



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

A Consultation Paper on

Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules

Hong Kong
January 2005

Consultation Document

i. This consultation document invites public comments on the draft amendments to the **Securities and Futures (Stock Market Listing) Rules (SMLR)**, which the Securities and Futures Commission (SFC) proposes to make under section 36(1) of the Securities and Futures Ordinance (5 of 2002) (SFO).

ii. Subsidiary legislative provisions are subject to negative vetting by the Legislative Council. In addition, for rules that the SFC proposes to make, section 398 of the SFO stipulates a mandatory consultation requirement. The SFC now releases the draft amendments to the SMLR for public consultation.

iii. The public may obtain copies of this as well as other consultation documents and attachments free of charge at the SFC office or via the Internet at <http://www.sfc.hk>.

iv. The SFC invites interested parties to submit comments on the draft amendments, and any other matters that might have a significant impact on the SMLR before 31 March 2005. Persons wishing to comment should provide details of any organizations whose views they represent. In addition, persons suggesting alternative approaches are encouraged to submit their proposed texts for the SMLR.

v. Written comments may be sent

By mail to: SFC (Stock Market Listing Rules)
Attn: Corporate Finance Division
8/F Chater House
8 Connaught Road Central
Hong Kong

By fax to: (852) 2810 5385

By on-line submission at: <http://www.sfc.hk>

By e-mail to: smlr@sfc.hk

vi. Please note that the names of the commentators and the contents of their submissions may be published on the SFC website and in other documents. In this connection, please read the Personal Information Collection Statement on the SFC website at <http://www.sfc.hk>.

vii. You might not wish your name to be published by the SFC in connection with your submission. If this is the case, please state that you wish your name to be withheld from publication when you make your submission.

Background

1. Hong Kong's regulatory framework for listings and listed companies has been largely based on non-statutory Listing Rules made by The Stock Exchange of Hong Kong (SEHK), itself a wholly-owned subsidiary of the listed Hong Kong Exchanges and Clearing Limited (HKEx). The Listing Rules, contained in the so-called "Red Book", are contractual obligations that listed companies undertake to SEHK to fulfill. They do not have the force of statute and cannot provide SEHK with statutory regulatory powers.
2. This non-statutory approach was broadly in line with the regulatory regimes in place for the United Kingdom, Australia, Singapore, and other well-developed securities markets at the time our regime was established. The most notable exception was the United States, which since 1933 has had a statutory securities regulatory framework.
3. In recent years, however, many jurisdictions have moved to the statutory approach. Australia and Singapore gave their listing rules "statutory backing" and empowered statutory agencies and courts to take statutory action against those breaching the rules. The UK transferred its listing regulatory role from the London Stock Exchange to the Financial Services Authority (FSA), which re-promulgated the listing requirements as statutory rules with statutory enforcement.
4. In Hong Kong, market participants and the public have expressed increasing concerns about the lack of regulatory teeth in the Listing Rules. Many believe it would hinder our continued development as an international financial centre and the premier listing centre for Mainland China. The success of Hong Kong depends on the quality of our market, the maintenance of which, in turn, requires credible rules that are capable of proper enforcement.
5. The Government and the SFC have taken a number of initiatives aimed at continually strengthening our listing regulatory structure. A "Dual Filing" regime was established pursuant to the Securities and Futures (Stock Market Listing) Rules (SMLR) under the Securities and Futures Ordinance (SFO) and became effective on 1 April 2003. This provides for criminal liability where listing applicants and listed issuers intentionally or recklessly disclose to the public materially false or misleading information.
6. In addition, the Government appointed an Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure. Their report in March 2003 was followed by the Financial Services and the Treasury Bureau's Consultation Paper on Proposals to Enhance the Regulation of Listing in October 2003. This, in turn, resulted in the Consultation Conclusions on Proposals to Enhance the Regulation of Listing in March 2004.
7. The Government's policy conclusions in March 2004 were, broadly speaking, to build on the Dual Filing regime, codify the important requirements in the Listing Rules into subsidiary legislation, and make the SFC responsible for enforcing those provisions, while continuing to have SEHK receive applications at the frontline and administer the listing process. The Government and the SFC have been working on the necessary legislative amendments. We now publish the proposed rule amendments for public consultation.

Principles in Drafting the Proposed Rules

8. The Government's proposals would make certain amendments to primary legislation, mainly the SFO, while the SFC's proposals would promulgate subsidiary legislation pursuant to its rule-making power under the proposed revised section 36 of the SFO, to implement the Government's policy directions. The SFC's proposals are related to the Government's proposals and this consultation paper should be read together with the *Consultation Paper on Proposed Amendments to the Securities and Futures Ordinance to Give Statutory Backing to Major Listing Requirements* published by the Financial Services and the Treasury Bureau on the same day. The Government's proposals, broadly speaking, would set out the liability for breaches of the new rules, provide for sanctions, and subject the regime to checks and balances.
9. The SFC's proposals would implement the Government's decision to codify the more important requirements in the Listing Rules into subsidiary legislation. The proposed provisions would be incorporated into the present SMLR as new sections 7A, 16A, 19A, and new Schedules 1 to 8. The full SMLR, containing both the existing and proposed provisions, is set out at Appendix 1.
10. The SFC proposes to make these rules pursuant to section 36 of the SFO. We seek the public's views and comments.
11. In codifying the more important requirements of the Listing Rules into provisions in the SMLR, we have followed four general principles.
 - (a) The requirements relate only to disclosure. They do not include Listing Rules dealing with issues of corporate governance.
 - (b) There are no substantive changes from the present Listing Rules, except in a few instances where there are compelling reasons and where the changes are expected to receive market consensus.
 - (c) There are no pre-vetting or approval requirements. Listed issuers who follow the rules would not have any additional compliance or administrative burden.
 - (d) SEHK will remain the frontline regulator and continue to receive applications as well as other disclosure materials and administer the processing.
12. *Only disclosure requirements*. The proposed requirements relate only to disclosure. Corporate governance requirements are not included.
13. Statutory requirements and the statutory regulator should focus on ensuring that listed issuers make accurate, full, and fair disclosure to their investors and the public. It is generally not appropriate for securities laws and a securities regulator to set rules on the business conduct and internal workings of a business enterprise.

14. This approach of covering only disclosure requirements follows the policy direction the Government has set out in its Consultation Conclusions of March 2004.
15. The proposed rules would be minimum requirements applicable to all issuers listed on the Main Board or the Growth Enterprise Market (GEM). SEHK may require more. For example, the proposed provisions would require issuers to publish half-yearly accounts. SEHK may wish to require issuers on GEM to publish quarterly accounts as currently provided under the GEM Listing Rules.
16. *No substantive changes.* To avoid any disturbance to market practices and activities, the proposed rules would follow the present requirements in substance. Listed issuers and market practitioners would not need to be concerned about new obligations or new requirements. Each proposed section in the SMLR in Appendix 1 is marked with a cross-reference to the present Listing Rule from which the requirement is derived. In addition, a derivation table setting out the present Listing Rule requirements and the equivalent provisions in the proposed SMLR can be found on the SFC website at <http://eapp01.sfc.hk/apps/cf/smlr.nsf/eng/page>.
17. The existing Listing Rules have been subject to public consultation and seek to strike a balance among different interests and considerations. It would not be appropriate for this exercise to alter their substance. As with other regulatory requirements under the SFC's charge, we will keep the provisions in the SMLR under ongoing review and consult the market and the public when potential changes are identified.
18. The new provisions in the SMLR, taken from the existing Listing Rules, are drafted in plain language and a logical format following modern legislative drafting conventions. We have taken the opportunity to clarify some present requirements, especially where market practitioners have given us feedback on interpretive difficulties. In addition, the present rules contain a degree of internal duplication that has inevitably resulted from the overlaying of revisions over the years. In drafting the new provisions in the SMLR, we have reduced such duplication wherever possible.
19. Certain existing Listing Rules repeat requirements on accounting information that are already applicable because listed companies have to follow the Hong Kong Financial Reporting Standards or the International Accounting Standards. In drafting the new statutory provisions, we have again reduced such duplication wherever possible.
20. In a few instances we have proposed minor changes from the present requirements. They are expected to meet market consensus. The proposed changes are explained in Appendix 2 with detail analysis and reasoning.
21. *No pre-vetting or other regulatory approvals.* To reduce the administrative burden on listed issuers and market practitioners, the proposed provisions would not require any pre-vetting or other regulatory approval of disclosure materials. Issuers and advisers who follow the rules in making timely, accurate, and full disclosure to the public can interact directly with the market. The SFC's administrative touch will be light. There will be no additional compliance costs to the market or the public.

22. By not requiring pre-vetting, the proposed provisions would also place responsibility for the disclosure where it should lie – with listed issuers, their directors, and advisers. The objective in codifying the Listing Rules and the SFC’s work focus are simple: If someone breaks the statutory rules, the SFC will be able to investigate and hold him/her liable as appropriate.
23. The move away from pre-vetting is in line with the direction of SEHK’s practice.
24. *SEHK will remain the frontline regulator.* The proposed new provisions would not alter SEHK’s work. It will continue to receive listing applications and administer the listing process. Its Listing Committee will continue to be vested with the authority to decide whether to accept an applicant onto the trading platform.
25. Under the proposed new provisions, as under the current requirements, listed issuers would not need to file disclosure materials with the SFC directly. SEHK will remain the point of contact at the frontline. Listing applicants, listed issuers, and market practitioners will continue to file materials with SEHK.

Key Aspects of the Proposed Rules

26. The proposed new amendments to the SMLR would codify existing important Listing Rules covering three areas. They follow the Government’s policy directions as stated in its Consultation Conclusions of March 2004.
 - (a) Disclosure of price-sensitive information and specific events are covered in proposed Schedule 2.
 - (b) Disclosure/publication of annual and periodic reports are covered in proposed Schedules 4 and 5.
 - (c) Disclosure and shareholders’ approval requirements for notifiable transactions and connected transactions are covered in proposed Schedules 6 and 7.
27. There are certain necessary supporting provisions.
 - (a) Definitions are in proposed Schedule 1.
 - (b) Accountant’s reports and financial information (in annual and periodic reports or disclosure for notifiable transactions or connected transactions) are covered in proposed Schedule 3.
 - (c) Mode of disclosure and miscellaneous items are in proposed Schedule 8.
28. In particular, the proposed provisions on disclosure of price-sensitive information and specific events would cover, amongst others:
 - general obligation of disclosure of price-sensitive information;
 - disclosure of substantial advances to a person or group of persons;
 - disclosure of substantial amounts due from affiliates;
 - disclosure of change in directors;

- disclosure of change of auditors;
 - disclosure of issue of shares under general mandate (not including the rules on limits and shareholders' approval).
29. The proposed provisions on disclosure/publication of annual and period reports would cover, amongst others:
- timing on publication of annual reports (with audited annual accounts), interim reports (with unaudited interim accounts), and preliminary announcements of financial results;
 - content of the disclosure in annual reports, interim reports, and preliminary announcement of financial results.
30. The proposed provisions on disclosure and shareholders' approval requirements for notifiable transactions and connected transactions would cover, amongst others:
- classification of transactions;
 - disclosure of transactions by announcements and circulars;
 - content of the disclosure in announcements and circulars;
 - independent financial advice requirements for certain transactions;
 - shareholders' approval requirements for certain transactions.
31. The Government's Consultation Conclusions did not include disclosure requirements applicable to "discloseable transactions" (a defined category of transactions under the Listing Rules) for statutory codification. We have considered the matter more fully. Discloseable transactions are significant events, disclosure of which would have been required under the general obligation on disclosure of price-sensitive information.
32. Not expressly covering discloseable transactions in the statutory rules would result in an internally inconsistent regime. Specific disclosure would be required, in the case of notifiable transactions other than discloseable transactions, by statutory provisions. But for discloseable transactions, specific disclosure would only be required by the non-statutory Listing Rules. This would be confusing and there is no benefit to such an arrangement.
33. We therefore propose also to codify those requirements on discloseable transactions. Proposed provisions that reflect this are denoted as "Option A" in the relevant places in the draft SMLR. An alternative version, which would exclude those requirements, is shown as "Option B" alongside for ease of comparison.
34. There is a second question of whether the SMLR should cover other transactions, in addition to notifiable transactions and connected transactions, that are subject to shareholders' approval, for example, authorization of general mandate and approval of share option schemes. We have carefully examined the question and concluded that such matters, relating more to corporate governance than disclosure, should remain to be regulated by SEHK's non-statutory Listing Rules.
35. Public discussion on the subject of codifying the Listing Rules and giving disclosure requirements "teeth" has focused on listed companies, meaning issuers with listed common shares. There has been little attention on issuers of listed debt, structured

products, or other securities or debentures. We have examined this matter carefully. It would be consistent to extend the new SMLR to provide disclosure requirements for issuers of listed debt and structured products. But these issuers are presently subject to special chapters of the Listing Rules with very different disclosure requirements. They are also relatively less likely to give rise to disclosure problems. Accordingly, we believe that, at this stage, the detail disclosure requirements in the proposed SMLR should only cover issuers of listed common shares.

Codes and Guidelines

36. Some sections of and notes to the present Listing Rules serve to clarify the rules or cover common compliance issues. They provide useful guidance to listed issuers and market practitioners. We intend to promulgate the relevant provisions as guidelines to the SMLR. In due course, in accordance with our stated policy, we will formally publish the guidelines for public consultation.
37. The publication of non-statutory codes and guidelines is also one of the Government's policy directions as set out in its Consultation Conclusions of March 2004.
38. For practitioners' ease of reference, we intend to compile an SFC Listing Regulatory Handbook containing both the proposed SMLR and the draft guidelines. Most of the guidelines will be printed below the particular SMLR provisions to which they relate. To highlight the difference between the statutory and non-statutory provisions, the guidelines will be in smaller and different fonts. An indicative draft of the handbook can be found on the SFC website at <http://eapp01.sfc.hk/apps/cf/smlr.nsf/eng/page>.

Flexibility in the Proposed Rules

39. No rules can cover all possible situations; a degree of flexibility in the administration is always necessary. This is especially the case in securities regulation, as the market is fast changing and the business activities of listed issuers are diverse.
40. The publication of codes and guidelines, as explained above, will provide for a degree of flexibility. The SFC will keep them under ongoing review and ensure appropriate updating to stay in line with market development.
41. SEHK can waive specific requirements in the Listing Rules for individual cases. The SFC has an equivalent authority pursuant to section 17 of the existing SMLR to waive specific sections of the rules. This would also extend to the proposed new provisions. It would enable the SFC to modify or waive a requirement if the compliance would be unreasonable or unduly burdensome to a listed issuer, irrelevant to its circumstances, or detrimental to its commercial interests. This allows flexibility for the SFC to take into account the specific facts and circumstances of each case as listed issuers find themselves in different situations in the fast changing marketplace.
42. Transparency is vital to market operations. Market participants need to know how the rules will be administered, and be assured that the rules will be applied fairly to all, in order to focus on their own business activities and planning of transactions. The SFC is committed to transparent administration of the amended SMLR.

43. The intended guidelines already set out certain places where we anticipate some listed issuers might encounter compliance difficulties at times and would need appropriate waivers. The SFC will keep the waiver guidelines under ongoing review so that listed issuers and market practitioners can readily ascertain how to obtain the appropriate flexibility.
44. To increase regulatory transparency, on a prior occasion the SFC has committed to the Legislative Council that it shall publicize any waiver it grants in any particular case. The SFC will continue with this practice and would post on its Internet website any waiver from the proposed SMLR that it gives to any listed issuer.
45. Furthermore, where the SFC expects a waiver to have equal application to a number of listed issuers, we would seek to provide a “class exemption”. Such an exemption would be subsidiary legislation subject to negative vetting by the Legislative Council. Thereafter it would automatically entitle listed issuers to relief without any need for application to the SFC.

This Consultation Exercise

46. The policy direction for enhancing listing regulation and the approach in codifying the more important parts of the Listing Rules were subject of two public consultations (by the Expert Group in 2002/03 and the Financial Services and the Treasury Bureau in late 2003/04). The present proposals aim to implement the conclusions drawn from the previous exercises.
47. The proposed provisions represent no substantive changes from the existing Listing Rules, except in a few beneficial and uncontroversial respects, which are specifically noted and explained. We nonetheless believe it helpful for the market and the public to be assured of this with sight of the proposed texts. We also believe comments from market practitioners on the wording of the proposed provisions could facilitate better understanding and clarification of any issues for all involved.
48. We would be grateful for your input.

Securities and Futures Commission
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