing applicants on regulatory issues.
16. In 2018, the Listing Department received 372 listing applications. In the same year, the HKEX business side referred 10 pre-IPO enquiries to the Listing Department. We selected six of these 10 referrals to conduct a study of the interactions between the Listing Department and the HKEX business side in this context. Summaries of our findings from these case studies are set out in Appendix A.
17. While the Exchange had systems and procedures to implement the "Chinese Wall" in 2018, there were limited guidelines, training materials or other internal documents available regarding the policy or the related systems and procedures. The only document available comprised a single slide in the 2018 training materials for new joiners entitled "Conflicts of interest and Chinese Wall", which briefly mentions (in bullet points), (a) the physical segregation<sup>14</sup> (to avoid leakage of price sensitive information), (b) process integrity oversight by the Listing Committee and the SFC, and (c) Conflicts Committee procedures, with no further explanations of the processes and procedures mentioned in (b) and (c).

*The Exchange's response: during the training for new joiners, the processes and procedures for (b) and (c) were verbally explained.*

### Implementation of the "Chinese Wall" by the Listing Department

18. To manage actual, potential and perceived conflicts of interest with HKEX and SEHK, the Listing Department primarily relies on its segregation from the remainder of the operations of HKEX and SEHK in that:
  - (a) access to the Listing Department offices by other employees of HKEX and SEHK is restricted;
  - (b) non-Listing Department staff cannot access physical or electronic files of the Listing Department; and
  - (c) Department staff are prohibited from sharing non-public, case-specific information with other HKEX and SEHK staff (together, the **Chinese Wall procedures**).

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<sup>12</sup> See paragraph 3.

<sup>13</sup> In this report, "HKEX business side" (or sometimes referred to as "HKEX business unit") refers to any one or all of HKEX Global Issuer Services, HKEX Group Strategy Department and the HKEX Chief Executive. Global Issuer Services is the division within HKEX responsible for marketing HKEX's IPO services and platform. HKEX's Group Strategy is another business division which communicates with potential listing applicants regarding their listing plans.

<sup>14</sup> The physical segregation only refers to the fact that the Department's offices are separated from the rest of HKEX and SEHK and cannot be accessed by non-Department staff. There is no policy, for example, discouraging Department staff from fraternizing with non-Department staff.

19. The Department did not maintain any system, process or procedure for monitoring staff compliance with the “Chinese Wall” policy and procedures. Ongoing reminders and training given to Department staff in 2018 did not discuss the “Chinese Wall”.

### **Implementation of the “Chinese Wall” by the HKEX business side**

20. Based on our review of the case studies and interviews of HKEX business executives:
- (a) there was an understanding on the HKEX business side that Listing Rules-related issues raised by potential listing applicants should be referred to the Listing Department; but it was considered acceptable for the HKEX business side to give general explanations of the Listing Rules based on their own understanding in response to specific questions raised by prospective listing applicants;
  - (b) while the HKEX business side were aware that they should not ask for case-specific information, it was considered acceptable to obtain any non-case-specific listing information, e.g. concerning listing market trends and developments, from the Listing Department;
  - (c) it was considered acceptable for the HKEX business side to speak to Listing Department staff on behalf of potential listing applicants regarding pre-IPO enquiries raised by the potential applicants; and
  - (d) it was considered acceptable for the HKEX business side to invite the Listing Department to attend business introductory presentations with potential applicants to make the process more expedient for the applicant (such an invitation would normally be made to the Head of Listing).

### **SFC observations**

21. The following observations are based on our findings from the case studies summarised in [Appendix A](#) as well as interviews with the Listing Committee chairs, the former Head of Listing, Department executives and HKEX business executives.

#### *Meetings with prospective listing applicants*

22. The former Head of Listing and other Listing Department executives occasionally attended introductory presentations by potential applicants jointly with HKEX business executives when it was considered expedient for the potential applicants. Such joint meetings took place in two of the six cases reviewed by us (see Cases 4 and 5 in [Appendix A](#)).
23. There was a general view among senior HKEX and Department executives that, as the Listing Department is “*one of the departments within HKEX*”, it would appear strange to request separate business presentations by the potential applicant. We were informed by the former Head of Listing that he was invited by the Chief Executive to attend the two business presentations mentioned above and accepted the invitations so that the applicants would not have to give the same presentation twice. We noted, however, that, in another case reviewed by us (see Case 1 in [Appendix A](#)), the former Head of Listing turned down a similar meeting invitation because he considered it more appropriate for the Listing Department to meet with the applicant separately.

24. To maintain the “Chinese Wall” in the meetings attended jointly by the business side and the Listing Department, all the business executives would leave the meeting before the Listing Department commenced discussion of the regulatory issues with the potential applicant.
25. We consider the participation by senior Listing Department executives in these types of introductory meetings alongside HKEX business executives to be inadvisable.
26. To be clear, there is no indication that the former Head of Listing or the Listing Department executives in attendance said anything untoward at those meetings (although no minutes of such meetings are available).
27. However, the mere presence of the Head of Listing and senior Department executives at a meeting led by the Chief Executive where the HKEX business side was clearly pitching for business may undermine the perceived independence of the listing regulatory function and should be avoided entirely. After attending a meeting where the Chief Executive (to whom the Head of Listing reports) is pitching for business from the potential applicant, it may be harder for the Head of Listing to maintain a completely independent and objective tone in the subsequent discussions on regulatory issues.
28. The listing regulatory function should not be made a part of, or otherwise be involved with, the HKEX business side’s efforts to win business or to provide services to issuers and applicants, and we recommend that HKEX consider how to promote and reinforce compliance in this regard. We recommend that the Chief Executive and the HKEX business side avoid issuing invitations to the Head of Listing and other Listing Department executives to join business meetings in the future.

*The Exchange’s response: the HKEX business side no longer sends such invitation.*

#### *Communications from HKEX business side to Listing Department staff*

29. We observed, on occasions, that the HKEX business executives sought to get the Listing Department to respond sooner to particular applicants by repeatedly referring to the desirability of those applicants or by copying the HKEX Chief Executive (to whom the Head of Listing reports) on an e-mail (see Cases 1 and 2 in [Appendix A](#)). This type of behaviour is inappropriate and should be avoided as it may negatively affect the Department’s performance of its regulatory duties and perception thereof.
30. We recommend that HKEX review its protocols and consider ways to further promote and reinforce compliance with the “Chinese Wall” in this regard. In reviewing its policies and procedures, HKEX should recognize that Listing Department executives should not be and should not be seen to be pressurised to respond more swiftly to particular applicants in indirect ways (for example, by copying the Chief Executive (to whom the Head of Listing reports) on an e-mail) (see Cases 1 and 2 in [Appendix A](#)).

#### *Questions from prospective listing applicants*

31. We note that the HKEX business executives believe it is acceptable for them to discuss regulatory questions with potential applicants on a general, non-committal

basis provided that they have informed the potential applicant that such questions should be answered by the Listing Department (see Cases 1 and 2 in [Appendix A](#)).

32. Given HKEX's dual capacities, applicants and issuers may attach undue weight to statements made by the HKEX business side on regulatory issues. This is risky particularly if the discussion concerns specific questions that the potential applicant has. It would be prudent for the HKEX business side to avoid discussing, even on a general, non-committal basis, any *specific* question that a potential listing applicant may have regarding the application of the Listing Rules to the applicant's particular situation.

*The Exchange's response: the HKEX business side would make it clear to potential applicants that issues requiring Rule interpretation should be directed to Listing.*

### **Non-Listing Department staff's involvement in the appraisals of Listing Department staff**

33. During our interviews with HKEX executives, we were informed that, as part of HKEX's "360°-review" appraisal process, HKEX business executives have on an unspecified number of occasions been invited to provide feedback on a Listing Department executive or staff member, e.g. where they have worked closely on certain policy projects (e.g. the new listing rule regime for biotech companies) during the year.

#### **SFC observations**

34. To avoid potential and perceived conflicts of interest, HKEX business executives should not be given the opportunity to provide feedback, whether formally or informally, on the performance of Listing Department executives and staff regardless of the circumstances. Such a practice may undermine the independence of the Listing Department. We recommend that any such practice cease as soon as practicable.

### **Information sharing between the Listing Department and the HKEX business side**

35. The HKEX business side and the Listing Department share non-case specific information, such as market trends and research, as the Listing Department is considered "one of the departments within HKEX". In particular, the HKEX business side supplies the research and market data for the development of listing policies that are relevant to HKEX's major strategic, commercial or other interests (**relevant listing policies**). Examples cited include the Exchange's consultation papers on the new biotech and weighted voting rights regimes<sup>15</sup>.
36. Similarly, the Listing Department from time to time provided to the HKEX business side information such as:
- (a) feedback from stakeholders on "soft" market consultations;

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<sup>15</sup> Concept Paper on New Board (June 2017), Consultation Paper on a Listing Regime for Companies from Emerging and Innovative Sectors (February 2018) and Consultation Paper on Corporate WVR Beneficiaries (January 2020).

- (b) the non-public findings of the Listing Department from its studies of some types of listed companies (without case-specific information); and
  - (c) listing market statistics for HKEX's strategic planning.
37. Monthly meetings are held between the HKEX business side and the Listing Department<sup>16</sup> to discuss developments in the Hong Kong capital markets (including the IPO pipeline). Requests are sometimes made by the HKEX business side for support from the Listing Department, for example, for a "Country Guide"<sup>17</sup> to be issued for a particular jurisdiction. There are no minutes or other records of these discussions.

*The Exchange's response: the HKEX business side acts as a conduit to pass on general market feedback to Listing in making such requests. The Listing Department does independently assess the need to issue a "Country Guide" for a particular jurisdiction. In addition, the HKEX business side has no influence on whether and how a Country Guide would be developed.*

#### **SFC observations**

38. It is recognized and accepted that certain listing rules and policies have both regulatory and commercial implications and that the HKEX business side should be consulted in the policy development process.
39. Having said that, this exception to the "Chinese Wall" must be accompanied by appropriate processes and procedures to ensure that the spirit and intent of the "Chinese Wall" is not unduly undermined.
40. In developing listing policies, the listing regulatory function should be mindful to avoid undue reliance on research and other information provided by the HKEX business side, particularly when the policy affects HKEX group's strategic, financial, regulatory, risk management, commercial and operational interests. As a general rule, the Listing Department should conduct its own independent research and information gathering (or obtain information from an independent source) to ensure the objectivity and independence of the data and research used and reach a balanced view (taking into account business input as well as the regulatory (e.g. investor protection) perspective).
41. The Exchange should ensure that listing policy development by the regulatory function remains independent. In other words, views and suggestions provided by the HKEX business side should be considered and assessed independently and objectively by the regulatory function, taking into account section 21 of the SFO. For example, it would not be appropriate for an HKEX business executive to be directly involved in drafting a listing rule, or to request the Listing Department to develop a "Country Guide"<sup>18</sup> for a particular jurisdiction.

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<sup>16</sup> These meetings are attended by *amongst others* the Head of Global Issuers Services, Head of Group Strategy, Head of Listing and a few senior personnel of HKEX and the Listing Department.

<sup>17</sup> The Exchange issues Country Guides to give guidance on its treatment of listing applications from overseas issuers incorporated in a particular jurisdiction. The aim of these guides is to enhance applicants' understanding of the Exchange's expectations, practices, procedures and the criteria it considers when applying the Rules for overseas issuers.

<sup>18</sup> See footnote 17.

42. The Department should not freely share non-case specific listing information that is not public information with the HKEX business side. Before sharing any non-public (albeit non-case specific) listing information with the HKEX business side, the Department should consider, *amongst other things*:
- (a) whether there is a legitimate regulatory purpose or reason for sharing the information with the HKEX business side (taking into account, *amongst others*, how the information would be used by the HKEX business side), and whether the information sharing is necessary for that purpose or reason;
  - (b) whether any conflicts of interest exist in providing the information;
  - (c) whether the persons who provided the non-public information (e.g. the respondents in a “soft” consultation) consented to the disclosure; and
  - (d) whether the scope of information requested by the HKEX business side is reasonable and justifiable.

#### **Subsequent development – the 2019 Chinese Wall Protocol**

43. In May 2019 (after the period covered by this 2019 review), the Listing Department adopted as part of its staff training materials a “2019 Chinese Wall: protocol” (**Chinese Wall Protocol**), which provides that:
- (a) *If practicable* (emphasis added), third parties should meet Listing staff and non-Listing staff separately; if this is not possible, non-Listing staff should step out of any meeting prior to the discussion of listing-related information on individual companies with a third party.
  - (b) At an internal or external meeting where non-public, *case specific* listing-related information is discussed, Listing staff must ensure such information is not shared with any non-Listing staff verbally or in writing. Case-specific questions relating to the Listing Rules raised by potential listing applicants, listed companies or their advisers with non-Listing Department staff must be referred to the Listing Department to be dealt with independently.
  - (c) The “Chinese Wall” imposes a one-way restriction and does not restrict the flow of information from non-Listing Department staff to Listing Department staff.
  - (d) Listing staff are permitted to share with non-Listing staff information on policy matters which: (i) are of relevance to HKEX group’s policies on major strategic, financial, regulatory, risk management, commercial and operational issues; or (ii) may give rise to potential liability issues for HKEX as a group or its directors; or (iii) may have an impact on HKEX’s corporate governance or which may be political or controversial; or (iv) any other important policy matters which the Head of Listing considers appropriate.
44. We have been informed that the Listing Committee did not receive a draft of the Chinese Wall Protocol to comment on, although the chairs of the Listing Committee were briefed about its adoption.
45. The Chinese Wall Protocol was circulated to Listing Department staff in September 2019 as part of the Department’s periodic reminders to its staff. We have been

informed that the Human Resources department of HKEX has incorporated it in the HKEX human resources (**HR**) manual in March 2020.

### **SFC observations**

46. The Chinese Wall Protocol (a) contains numerous ambiguities and does not fully address key aspects of the “Chinese Wall”, and (b) should be subject to appropriate review and approval processes given the central importance of the “Chinese Wall” to the Exchange.
47. We note that, as currently drafted, some of the policies and guidance stated in the Chinese Wall Protocol may be difficult for Department staff to interpret or follow.
48. For example, the caveats referred to in paragraph 43(d) above are very broadly drafted and no guidance is given on how to identify and manage potential conflicts of interest in those contexts (which may be interpreted by Department staff to mean there is no need to consider potential conflicts of interest as long as a matter is relevant to HKEX group’s policies on major strategic, financial, regulatory, risk management, commercial and operational issues, etc.). A Listing Department staff member is not necessarily in a position to judge what information is of relevance to HKEX group’s policies. Such ambiguities in the Protocol may result in unrestricted sharing of listing information requested by the business side without appropriate safeguards to identify and manage potential conflicts.
49. As another example, the Chinese Wall Protocol states that, *if practicable* (emphasis added), third parties should meet Listing Department staff and non-Listing Department staff separately. The Protocol fails to explain what is meant by “practicable” and who would decide this. Such ambiguous provisions allow substantial discretion which undermines the effectiveness of the Protocol.
50. We recommend that the Exchange promptly conduct a thorough and comprehensive study to further clarify and develop written rules, practices, policies, guidelines and procedures that are necessary and appropriate for the Chinese Wall, taking into account the listing regulatory function’s role as a public authority and its statutory duty under section 21 of the SFO, including making provisions for:
  - (a) a description of the objectives and general principles that should be followed by all executives and staff in identifying, avoiding and managing actual, potential and perceived conflicts of interest;
  - (b) a statement that the Chinese Wall Protocol applies to all HKEX and SEHK executives and staff (not just those of the Listing Department);
  - (c) common scenarios where actual, potential or perceived conflicts of interest may arise in the day-to-day operations of the listing and business functions (including but not limited to the handling of pre-IPO enquiries); and how such situations should be handled;
  - (d) clearly defining the circumstances under which exceptions are permitted, along with (i) appropriate safeguards and guidelines to ensure that any potential conflicts of interest are promptly identified and appropriately managed and handled; and (ii) the necessary systems, processes and procedures to ensure compliance; and

- (e) the internal organisational structure(s) for supervising, reporting and resolving “Chinese Wall” questions or issues.
51. HKEX should also consider whether:
- (a) to introduce systems or procedures for better monitoring compliance with the “Chinese Wall”; and
  - (b) to introduce more comprehensive and regular “Chinese Wall” training for the Listing Department, and all HKEX business executives who interact with the Listing Department (i.e. not just new joiners).
52. Given the central importance of the “Chinese Wall” to the Exchange’s organisation, the discharge of its statutory duty and the independent operation of the regulatory function, it should be reviewed and approved by the Listing Committee as well as the boards of HKEX and SEHK. We recommend that the Exchange submit the revised Chinese Wall Protocol for review and approval through these processes after it has been amended and supplemented to address the SFC’s recommendations above.

## The oversight of the Listing Department and the Listing Committee’s supervisory role

### Overview

53. To manage actual, potential and perceived conflicts of interest<sup>19</sup> on its part, the SEHK Board has delegated “all of the SEHK’s powers and functions in respect of all listing matters” to the Listing Committee<sup>20</sup>. The Listing Committee has in turn delegated most of these powers and functions to the Listing Department<sup>21</sup> subject to the reservations and review procedures<sup>22</sup> set out in the Listing Rules.
54. The scope of powers and functions delegated by the Committee to the Department is set out in the following:
- (a) a 2012 document titled delegation of powers (**2012 DOP**)<sup>23</sup>, which delegated to the Listing Department a general power to interpret the Listing Rules and to

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<sup>19</sup> See paragraph 13.

<sup>20</sup> See Rule 2A.01 and the Amended and Restated Memorandum of Understanding Governing Listing Matters between SFC and SEHK dated 6 March 2000 (**2000 MOU**), paragraph 4.1. The delegation of powers by the SEHK Board to the Listing Committee was reaffirmed in paragraph 4.6 of the Listing MOU in 2003.

<sup>21</sup> Rule 2A.02.

<sup>22</sup> Rule 2B.01 of the Listing Rules provide that the Listing Committee will:

- (a) act as an independent review body and has the right to review the decisions of the Listing Department and to endorse, modify or reverse its decision;
- (b) impose directions, regulations or restrictions on the Listing Department in respect of the way it carries out its delegated authority.

<sup>23</sup> In July 2012, the Listing Committee approved a delegation of powers which consolidated all the powers that had previously been delegated to the Listing Department and had not been codified into the Listing Rules. These powers include the powers to deal with specific matters, as well as the broad power “to interpret the Listing Rules in accordance with the policy and directions of the Listing Committee and to waive, modify or dispense with compliance in their absolute discretion”. In the exercise of these delegated powers, the Head of Listing is required to consult with the Listing Committee on any matter which is likely to be of an unusually sensitive nature or of unusually great public interest. The Listing Committee retains the right to review any decision of the Listing Department made under any of the delegated powers.

- waive, modify or dispense with compliance and the power to decide certain specific matters;
- (b) rules 2A.05, 2A.05A, 2A.05B, 2A.06, 2.07C(3) and 15A.04 of the Listing Rules; and
  - (c) the minutes of certain Listing Committee meetings at which the Listing Department was delegated the authority to decide specified matters.
55. In a memorandum of understanding signed in 2000 (shortly before HKEX became a listed corporation), it was provided that<sup>24</sup>:
- (a) the Listing Committee is responsible for the primary regulation of the market in relation to all listing related matters; and
  - (b) the Listing Committee shall be responsible for overseeing the activities of its sub-delegates to ensure that the integrity and independence of the SEHK listing procedures and process and the standards of professionalism exercised are maintained at the highest levels and, in doing so, the Listing Committee is empowered to review, of its own volition, any decisions of its sub-delegates and to give directions to, and impose restrictions on, its sub-delegates in respect of the way in which they are to carry out their delegated authority.
56. The Listing Committee's report in 2018 described the Committee's principal functions as follows<sup>25</sup>:
- (a) to oversee the Listing Department (to the extent practicable given the Committee's mode of operation);
  - (b) to provide policy advice to the Listing Department on listing matters and approve amendments to the Main Board Listing Rules and GEM Rules; and
  - (c) to act as a review body (in its role as the Listing (Review) Committee) for decisions made by the Listing Department and by the Listing Committee<sup>26</sup>.

## **The role of the Listing Committee**

### ***Reviews of Listing Department's decisions***

57. The Listing Committee performs its oversight of the Listing Department mainly through acting as an independent review body for decisions made by the Head of Listing and any Listing Department staff<sup>27</sup>. The Listing Committee would review a decision of the Department upon request by a listed issuer or applicant (or if the SFC exercises its

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<sup>24</sup> See paragraph 4.1(b) and (c) of the 2000 MOU.

<sup>25</sup> Page 32 of the Listing Committee Report 2018.

<sup>26</sup> The Listing Committee no longer acts as a review body for Listing Committee decisions (subject to the transitional arrangements) from 6 July 2019 when the Listing Rule amendments on the review structure in relation to Listing Committee decisions became effective. Under the new regime, this role is performed by a newly-established Listing Review Committee.

<sup>27</sup> Rule 2B.01.

discretion to request such a review). The proportion of Department decisions that are reviewed by the Listing Committee each year is normally very small:

- In 2018, the Listing Committee reviewed decisions made by the Listing Department in six IPO applications (2017: four) and 14 cases involving listed issuers (2017: 10)<sup>28</sup>.
- During the same period, the Exchange vetted 511 listing applications (2017: 412) and handled 70,293 compliance and monitoring actions involving listed issuers (2017: 66,368 actions)<sup>29</sup>.

### ***The Listing Liaison Forum***

58. The chair and deputy chairs of the Listing Committee meet with the Head of Listing monthly at a Listing Liaison Forum<sup>30</sup> during which operational matters of the regulatory function are raised and discussed<sup>31</sup>. In 2018, the Chief Executive did not attend any of the Listing Liaison Forum meetings although he remains a member of the forum.
59. The information reported and discussed at the forum mainly related to transaction volumes (e.g. the numbers of listing and waiver applications received) and the time taken to process applications and transactions<sup>32</sup>. No minutes are kept of the Listing Liaison Forum meetings, but a log is maintained for the actions agreed to be undertaken at the Listing Liaison Forum.
60. The Listing Committee receives a more condensed version of the monthly reports received by the Listing Liaison Forum along with the action log.

### ***Reports to the HKEX Board***

61. The chair and deputy chairs of the Listing Committee attend a meeting of the HKEX Board semi-annually, together with the Head of Listing, to report on the work of the Listing Committee. These semi-annual meetings need to cover a large number of topics within the time allocated and the discussions are necessarily confined to very high-level briefings. Moreover, these semi-annual reports by the Committee chair and deputy chairs primarily cover the work of the Listing Committee.
62. Separately, the HKEX Board receives various other high-level reports on the listing regulatory function from the Listing Department with case statistics such as the

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<sup>28</sup> Paragraph 110 of the 2018 Listing Committee Report and paragraph 103 of the 2017 Listing Committee Report.

<sup>29</sup> HKEX 2018 Annual Report, pages 54-56.

<sup>30</sup> The Exchange's Listing Liaison Forum comprises the Chairman and two Deputy Chairmen of the Listing Committee, the Chief Executive of HKEX and the Head of Listing.

<sup>31</sup> The Listing Liaison Forum is intended as a forum for the chair and deputy chairs of the Listing Committee to raise operational matters with the Chief Executive and the Head of Listing (and vice versa) (see page 32 of the 2018 Listing Committee Report).

<sup>32</sup> The report contains statistical information relating to the operation and performance of the Listing Department (e.g. information on headcounts, training to Department staff, number of days taken by the IPO Vetting team to issue its first comment letters, time taken to process IPOs and LIR activities volume such as the number of pre-vetted and post-vetted announcements and notices) and an update on the progress of major policy projects.

number of listing applications received and approved and the current listing policy agenda.

63. In our view, the semi-annual briefings by the Committee chairs and the monthly reports are insufficient, on their own, to facilitate a meaningful discussion of the topics covered or to constitute proper oversight of the listing regulatory function by the HKEX Board.

### **SFC observations**

#### *Administration and interpretation of the Listing Rules*

64. The Exchange introduced various listing policy changes in 2018 to enhance market quality and investor protection, including rules and guidance to tackle backdoor listings<sup>33</sup> and to handle issuers with disclaimer audit opinions<sup>34</sup>, and implemented a new listing regime for biotech companies (Chapter 18A)<sup>35</sup>. The Listing Committee was proactively involved throughout the policy development process and played an important role in shaping the final proposals.
65. The Listing Committee's role as a review body for the Listing Department's decisions is an important avenue for listed issuers and listing applicants to seek redress. The proportion of cases for which a review is sought in any given year is normally very small. The Committee should explore further avenues in addition to its review function and the existing oversight processes to ensure that the Listing Department exercises the delegated powers and carry out the delegated functions as specified in the Listing Rules<sup>36</sup>.
66. At present, outside of the review process, there is no system or process in place for the Listing Committee to check that the Listing Department is generally administering and interpreting the Listing Rules in accordance with the policy and direction of the Committee or that matters have been brought to their attention as required.
67. In other words, in order for the Listing Committee to perform its role to oversee the Listing Department, it depends, to a considerable extent, on the Listing Department (its supervisee) to bring relevant matters to the Committee's attention and to prepare the information that it needs to assess and decide the matter. This structure leaves significant discretion for the Listing Department to decide which matters to report. The following are examples of regulatory matters during the review period covered by this report that were not reported to the Listing Committee or the Listing Liaison Forum:
- (a) Unlike for IPOs, the Listing Committee was not briefed on noteworthy complaints against listed issuers in 2018, nor consulted on how cases should be handled. (We noted that it was recently reported to the Committee that, until 2018, "the Department reported to the SFC on its handling of *each* individual complaint

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<sup>33</sup> Consultation Paper on Backdoor Listing, Continuing Listing Criteria and Other Rule Amendments (June 2018). See also paragraphs 127 to 129.

<sup>34</sup> See paragraph 130.

<sup>35</sup> See footnote 15.

<sup>36</sup> See rule 2B.01 ("in a professional and impartial manner") and 2A.03 ("in the best interest of the market as a whole and in the public interest").

case via its monthly reporting, and responded to any query by the SFC<sup>37</sup>. As the Department is aware, the previous monthly reports to the SFC merely listed the outstanding complaints with a brief description of the status or outcome, and were not designed to be a form of direct oversight by the SFC of the Exchange's complaint handling.)

- (b) The Listing Committee did not receive a draft of the 2019 Chinese Wall Protocol to comment on despite the central importance of this policy to the independence of the regulatory function (see paragraph 44); the chairs of the Listing Committee were however briefed about the adoption of the protocol.
- (c) In our review of pre-IPO enquiry cases, which were primarily cases under the Chapter 18A (biotech) listing regime, which was new at the time, we noted that extensive discussions on certain policy and interpretation issues, which were arguably novel, sensitive or difficult, took place between potential applicants and the Listing Department during the preliminary oral consultation stage without the involvement of the Listing Committee (see Cases 1 to 5 of [Appendix A](#)). A formal written pre-IPO enquiry would be submitted to the Listing Committee later for endorsement *after* a consensus position has been developed through the Department's discussions with the applicant.

*The Exchange's response: the purpose of pre-IPO enquiries is to allow prospective applicants to obtain a certain level of comfort on specific novel elements or policy considerations regarding the potential listing before committing significant resources in the listing preparation. Where a pre-IPO enquiry is straightforward and does not involve any novel issues, the Listing Department may give a view on its own. In cases where novel issues or threshold issues (e.g. suitability) are involved, the Listing Department may ask for more information from the enquirer and after assessment, may decide to escalate to the Listing Committee for its guidance. For cases where the enquirer requests to receive the Listing Committee's guidance, the Listing Department will seek the Listing Committee's guidance depending on the complexity and circumstances of the enquiry. When the Listing Department presents the enquiry to the Listing Committee, its analysis is also presented and the Listing Committee will have an opportunity to review the decision-making process. The letters to the enquirer on the pre-IPO guidance will also state that the Listing Department's views are based on the information provided, and may be altered during handling the application if there is additional information or any change in information, and that such views may also be endorsed, modified or varied by the Listing Committee.*

- 68. The Listing Committee should review the decision-making process for pre-IPO consultations and consider whether it is necessary to provide clearer guidelines for the Department and/or to the market as to when pre-IPO enquiries should be referred to the Committee.
- 69. To reduce the extent of the Listing Committee's dependence on the Department (its supervisee) to identify and report matters that are relevant to the discharge of its oversight function, we recommend that the Department, after consulting the Listing Committee, expand its regular reporting of matters and decisions handled and made

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<sup>37</sup> Listing Division report dated 20 March 2020 on Periodic Update on Listing Committee's Oversight of Listing Division.

by the Department during the period to include, *amongst others*, notable waiver approvals and rejections; reasons for notable decisions not to take disciplinary or other further action against an issuer or director; and notable complaints against listed companies and how the complaints are being handled, to enable the Committee both (a) to discharge its oversight function, and (b) to identify and monitor emerging market conduct issues.

70. To manage potential conflicts of interest on the part of Committee members in relation to waivers and other applications involving listed companies, that part of the report can be limited to completed cases.
71. We recommend that these reports be made at least on a monthly (if not a weekly) basis. The report should contain sufficient information for the Committee to understand the nature and significance of the cases and matters being reported on, and to raise further enquiries with the Department if they consider necessary or appropriate. Time should be made in regular Committee meetings for members to raise questions regarding decisions made by the Department. There should be proper recordkeeping of the Listing Committee's questions and discussions on these reports.

#### *Management and operations of the listing regulatory function*

72. We noted that, in 2018, the Listing Liaison Forum sought to enhance its oversight of the Listing Department. For example, the Committee chairs requested for (a) more details to be provided in the Department's monthly operational reports, (b) an annual review<sup>38</sup> of the powers delegated by the Listing Committee to the Department and (c) the Department to prepare a draft staff training plan for the Listing Committee to approve at the beginning of each year. Where appropriate, the Committee chairs have also requested the various team heads within the Department to attend the forum to explain or discuss important issues.
73. Notwithstanding these efforts, the Listing Committee's oversight role is largely confined to listing policy and the handling of cases. The degree of oversight and supervision that the Listing Committee is able to exercise over other aspects of the listing regulatory function is limited because, as an independent outside committee, the Committee does not always have access to the necessary information, which is often confidential. For example, the Listing Committee has no involvement in decisions regarding (a) HR issues involving Listing Department executives or staff, (b) their performance appraisals, promotions or remuneration, (c) complaints against Listing Department staff, (d) conflicts of interest issues involving Department executives or staff, or (e) other operational decisions such as financial and budget matters.
74. For example, in June 2019, there were media reports that a senior executive of the IPO Vetting team had been arrested by the Independent Commission Against Corruption for suspected corruption. The Listing Committee chairs sought to discuss the matter with the former Head of Listing to determine if any remedial action was warranted. In response to their enquiry, the former Head of Listing only provided them with information that was already reported in the press as instructed by lawyers. The former Head of Listing informed the Listing Committee chairs that he did not think that the incident had any policy implications.

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<sup>38</sup> See paragraph 77.

75. We recommend that the Exchange review the existing organisational structure and reporting lines for the listing regulatory function to enhance oversight by the HKEX Board, or its delegates, while maintaining the independence required to discharge the requirements of the SFO.

*The Exchange's response: HKEX has been actively considering and reviewing, amongst others, the controls relating to the organisation and the operation of the Listing Department with an aim to implement measures to enhance the oversight of the Listing Department (including implementation of "Chinese Wall" and complaints handling).*

### **Scope of Powers Delegated to the Listing Department**

76. The 2012 DOP grants broad powers to the Listing Department to interpret the Listing Rules "in accordance with the policy and directions of the Listing Committee". This requires the Listing Department to remain aware of the policy and directions of the Listing Committee from time to time.
77. We noted that one of the powers that was delegated to the Listing Department in 2015 (namely, the power to waive assured entitlements in spin-off transactions and approve spin-off proposals) was reversed in October 2018 following an internal review conducted at the request of the Listing Committee. The internal review found that, as the Listing Rules<sup>39</sup> expressly provide that the Listing Committee is the decision-maker for spin-off transactions, decisions on such waiver applications should not be taken by the Listing Department.

#### **SFC observation**

78. We recommend that the Listing Committee, together with the Listing Department, continue to review, from time to time, the scope of the powers and functions delegated to the Department to interpret and administer the Listing Rules to ensure that decisions are in general being made in accordance with the policy and directions of the Committee as contemplated by the 2012 DOP.

### **Recordkeeping for the Listing Committee and sub-committees' meetings**

79. Although the Listing Committee minutes have been finalised on a more timely basis in 2018, there remain instances where the recordkeeping practices for the Listing Committee and its sub-committees' meetings<sup>40</sup> continue to require improvement<sup>41</sup>.
80. For example, the sub-committee on backdoor listings did not keep any meeting minutes. We have been informed that the sub-committee's comments were reflected in the reports to the Listing Committee prepared by the Listing Department. These reports however serve a different purpose and function compared to meeting minutes.
81. In another example, we have been informed that the meeting records of the sub-

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<sup>39</sup> Paragraph 3(f) of Practice Note 15.

<sup>40</sup> The Listing Committee establishes sub-committees from time to time to study and make recommendations for certain listing policy projects as complex issues can be more efficiently deliberated in a smaller, more focused group. In 2018 the Listing Committee considered a number of major policy projects (for example, backdoor listing and new board/corporate weighted voting rights) which required certain technical expertise and knowledge.

<sup>41</sup> Also see paragraph 126.

committee discussing the “new boards” (i.e. weighted voting rights and biotech listings) were meant for the Listing Department’s internal use only and were not circulated to the sub-committee for comments.

82. Where minutes of sub-committees’ meetings are available, they are usually undated.
83. We noted that a corporate governance proposal recommended by the standing sub-committee for corporate governance in 2018 was not adopted by the Listing Committee; although the minutes of the Listing Committee meeting recorded comments both for and against the relevant proposal, the rationale for not adopting the proposal was not actually articulated and recorded.
84. On one occasion, the minutes of a Listing Committee’s quarterly policy meeting took more than four months from the date of meeting to be finalised.

### **SFC observations**

85. We recommend that the Exchange continue to take action to improve the recordkeeping practices for the Listing Committee and its sub-committees’ meetings. Such recordkeeping is an important aspect of accountability and transparency in the listing regulatory structure. The minutes of the Listing Committee’s meetings should fully, fairly and accurately record the Committee’s discussion of the concerns or reasons set out in the Listing Department’s or GLAG’s report (irrespective of whether the Committee agrees or disagrees with those concerns or reasons). The minutes should also reflect all of the significant points raised in relation to each agenda item or case, including arguments both for and against, the reasons why a particular decision or outcome is settled upon by the Committee and any significant minority views. The Committee should evaluate whether the comments and views of individual Committee members in listing policy discussions should be attributed on a named basis.
86. We also recommend that the minutes of sub-committee discussions be circulated to the Listing Committee regularly throughout the policy development process to enhance the full committee’s appreciation of the issues and nuances that arose during the discussions.

*The Exchange’s response: views of the sub-committees will be captured in the reports to the Listing Committee and the subject matter will be discussed by the Listing Committee.*

87. We again recommend that meeting minutes be finalised as soon as possible, and in any event no more than three months after the date of a meeting.

## **The Exchange’s handling of share option schemes under Chapter 17**

### **Introduction**

88. The Listing Department pre-vets all shareholders’ circulars for adopting share option schemes and refreshing the scheme limit. It post-vets announcements relating to the grant of options.
89. We have been informed that LIR staff are given relevant training annually. The 2018 training materials explained features of share option schemes, the scope of Chapter 17,

and touched on selected issues and disclosure requirements<sup>42</sup> set out in the Listing Rules that the LIR staff should pay attention to in their vetting.

90. In ordinary course, any applications for waivers from strict compliance with Chapter 17 and cases involving issues that are considered unusual would be discussed at LIR’s management meetings or daily team meetings.
91. In 2018, there were 426 announcements relating to the grant of share options. To assess the Department’s approach to vetting share option schemes, we conducted a more in-depth review of selected cases. We observed that 151 (35.4%) of the 2018 share option grants were made to recipients whose identities were not disclosed in the initial announcements. Out of these cases, we selected 29 grants made by 22 issuers that were unusual in one or more of the following respects:

| Unusual aspects of the case  | Number of cases |
|--|-----------------|
| Share options granted to third parties unidentified in the initial announcements and subsequent periodic reports | 18 (62%)        |
| Share options exercised shortly after grant (within 3 months)  | 13 (45%)        |
| Share options exercised out-of-the-money or at-the-money   | 7 (24%)         |
| All of the above   | 3 (10%)         |

### Share options granted to undisclosed third parties

92. Chapter 17 requires disclosure of “*the participants of the scheme and the basis of determining the eligibility of participants*”<sup>43</sup> in the shareholder circulars. However, we noted that, in the cases reviewed by us, it was considered acceptable to use the term “eligible participants” to include a broad range of unidentified persons who were not directors or employees of the issuers<sup>44</sup>. For example:
- (a) In a number of cases, the term included persons who “have made or will make a contribution” to the issuers without stating (i) the nature or extent of the “contribution” made or to be made; or (ii) the conditions and/or circumstances under which the options would be granted.

<sup>42</sup> For example the calculation of scheme limits on the issued share capital, limits on grants to individuals and the exercise price, dealing restrictions on granting and exercise of share options, and the circumstances under which shareholders’ approval is required.

<sup>43</sup> Rules 17.02(2)(a) and 17.03(2) state that the participants of the scheme and the basis of determining the eligibility of participants must be set out.

<sup>44</sup> Examples of “eligible participants” include, but are not limited to, the following:

- (a) service providers such as suppliers, consultants, advisors, distributors, contractors, agents, any person or entity that provides research, development or other technological support or professional advice, promoters, landlords, producers;
- (b) business partners such as joint venture business partners;
- (c) non-service providers such as customers, holders of any securities convertible into securities issued by any member of the group, tenants (including sub-tenants), licensees (including sub-licensees), trustees of any trust pre-approved by the board; and
- (d) any other group or class of participants determined by the directors from time to time as having contributed to the development and growth of the group.

(b) It was common for the issuers to state in the related circulars that eligibility to receive option grants would be determined by the directors from time to time without specifying any specific criteria.

93. We also noted that, although most issuers properly disclosed option grants to directors, chief executives and substantial shareholders<sup>45</sup>, which is required by the Listing Rules, the disclosure of option grants to other types of participants, including so-called “eligible grantees”, is often unsatisfactory. There is no Listing Rule requirement to disclose the identity of grantees who are not directors, chief executives and substantial shareholders or the reason why the grantees are awarded the share options.
94. As noted in the table above, in 18 of the cases reviewed by us, the unidentified grantees did not appear to be directors or employees. The options granted to these unidentified parties ranged between 0.01% and 8.28% of the issuer’s total issued share capital. In two cases, the number of share options granted to such third parties represented more than 8% of the issuers’ issued share capital.

#### **Exercise of share options shortly after grant**

95. The Listing Rules require disclosure of the minimum vesting period (if any) for which a share option must be held before it can be exercised in the shareholders circular on adoption of the share option scheme<sup>46</sup>; however there is no mandatory requirement for issuers to prescribe a minimum vesting period.
96. In 15 of the 29 cases reviewed, no minimum vesting period was prescribed. We noted that, in 13 cases, a portion of the share options were exercised within three months after being granted, with the shortest durations being within one week after grant (five cases)<sup>47</sup>.

#### **Exercise of share options out-of-the-money or at-the-money**

97. We noted that, in six cases, some or all of the share options were exercised when the exercise price was in fact higher than the stock’s trading price, with the grantees paying premiums that ranged from 1.67% to 22.49%. In another case, the share options were exercised at-the-money.
98. In one of the cases examined by us, the issuer announced the grant of share options to *eligible participants* representing 8.28% of its issued share capital. In the issuer’s 2018 annual report (which was published 10 months after the grant), it was disclosed that the options were granted to nine consultants, whose identities were not disclosed. All of the options were exercised out-of-the-money at a premium of 11.11% one week after the options were granted.
99. In another case, the issuer granted share options to unidentified consultants that accounted to 1.11% of its issued share capital. 51% of the options granted to those

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<sup>45</sup> Rule 17.06A(5) requires the disclosure of the name of each of the grantees who is a director, chief executive or substantial shareholder of the listed issuer, or an associate of any of them and the number of options granted to each of them.

<sup>46</sup> Rule 17.03(6).

<sup>47</sup> More specifically, in five cases, the options were exercised within one week; in six cases, within one month; in one case, within two months; and in one case, within three months.

consultants were exercised within eight days of the grant at a premium of 3.94%.

### **Breach of the scheme mandate limit**

100. The Listing Rules provide that the scheme mandate limit is 10% of the issued share capital<sup>48</sup>. Where a share option lapses in accordance with the terms of the scheme, the unutilised 10% limit may be replenished by the lapsed option<sup>49</sup>.
101. During our review, we noted two instances where the issuer breached the 10% limit<sup>50</sup> but the non-compliance was not detected until much later.
102. The LIR team explained that because issuers are not required to announce the number of share options that lapse, it is difficult for them to ascertain the unutilised scheme mandate limit from time to time. Such non-compliance is normally detected only when an issuer submits a circular to refresh the scheme mandate limit.

### **SFC observations**

103. We noted that the LIR team presented a policy paper on its review of share option schemes and share schemes (including share grants under existing schemes) to the Listing Committee in November 2019 to consider, *amongst others*:
  - (a) tightening the disclosure requirements relating to option grants to non-employees including requiring issuers to disclose the names of such grantees and the rationale for making the grant;
  - (b) whether issuers should continue to be allowed to “refresh” the mandate limits of their share option schemes as frequently as they wish subject to the overall cap of 30% of issued share capital; and
  - (c) whether share award schemes should be regulated under the Chapter 17 regime.

We have been informed that the Exchange will seek preliminary views from stakeholders on the issues and proposals with a view to conducting a formal consultation in due course.

104. We have also been informed that the Exchange is in the process of developing an artificial intelligence system to assist with monitoring issuers’ compliance. We support such initiatives to help to maintain market integrity and standards.

## **The Exchange’s handling of complaints relating to listing applicants and listed issuers**

### **Introduction**

105. In 2018, the Exchange received 1,122 complaints against listing applicants and listed issuers, amongst which 217 related to IPO applications, 828 related to listed issuers,

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<sup>48</sup> Note 1 to rule 17.03(3).

<sup>49</sup> Note 1 to rule 17.03(3) states that options lapsed in accordance with the terms of the scheme will not be counted for the purpose of calculating the 10% limit.

<sup>50</sup> One of the two instances was amongst the 29 cases reviewed by the SFC.

and 77 related to structured products and fixed income products issuers (and/or its liquidity providers).

106. Our case review focused on complaints where the Exchange decided to take no further action (**NFA**), and complaints which remained open for more than six months as of 31 December 2018. The following table shows a breakdown of the statistics:

|  | <b>IPO Vetting team</b> | <b>LIR team</b> | <b>Structured Products and Fixed Income (SPFI) team</b> |
|--|-------------------------|-----------------|---|
| <b>Total number of complaints received in 2018</b> (Note 1)  | 217<br>(19.3%)          | 828<br>(73.8%)  | 77<br>(6.9%)  |
| <b>NFA cases</b> (Note 2)  | 134<br>(61.8%)          | 727<br>(87.8%)  | 64<br>(83.1%)   |
| <b>Cases reviewed</b> (Note 3)   | <b>16</b>               | <b>33</b>       | <b>7</b>  |
| <b>Cases which remained open for more than six months as of 31 December 2018</b> (Note 2)  | 31<br>(14.3%)           | 5<br>(0.6%)     | 1<br>(1.3%)   |
| <b>Cases reviewed</b> (Note 3)   | <b>4</b>                | <b>5</b>        | <b>1</b>  |
| <p><i>Note 1: Percentages shown are based on total number of complaints received in 2018.</i></p> <p><i>Note 2: Percentages shown are based on complaints received by the respective team.</i></p> <p><i>Note 3: Cases were selected based on the nature of complaints and the length of time spent by the Exchange in handling the cases.</i></p> |                         |                 |   |

107. The Exchange's complaint policy is published on the HKEX website<sup>51</sup>. The Exchange adopts a risk-based approach to evaluate complaints received to determine what action to take. The published complaint policy states that the Exchange normally takes no further action on complaints that:

- (a) are anonymous or filed with insufficient or inaccurate contact details;
- (b) appear groundless, are trivial, or contain too few details;
- (c) are unrelated to serious breaches of the Listing Rules or practices which undermine investor confidence in the markets; or
- (d) are designed to pursue commercial disputes or which contain elements of bad faith.

### **NFA standard**

108. The IPO Vetting team, the LIR team and the SPFI team each have their own internal policies, procedures and guidance for complaint handling.
109. The IPO Vetting team's manual states that the team will not ordinarily follow up on complaints that have been lodged with the Exchange for more than three years. The IPO Vetting team explained that this provision refers to pre-IPO complaints lodged against a company which has not submitted a listing application, and no listing

<sup>51</sup> See the Exchange's complaint policy published on the HKEX website at [https://www.hkex.com.hk/Global/Exchange/Contact?sc\\_lang=en](https://www.hkex.com.hk/Global/Exchange/Contact?sc_lang=en).

application is submitted by the subject company within three years after the date that the complaint has been lodged.

110. The IPO Vetting team's manual states that the team ordinarily takes no action in a complaint where "further action, for any other reason, is unnecessary" without further elaboration. The IPO Vetting team explained that this provision relate to, for example, listing applications that are withdrawn or that lapse.

### **SFC observations**

111. The Listing Department should amend its protocol that no further action is required when a listing application has been withdrawn or has lapsed. Instead, the IPO Vetting team should evaluate whether further regulatory action (e.g. a referral to the SFC) is called for on a case-by-case basis. A log of such complaints can be maintained for future reference in case the applicant re-submits a new listing application within a short period of time.

*The Exchange's response: for complaints relating to a listing application that has been withdrawn or lapsed, there is practical difficulty for the IPO Vetting team to proceed further with the sponsor/applicant given the application has been withdrawn/lapsed. Going forward, the IPO Vetting team will consider whether to refer such complaints to the SFC on a case-by-case basis.*

112. In a number of NFA cases we reviewed, the Listing Department found that there was no breach of the Listing Rules, but its replies to complainants stated that "the complaint appears unrelated to *serious* breaches of the Listing Rules..." (*emphasis added*). There have been complaints from the public that this reply suggests that rule breaches that are not considered "serious" are tolerated by the Exchange. We recommend that the Exchange review its replies to complainants to better reflect the finding of its enquiries and to avoid misunderstanding.

### **Complaint handling procedures**

113. Upon receipt of a complaint the Exchange will issue an acknowledgement to the complainant within five business days<sup>52</sup>, and conduct an initial assessment, normally within 10 business days of receipt, to determine whether any further action is required. This initial assessment will then be submitted to the Complaints Control Committee (CCC)<sup>53</sup> for endorsement. If CCC endorses an initial assessment that no further action is required, an NFA letter will be issued to the complainant (if the person's contact information is known).
114. If any follow-up action is considered necessary, the case would be followed up by the relevant case team. After an enquiry, the case team would decide on an appropriate mode of disposal and send a final reply to the complainant<sup>54</sup>. For LIR complaints that are open for more than 30 days, the team should ordinarily consider reporting back to

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<sup>52</sup> According to the LIR manual in force in 2018, the acknowledgement was required to be sent within 10 business days of receipt of a complaint. The manual was amended in 2019 and the acknowledgement period was shortened to five business days.

<sup>53</sup> CCC comprises one representative from each of the IPO Vetting team, LIR team, SPFI team, Listing Enforcement team and Listing Policy team.

<sup>54</sup> The IPO Vetting team is required to send the reply as soon as they decide on a course of action to take. The LIR team and the SPFI team are required to send the reply within 10 days after the case is closed.

the CCC on the status and reasons for the case remaining open<sup>55</sup>.

### SFC observations

115. In the cases reviewed, Listing Department staff in general followed the complaint handling policies and procedures published on the website and set out in the internal manuals. There were instances where those policies or procedures were not fully adhered to, including:

- prolonged initial assessment in one case<sup>56</sup>;
- failure or delay in sending the acknowledgement letters or the final replies in a number of cases<sup>57</sup>;
- insufficient follow-up with two issuers who failed to respond to the LIR team's enquiries<sup>58</sup>; and
- untimely report-back to the CCC in four cases<sup>59</sup>.

The reasons given for the non-compliance included inadvertent oversight and low prioritisation (compared to other work).

116. We recommend that the Exchange continue to promote staff compliance with the complaint handling policy and procedures through training, supervision, management's reinforcement of the importance of this work and technology (such as automatic reminders to staff of impending deadlines).

117. We observed that, in a number of cases where the complaints against the listing applicants were received *after* the Listing Committee hearing, they were not reported by the IPO Vetting team to the Listing Committee, and there was no record on file of the internal discussions (if any) of the complaints nor explanations for why they were not reported back to the Committee. (By comparison, similar complaints that are received before a Listing Committee hearing are usually reported to the Committee or, if not so reported, a file note would be made of the related internal discussion and reasoning.)

118. In response to our enquiry, the case teams merely responded that the decisions not to report the complaints to the Listing Committee were endorsed by the Head of IPO Vetting. We recommend that (a) in the future, each such decision not to report a complaint to the Listing Committee should be properly recorded along with the

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<sup>55</sup> The LIR team will ordinarily allow a reasonable time between five and 15 business days for issuers to respond to its enquiries. If an issuer fails to respond in a timely manner, the internal manual requires the team to send a reminder to the issuer and consider whether a referral to Listing Enforcement should be made.

<sup>56</sup> See paragraph 113.

<sup>57</sup> See paragraph 113 and footnote 54.

<sup>58</sup> See footnote 55. In response to our enquiry, the LIR team explained that these cases involved long suspended issuers, which often respond less promptly to a complaint because they have other more fundamental regulatory issues to resolve, and the subject matter of the complaint often relates to the issues leading to the trading suspension. Therefore, for complaints relating to a long-suspended issuer, it is not particularly meaningful to do interim follow-ups if the issuer is already taking steps towards addressing its regulatory issues.

<sup>59</sup> See paragraph 114.



reason(s) for the decision, (b) the IPO Vetting team's staff manual should be updated to reflect this requirement, and (c) for the Listing Committee to monitor how complaints against listing applicants are handled and dealt with by the Department, the Committee should be regularly provided with an overview or summary of the complaints that were not reported to the Committee when they were received.

## Section 3

### Follow-up from the 2018 review

119. In 2018, we reviewed the Exchange’s performance in its regulation of listing matters during 2016 and 2017. We identified a number of areas for potential improvement and suggested recommendations for the Exchange to consider. Set out below is a discussion of the steps taken by the Exchange to address the recommendations in the 2018 review report.

### The Exchange’s vetting of IPO applications and suitability for listing

120. We reviewed the Exchange’s decision-making when vetting new listing applications and assessing the suitability<sup>60</sup> for listing of new listing applicants that exhibit “shell” features with reference to the principles set out in the Exchange’s June 2016 IPO Guidance Letter<sup>61</sup>. We suggested then that the Exchange should review its practices and procedures to enhance its recordkeeping for the Listing Committee’s deliberations of issues raised by the Listing Department.

121. In April 2018, the Exchange updated the guidance letter to clarify its approach to reviewing the suitability of listing applicants<sup>62</sup> with “shell” features.

122. The Exchange informed us that, after our last review, its staff manual was amended, and an internal memorandum was issued, to require the minutes for Listing Committee meetings to record the Committee’s discussion of any concerns raised in the Listing Department’s report or by the GLAG<sup>63</sup>. In addition, the Listing Department staff are required to document in the case files how significant issues were resolved. The Listing Department staff have been given training on these changes.

### SFC observations

123. In 2019, we noted a number of 2018 IPO cases which suggested that the IPO Vetting team’s reporting and recordkeeping in relation to “suitability” issues in listing applications may still require improvement (it is unclear whether the new measures mentioned in the preceding paragraph have been implemented). Below is a summary of our findings.

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<sup>60</sup> Rule 8.04 states that both the issuer and its business must, in the opinion of the Exchange, be suitable for listing.

<sup>61</sup> HKEX-GL68-13A – Guidance on IPO vetting and suitability for listing (June 2016, updated April 2018).

<sup>62</sup> The Exchange emphasised that the focus of its suitability review is qualitative and is not a “checklist” approach. The Exchange would assess a listing applicant’s suitability holistically, for example it would examine whether the stated use of proceeds and funding needs are consistent with its future objectives and strategies and whether the listing applicant has a commercial rationale for listing.

<sup>63</sup> The authority to approve or reject GEM listing applications was delegated by the GEM Listing Committee to the Listing Department (GLAG) from 1 July 2008 although GLAG was still subject to the oversight of the GEM Listing Committee. This delegation was unwound from 1 January 2020 and since that date, the authority to approve or reject GEM listing applications reverted to the GEM Listing Committee. GLAG comprised the Head of Listing, the Head of IPO Advisory and Projects, Vice Presidents or above of the IPO Vetting team, the Heads and certain senior executives of other teams within the Listing Department. The Head of IPO Advisory and Projects chaired the GLAG meetings and the quorum of five should have at least one-third and no less than two members from outside the IPO Vetting team.

124. In certain 2018 IPO applications, the Listing Department reports did not fully address material issues. For example, in one case (see (b) below), there was no analysis of whether the listing applicant displayed “shell-like” characteristics as set out in the IPO Guidance Letter and the reasons for listing. Specific examples of deficiencies in the Department’s reports are:

- (a) In one case, the Listing Department did not draw the Listing Committee’s attention to another recently rejected case with similar facts.
- (b) In a second case, the GLAG was of the view that some of the stated reasons for listing were boilerplate and generic<sup>64</sup>.
- (c) In a third case, the GLAG spotted a director’s suitability issue which had not been considered an issue by the Listing Department; the GLAG subsequently required the listing applicant to disclose the sponsor’s view on the director’s suitability in the prospectus.

125. In another 2018 case, the Listing Department’s report did not identify a material eligibility<sup>65</sup> issue concerning intensifying competition that might impact the sustainability of the listing applicant’s business. The Listing Committee identified the issue itself and, for that reason, did not approve the application at the first two Committee hearings before finally rejecting the application at the third hearing.

*The Exchange’s response: the Exchange has reviewed the cases in question and has explanations for its approach in these cases. The Exchange has noted the recommendations.*

126. Based on our review of the Listing Committee, Listing (Review) Committee and GLAG’s meeting minutes in 2018, in certain cases, the committees’ deliberations did not adequately address, analyse or otherwise respond to the “suitability” issues raised by the Listing Department. The Listing Department should continue to take steps (including the provision of appropriate staff guidelines and training) to enhance the analysis of “suitability” issues included in its reports, and the recordkeeping of related discussions by the Listing Committee (and other committees as applicable), including the significant points raised and reasons for decisions or views taken. Minutes of Listing Committee meetings should fully, accurately and fairly reflect the discussions; if any material issue, fact or observation is not discussed, the reasons for not considering it should be recorded.

### **The Exchange’s work in regulating reverse takeover transactions**

127. We reviewed the Listing Department’s assessment of potential reverse takeover (RTO) cases using the principle-based test under the RTO rules (**RTO Guidance Letter**<sup>66</sup>).

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<sup>64</sup> For example, that the listing would raise the applicant’s profile, credibility and visibility, and strengthen its competitiveness.

<sup>65</sup> Eligibility issues are, in general, issues which relate to whether a listing applicant meets the minimum listing criteria set out in the Listing Rules. These issues include, for example, whether the listing applicant meets the minimum profit requirement under Rule 8.05(1)(a), the sustainability of the listing applicant’s business, and whether the directors of a listing applicant are fit and proper to be directors of a listed issuer. These issues are considered by the Listing Department during its vetting process and the Listing Department would raise enquiries on eligibility issues where appropriate.

<sup>66</sup> HKEX-GL78-14 - Guidance on application of the reverse takeover requirements under rule 14.06(6) (GEM Listing Rule 19.06(6)) (May 2014).

128. We suggested that the Listing Department should develop written guidelines on how RTO cases should be assessed and staff training should be given more regularly. In cases where the issuer makes representations or provides information in respect of the issuer's business or the prospects of its business, we suggested that the Department should critically assess all relevant information and make follow-up enquiries before relying on the representations given. The Department should also maintain a more detailed record of the reasons for its conclusions.
129. In July 2019, the Exchange issued the conclusions<sup>67</sup> to its consultation on proposed rule amendments to tackle the problems associated with backdoor listings and shell activities, adopting all the proposals with a few modifications. A new RTO guidance letter<sup>68</sup> was also issued to clarify how the Exchange would interpret the rules and make its assessment. In response to our suggestions, the LIR team has developed written guidelines and provided training for LIR staff on the new RTO rules<sup>69</sup>. The LIR manual has been updated to provide guidance on the preparation of meeting notes and the requirements for maintaining appropriate records of LIR staff's assessment and decisions.

### **The Exchange's handling of disclaimer audit opinions**

130. We reviewed the Exchange's approach in respect of issuers that published financial results with disclaimer audit opinions. Following market consultation, in 2019, the Exchange introduced a new rule<sup>70</sup> to require a trading suspension where an issuer has published a preliminary annual results announcement and its auditor has issued, or has indicated that it will issue, a disclaimer or adverse opinion on the financial statements. The new rule applies to issuers' preliminary annual results announcements for financial years commencing on or after 1 September 2019.

### **The Exchange's policy on listing enforcement**

131. We suggested that the Exchange should try to accelerate its review of the Exchange's enforcement function and sanctions to examine whether this function can be discharged more effectively. We have been informed by the Listing Department that the Exchange is conducting a policy review of its disciplinary powers and sanctions with a view of issuing a consultation paper in 2020.
132. To strengthen the checks and balances for decisions relating to accepting or rejecting referrals received from other teams within the Listing Department, we recommended that some of these decisions (for example, those involving controversial or difficult issues) should be made by a committee comprising senior management of the Listing Department.
133. We also recommended that the reasons for rejecting, or not to take further action in relation to, a referral case should be properly documented; and if the facts and circumstances surrounding the case cast doubt on the reliability of the representations or information provided by the issuer, the Enforcement staff should critically consider

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<sup>67</sup> Consultation Conclusions on Backdoor Listing, Continuing Listing Criteria and other Rule Amendments issued in July 2019.

<sup>68</sup> HKEX-GL104-19 - Guidance on application of the reverse takeover Rules (October 2019).

<sup>69</sup> The new RTO rules became effective on 1 October 2019.

<sup>70</sup> Rule 13.50A.

all the relevant information before relying on the representations or information provided.

134. In December 2018, Listing Enforcement updated its operating manual to remind Enforcement staff to bring referral cases which involve controversial or difficult issues to the Disciplinary Coordination Meeting<sup>71</sup> for a decision and to critically consider all relevant information before relying on the representations or information provided.
135. In our review of the Exchange's handling of complaints this year, we noted a case where Listing Enforcement, in rejecting LIR's referral, may not have properly considered the issuer's submission. The facts of the case are set out below:
- (a) The complainant alleged that (i) the issuer made a certain capital contribution on behalf of its joint venture partner to a joint investment, and (ii) both the investment in the joint venture, and the amount owed by the joint venture partner to the issuer, were subsequently fully impaired. The complainant questioned the commercial rationale for the transaction and alleged that the transaction might have involved fraud or misappropriation, or breach of fiduciary duties by the directors.
  - (b) The issuer's response to LIR's enquiries revealed that, before making the capital contribution, the issuer conducted limited due diligence on the joint venture partner, which did not sufficiently cover the joint venture partner's financial resources or payment ability. The issuer also admitted that its non-executive directors and independent non-executive directors had not been provided with any relevant information for their assessment or prior approval and hence the capital contribution on behalf of the joint venture partner had not been properly approved by the board of the issuer at the material time.
  - (c) LIR referred the case, together with a number of other cases involving the same issuer, to Listing Enforcement.
136. Listing Enforcement rejected LIR's referral of this case, on the bases that (i) the issuer had carried out due diligence on the joint venture partner, (ii) the decision to make the capital contribution was a commercial decision which was difficult to challenge in light of the due diligence conducted and (iii) the issuer had taken some steps to chase for the repayment.
137. The reasons recorded on file for the Enforcement team's decision were inadequate to explain the decision. We recommend that the Exchange review the handling of this referral and consider whether any changes are required to avoid a recurrence.
138. We noted that Listing Enforcement has updated its operating manual to take account of our 2018 recommendations in late 2018 and it may take time for the team to implement the changes. We will consider reviewing Listing Enforcement's operations in our future reviews.

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<sup>71</sup> The Disciplinary Coordination Meeting provides a forum for cross-team discussions of issues which may have implications for any investigation or disciplinary proceedings. These meetings are attended by the Head of Listing, Chief Operating Officer of the Listing Department, Head of Enforcement, Head and Deputy Head of LIR team, Head of Policy and Secretariat Services Unit, Head of Accounting Affairs and all Enforcement professional staff.

## Section 4

### Review of the operations of the Listing Department in 2018

#### Overview

139. The following table indicates the level of operational activity reported by the Exchange in its listing regulation for 2014, 2015, 2016, 2017 and 2018<sup>72</sup>.

|  | 2014     | 2015     | 2016     | 2017     | 2018     |
|--|----------|----------|----------|----------|----------|
| Number of listing applications accepted for vetting by the IPO Vetting team            | 194      | 217      | 275      | 310      | 372      |
| Number of listing applications vetted by the IPO Vetting team <sup>73</sup>            | 232      | 256      | 349      | 412      | 511      |
| Number of applications for which approval was granted in principle                     | 148      | 151      | 181      | 216      | 245      |
| Number of compliance and monitoring actions handled by the LIR team <sup>74</sup>      | 58,450   | 71,088   | 64,932   | 66,368   | 70,293   |
| Number of investigations handled by the Enforcement team                               | 60       | 52       | 71       | 86       | 111      |
| Number of Listing Decisions published  | 8        | 8        | 11       | 14       | 3        |
| Number of Guidance Letters published   | 10       | 5        | 5        | 0        | 10       |
| Number of FAQs published   | 5 series | 1 series | 1 series | 3 series | 5 series |
| Number of other guidance materials published   | 6        | 3        | 3        | 2        | 2        |
| Number of listing applications processed by the Structured Products team <sup>75</sup> | 17,543   | 17,549   | 13,771   | 21,224   | 38,472   |
| - Derivative warrants  | 7,560    | 6,336    | 4,875    | 7,989    | 11,794   |
| - Callable bull/bear Contracts (more commonly known as CBBCs)                          | 9,983    | 11,213   | 8,896    | 13,235   | 26,678   |

<sup>72</sup> Source: HKEX 2018 Annual Report, pages 54-56.

<sup>73</sup> The number comprises new listing applications accepted in the current year and listing applications brought forward from the previous year.

<sup>74</sup> Compliance and monitoring actions include announcements and circulars vetted, share price and trading volume monitoring actions undertaken and complaints handled.

<sup>75</sup> The figures refer to issues of new structured products and do not include further issues.

## IPOs

140. The number of listing applications accepted for vetting by the Exchange was 372 in 2018 (2017: 310), representing an increase of 62 (or 20.0%) in 2018.
141. The number of listing applications vetted by the Exchange was 511 in 2018 and 412 in 2017, representing an increase of 99 (or 24.0%) in 2018. The number of applications vetted comprises applications accepted for vetting in the current year and “in-progress” applications brought forward from the previous year. The difference between the number of applications vetted and the number of applications accepted represents the number of cases brought forward from the previous year, which is affected by different factors including the number of applications received, the complexity of the cases and when the applications were received.
142. The average time between the acceptance of a case for vetting and the issue of the first comment letter in 2018 was 18 business day (2017: 22 business days)<sup>76</sup>. The Exchange stated that it continued to look at ways to better accommodate the increasing number of listing applications and expedite the vetting of complex listing applications in 2018. Going forward, the Department may issue subsequent rounds of comments prior to receiving the sponsor’s response (if such responses would not affect the Department’s comments) to further accelerate the vetting process.
143. The percentage of listing applications presented to the Listing Committee for hearing within 120 days was 34.0% in 2018 (2017: 31%). The number of listing applications approved in principle for listing by the Exchange was 245 in 2018 (2017: 216), representing an increase of 29 (or 13.4%) in 2018. The increase is in line with the increase in the number of listing applications vetted by the Exchange.
144. In 2018, the IPO Vetting team published eight guidance letters (2017: nil) and two listing decisions<sup>77</sup> (2017: two). Two of the guidance letters were issued as a result of the Exchange’s exercise to streamline its guidance materials in 2018<sup>78</sup>.

## Listed issuer regulation

145. The number of LIR actions handled by the Exchange was 70,293 in 2018 (2017: 66,368), representing an increase of 3,925 (or 5.9%) in 2018. The increase in LIR actions handled is consistent with the increase in number of listed issuers in 2018 (2018:2,315; 2017: 2,118). The following is a breakdown of the announcements

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<sup>76</sup> Based on the Detailed Vetting and Administrative Procedures for IPO applications, the first comment letter is expected to be issued as soon as practicable from the date of acknowledgement of receipt of a new listing application. We noted the shortest time and the longest time between the date of application and the date of the first comment letter was 4 business days and 86 business days, respectively.

<sup>77</sup> Guidance Letters: “Pricing flexibility for initial public offerings” (February 2018), “Reallocation of shares from placing tranche to the public subscription tranche in an initial public offer” (February 2018), “Suitability for listing of biotech companies” (April 2018), “Suitability for listing with a WVR structure” (April 2018), “Suitability for secondary listing as a qualifying issuer under Chapter 19C” (April 2018), “Guidance for applicants in the internet technology sector or that have internet-based business models” (July 2018), “Guidance on disclosure in listing documents – listing applicants’ names; statistics and data quoted; listing document covers; non-disclosure of confidential information; and material changes after trading record period” (July 2018) and “Guidance on assessment of a sponsor’s independence” (July 2018).

Listing Decisions: “To provide guidance on why the Exchange rejected certain listing applications” (March 2018), “To provide guidance on why the Exchange returned certain listing applications” (March 2018).

<sup>78</sup> The last two guidance letters stated in footnote 77 above.

handled by the LIR team in 2017 and 2018.

|      | <b>Post-vetted</b> | <b>% of Total</b> | <b>Pre-vetted</b> | <b>% of Total</b> | <b>Total</b> |
|------|--------------------|-------------------|-------------------|-------------------|--------------|
| 2017 | 57,376             | 99.79             | 122               | 0.21              | 57,498       |
| 2018 | 59,738             | 99.79             | 123               | 0.21              | 59,861       |

146. In 2018, remedial follow-up action by the issuer was required in 1,435 (or 2.4%) of the posted-vetted cases (2017: 1,426 or 2.5%).
147. The LIR team referred 81 cases to Listing Enforcement in 2018, representing a significant increase from 40 referral cases in 2017. The Exchange explained that the increase in the number of case referrals is mainly due to clearer referral criteria. Referrals to external regulatory bodies<sup>79</sup> slightly increased from 37 cases in 2017 to 39 cases in 2018.
148. For long-suspended companies, the Exchange issued a notice of intention to delist under the Listing Rules to three listed issuers (2017: three).
149. In terms of turnaround time, the Exchange:
- (a) post-vetted results announcements within three business days of publication in 99% of the cases in 2018 (2017: 97%);
  - (b) post-vetted other announcements within one business day of publication in 98% of the cases in 2018 (2017: 99%); and
  - (c) pre-vetted announcements<sup>80</sup> within the same day in 97% of the cases in 2018 (2017: 96%).
150. In 2018, the LIR team issued two guidance letters (2017: nil) and one listing decision (2017: 12)<sup>81</sup>.
151. The Exchange reported that, in 2018, it continued its initiative to promote self-compliance by listed issuers with the Listing Rules. This initiative was pursued primarily through issuing guidance materials, publishing reports on its reviews of listed issuers' annual reports, corporate governance practices and environmental, social and governance reports and introducing e-training for directors.

<sup>79</sup> The Securities and Futures Commission, the Financial Reporting Council and other regulatory bodies.

<sup>80</sup> These primarily comprised announcements made in relation to a very substantial acquisition, very substantial disposal, reverse takeover and cash company, which are required to be pre-vetted by the Exchange under the Listing Rules.

<sup>81</sup> Guidance Letters: "Guidance on long suspension and delisting" (May 2018) and "Guidance on listed issuer's suitability for continued listing" (June 2018).

Listing Decision: "Whether Company A had a sufficient level of operations or sufficient assets to meet Main Board Rule 13.24" (March 2018).

## SFC observations

### *Operational matters*

152. As noted above, the caseload of the IPO Vetting team increased by 24.0% in 2018 (see paragraph 141); while the number of LIR actions handled by the LIR team increased by 5.9% (see paragraph 145).
153. Over the same period:
- (a) the processing time for listing applications decreased between 2017 and 2018 (see paragraph 142) and the Listing Department was more efficient in terms of issuing the first comment letter and presenting the case to the Listing Committee in 2018; and
  - (b) the proportion of post-vetting results announcements within three business days and pre-vetting announcements within the same day increased slightly in 2018, and the proportion of other announcements vetted within one business day fell slightly in 2018 (see paragraph 149).
154. The IPO Vetting team issued a total of eight guidance letters and two listing decisions during 2018 (see paragraph 144); while the LIR team issued a total of two guidance letters and one listing decision (see paragraph 150). We noted that the Exchange continued its ongoing exercise to codify and streamline existing listing guidance in 2018<sup>82</sup> in response to market feedback.
155. We noted in last year's report that the documented performance measures reported by the operational teams related to the length of time taken to process cases and the efficiency of the teams. We stressed the importance of having qualitative performance measures to ensure that the Department staff do not prioritise the turnaround time for cases over other aspects of their work (for example, the depth or scope of their case review, accuracy and success in spotting issues). We noted that, in June 2018, the Head of Listing issued a memorandum reminding his staff to focus on the proper discharge of the Exchange's regulatory duties when setting performance objectives.

### **Notable case**

156. In the course of handling a 2019 complaint against the Exchange's handling of a listing application by an applicant (Company A), we noted a lack of timely communication between the IPO Vetting team and the LIR team.
157. We noted a case where a subsidiary of a listed issuer (Company B) had agreed to be a cornerstone investor in the pending IPO of Company A, but Company B failed to issue a notifiable transaction announcement as required under the Listing Rules. The IPO Vetting team was later informed by Company A's lawyers that the settlement of the payment for the investment may be delayed. The IPO Vetting team failed to inform the LIR team of this information. The LIR team learnt about the issue more than two weeks later when Company B issued a notifiable transaction announcement regarding its subsidiary's cornerstone investment in Company A. Several complaints

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<sup>82</sup> As a result of the exercise to update and streamline its guidance materials, the Exchange issued two new guidance letters (see paragraph 144 above), updated four guidance letters, updated one FAQ and withdrew 20 guidance materials.

were received by the Exchange regarding the late settlement of the cornerstone investment. Following further enquiries by the LIR team, the cornerstone investment was aborted nearly two months after Company A was listed. The matter was then referred by the LIR team to Listing Enforcement.

158. If the LIR team had been earlier informed of the delay in this case by the IPO Vetting team, the Exchange could have taken sooner action. We recommend that the Listing Department review its systems, processes and procedures for information sharing to avoid a recurrence in the future.

*The Exchange's response: the procedures have been revised to inform LIR when a listed issuer is a cornerstone investor/pre-IPO investor.*

### **Investigation and enforcement**

159. The Exchange adopts a thematic approach in its enforcement work. In 2018, the Exchange focused on the following themes<sup>83</sup> in respect of its investigation and enforcement activities:
- (a) director's performance of fiduciary duties;
  - (b) financial reporting – delays, or internal controls and corporate governance issues;
  - (c) delayed trading resumption;
  - (d) failure of issuers and directors to cooperate with the Exchange's investigation;
  - (e) inaccurate, incomplete and/or misleading disclosure in corporate communication;
  - (f) failure to comply with procedural requirements in respect of notifiable/connected transactions; and
  - (g) repeated breaches of the Listing Rules.
160. The Exchange reported that it handled 111 investigations in 2018 (2017: 86), representing an increase of 29.1% from 2017. Out of the 111 investigations handled in 2018 (2017: 86), 101 or 91.0% (2017: 78 or 90.7%) related to one or more of the seven specified enforcement themes.
161. The Exchange completed 21 disciplinary cases in 2018 (2017: nine). All of these disciplinary cases were concluded with public sanctions being imposed by the Exchange (2017: nine).
162. Apart from disciplinary action, the Exchange also issued the following:
- (a) other public statements<sup>84</sup> in respect of three cases in 2018 (2017: nil);

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<sup>83</sup> The themes were last reviewed in 2017.

<sup>84</sup> These include a rule 2A.09(7) statement where, in the case of wilful or persistent failure by a director to discharge his responsibilities under the Listing Rules, the Exchange states its opinion that the retention of

- (b) 22 directions<sup>85</sup> (2017: five); and
- (c) 14 warning or cautionary letters (2017: nine).

163. In 2018, the Exchange also took action against 120 directors<sup>86</sup>, representing a significant increase from 2017 (24 directors). This is consistent with the increase in the number of investigations carried out by the Exchange.

164. Set out below is a summary of the number of investigations handled by the Exchange and the enforcement outcomes from 2014 to 2018:

|             | Investigations* | Warning/caution letters issued | Cases closed by way of “no further action” | Disciplinary cases |
|-------------|-----------------|--------------------------------|--|--------------------|
| <b>2014</b> | 60              | 14                             | 12   | 6                  |
| <b>2015</b> | 52              | 5                              | 10   | 6                  |
| <b>2016</b> | 71              | 15                             | 8  | 8                  |
| <b>2017</b> | 86              | 9                              | 11   | 9                  |
| <b>2018</b> | 111             | 14                             | 13   | 21                 |

\*The numbers represent cases concluded in the year and cases which remained active at year-end. The number of outstanding investigations at the end of 2018 was 35, compared to 28 at the end of 2017. The number of cases pending disposal or disciplinary action at the end of 2018 was 27, compared to 29 in 2017.

165. The average time taken to complete an investigation was 9 months in 2018 and 9.4 months in 2017<sup>87</sup>.

### **SFC observations**

166. The number of listed issuers increased by 9.3% from 2017 to 2018<sup>88</sup> and the number of investigations of Listing Rules breaches handled by the Exchange and action taken

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office by that director is prejudicial to the interests of investors; and also where the Listing Committee expresses its views that it would be minded to make such a statement had the resigned directors stayed in office.

<sup>85</sup> These represented directions requiring listed issuers and directors to take proactive remedial actions to rectify breaches, improve internal controls and overall corporate governance. In 2018, the Exchange issued two internal control review directions (2017: nil), eight retention of compliance adviser directions (2017: one) and 12 training of directors directions (2017: four).

<sup>86</sup> Directors are required to provide a personal undertaking to procure compliance with Listing Rules by listed issuers.

<sup>87</sup> Based on the Exchange’s information, the average time for completion of an investigation in 2017 was 9.4 months and not 8.7 months as previously disclosed.

<sup>88</sup> The number of listed issuers increased from 2,118 in 2017 to 2,315 in 2018 representing an increase of 197 (9.3%).



also increased<sup>89</sup>. The number of outstanding investigations also increased from 28 in 2017 to 35 in 2018.

### **Debts and derivatives**

167. The total number of derivative warrants and CBBs listing applications processed by the Debts and Derivatives Team in 2018 (38,472) increased by 81.3% from 2017 (21,224).

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<sup>89</sup> See paragraphs 160 to 164.

## Appendix A

### Pre-IPO enquiry cases

#### Case 1

1. In February 2018, a potential listing applicant approached the HKEX business side and asked whether its listing application could be made on a confidential basis. Rule 12.01A requires a new applicant to publish its application proof on the Exchange's website, so the applicant was effectively asking about a waiver from compliance with rule 12.01A.
2. A senior executive from the HKEX business side (**HKEX executive**) then approached a Listing Department executive regarding the potential applicant's question. The Listing Department executive replied by email and drew the HKEX executive's attention to the provisions relating to confidential filing in the Exchange's guidance letter GL57-13. The Listing Department executive said that the Department would assess each applicant's situation on a case-by-case basis and suggested that the potential applicant contact the Listing Department directly. On the following day, the HKEX executive forwarded the Listing Department executive's e-mail with those views (which were not addressed to the potential applicant) directly to the potential applicant.
3. In March and April 2018, the Listing Department was in discussions with the potential listing applicant on a number of Listing Rule issues (including confidential filing). In early April, the potential applicant's legal advisers submitted a pre-IPO enquiry to the Listing Department on these issues. These pre-IPO issues were presented to the Listing Committee for its consideration in early May 2018.
4. In early May 2018, the potential applicant's legal advisers submitted a second pre-IPO enquiry to the Listing Department on other Listing Rule issues including the company's eligibility to list as a biotech company.
5. Around mid-May, the Listing Department was requested to join the Chief Executive of HKEX and the HKEX business side in a meeting with the potential applicant. That request was turned down by the Head of Listing as he considered it more appropriate for the Listing Department to meet with the applicant separately to discuss specific listing-related issues. The Listing Department and the HKEX business side met with the potential applicant separately. Nonetheless, the Head of Listing asked the Listing Department executive who attended the meeting to send a short note with details of that meeting to the Chief Executive of HKEX.
6. On the day after the Listing Department's meeting with the potential applicant and its advisers, the potential applicant's legal advisers contacted the HKEX executive to follow up on their discussion with the Listing Department (although this executive was not present at that meeting). No minutes or other record were made of that discussion and, when asked, the HKEX executive could not recall the details of the discussion. He said that he may have discussed Listing Rules-related issues with the company's legal adviser as he was interested to understand the company's specific concerns and their implications on the new listing regime for biotech companies.
7. While the Listing Department was handling the second pre-IPO enquiry, the potential applicant submitted a formal listing application at the end of May 2018. These issues

were subsequently considered by the Listing Committee at its hearing of the listing application at the end of July 2018.

8. The day after the second pre-IPO enquiry was submitted, the potential applicant's legal adviser contacted the HKEX executive and executives of the Listing Department on a different question regarding whether the company would be treated as a Mainland issuer as this would affect its eligibility for inclusion in the Hang Seng Index and the Stock Connect scheme. The next day, the adviser sent an e-mail to both the HKEX business side and the Listing Department to follow up on the enquiry with a copy to the Chief Executive of HKEX. The Chief Executive of HKEX replied that the HKEX business side would follow up on the matter.
9. There were several rounds of discussions between the Listing Department and the HKEX business side on whether the company would be treated as a Mainland issuer. During the process, the HKEX business executive contacted the Listing Department several times on behalf of the potential applicant. In an e-mail to the Listing Department, the HKEX executive remarked *"Is there someone in Listing who makes our determination, who can I speak with to get a better understanding? Have been holding off sometime to [the potential applicant] pending clarity on this point, but clearly if [the potential applicant] won't be classified as Mainland (and hence no Connect inclusion), they will likely pull the HK IPO."*
10. As the matter was not strictly a Listing Rule issue, the Listing Department declined to give a definitive answer.

## Case 2

1. From March to August 2018 executives from the HKEX business side and a potential listing applicant were engaged in discussions about a possible listing in Hong Kong. We noted from our review of the files that the HKEX business side considered this to be a significant listing for HKEX.
2. On 30 August 2018 the HKEX business side, led by the Chief Executive of HKEX, met with senior executives from the potential listing applicant at the company's request. Four out of the five topics on the meeting agenda related to specific waivers from the Listing Rules or listing-related matters. A few days before this meeting, the company's legal adviser contacted a senior executive of the HKEX business side (**HKEX executive**) to arrange a pre-meeting to go through the issues to be discussed. However there was no record of either of these meetings. In response to our enquiry, another senior executive of HKEX who attended the 30 August meeting informed us that, although the majority of the agenda items related to Listing Rule waivers, there was no detailed discussion of specific waivers and the potential applicant was asked to contact the Listing Department directly to discuss the waivers.
3. In September 2018, the potential listing applicant's legal adviser contacted the Head of Listing and a meeting was set up with the Listing Department for October 2018. The legal adviser mentioned to the Head of Listing that the company's management team had met with the Chief Executive of HKEX and the HKEX business side to discuss the potential issues.
4. Before the meeting with the Listing Department, the potential applicant's legal adviser sent the relevant meeting materials to the Listing Department with a copy sent to the HKEX executive for information. Upon our enquiry, the HKEX executive said that it

was not unusual for potential applicants and their legal advisers to copy the HKEX business side on correspondence with the Listing Department.

5. In October 2018, the potential applicant met with the Listing Department to discuss a number of Listing Rule issues, including the issues discussed with the HKEX executives in August. A few days later, the potential applicant sent an e-mail to the Head of Listing and Listing Department executives to thank them for their “constructive approach” to the matters raised. On the same day, the Head of Listing responded to the potential applicant and forwarded the same e-mail to the same HKEX executive on a confidential basis.
6. In November 2018 the potential applicant formally submitted its first pre-IPO enquiry to the Listing Department on a number of regulatory issues. On the same day, the HKEX executive e-mailed the Head of Listing and advised him that he would be meeting the potential listing applicant the next day and he would give the company “a broadly positive message, basically saying that we are committed to supporting them, but not to get into the details of all the waivers they are seeking since this is a regulatory matter for Listing”. The HKEX executive also asked for input from the Head of Listing. The Head of Listing’s response was “...that sounds like the right message – I agree that you shouldn’t get into the Listing matters...”.
7. After that meeting, the HKEX executive sent an e-mail to the Chief Executive of HKEX, the Head of Listing and several senior executives of HKEX and the Listing Department reporting the key points of the meeting and adding “I reiterated on [HKEX Chief Executive’s] behalf HKEX’s commitment to supporting them on [their listing plan] and stressed importance to both HK as well as HKEX.”
8. The potential applicant submitted a number of pre-IPO enquiries to the Listing Department in November and December 2018, which were dealt with by the Listing Department.

### Case 3

1. In March 2018, a senior executive of the HKEX business side (**HKEX executive**) contacted a potential listing applicant and proposed to provide it with a detailed overview of the Hong Kong IPO process. The HKEX executive then told a senior executive of the Listing Department that the company was a prospective listing applicant and asked the Listing Department to meet with the company’s Chief Executive Officer to explain the IPO process in Hong Kong. The HKEX executive requested the Listing Department to revert to him after the meeting to keep him abreast of the matters discussed. There was no record of the subsequent reply from the Listing Department to the HKEX executive. In response to our enquiry, the Listing Department informed us that it did not reveal any specific details of its discussion with the potential applicant to the HKEX business side.
2. After the Listing Department’s meeting with the potential listing applicant, the HKEX executive contacted the potential listing applicant and mentioned that he had heard from a major investor of the potential applicant that the meeting with the Listing Department went well. He also suggested that the business unit would be the HKEX contact point for the potential applicant and its enquiries would be re-directed to the relevant teams within HKEX.

3. In July 2018 an executive of the Listing Department e-mailed the HKEX executive and informed him that the potential applicant had submitted its listing application. Upon our enquiry, the Listing Department informed us that neither the Head of Listing nor HKEX's Regulatory Compliance Department were informed of these internal conversations.

#### Case 4

1. In January 2018 a meeting was held with a potential listing applicant which was attended jointly by the HKEX business side and the Listing Department to discuss the company's listing plans under the proposed biotech regime which SEHK consulted the market on in early 2018<sup>90</sup>. There was no record of the discussions at the meeting but from an HKEX's email correspondence which was copied to Listing Department executives we noted that the discussions included the listing of early-stage companies under the proposed biotech regime.
2. From February to May 2018 the potential listing applicant discussed its pre-IPO enquiries with the Listing Department which were then considered by the Listing Committee in April and June 2018. The potential applicant did not submit a listing application.
3. In December 2018, the HKEX business side sent an e-mail to the Listing Department informing it that the applicant was considering a listing either in Hong Kong or in another market.

#### Case 5

1. In February 2018 a meeting was held with a potential listing applicant which was attended jointly by the HKEX business side and the Listing Department to discuss the proposed requirements under the biotech regime which SEHK consulted the market on in early 2018<sup>91</sup>. The handwritten notes of the meeting included a discussion about the potential applicant's business and the proposed requirements under the biotech regime.
2. The potential listing applicant did not make any formal pre-IPO enquiries subsequent to the meeting. Several months later the company submitted its listing application and was subsequently listed.

#### Case 6

1. In May 2018 a meeting was held between the Listing Department and a potential listing applicant to discuss certain Listing Rule issues. The HKEX business side had a separate meeting with the potential listing applicant on the same day.
2. The potential listing applicant did not make any formal pre-IPO enquiries subsequent to the meeting. Several months later the potential listing applicant submitted its listing application and was subsequently listed.

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<sup>90</sup> See footnote 15.

<sup>91</sup> See footnote 15.