



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

**Report on the Securities and Futures Commission's  
2013 annual review of the Exchange's performance  
in its regulation of listing matters**

December 2013

# Table of Contents

<b>Executive Summary</b>	<b>1</b>
<b>Section 1</b>	<b>2</b>
<b>Purpose and focus of our review</b>	<b>2</b>
<b>Our approach and scope</b>	<b>3</b>
<b>How we conducted the assessment</b>	<b>4</b>
<b>Gauging market perception of the Exchange's performance</b>	<b>4</b>
<b>The assessment process</b>	<b>5</b>
<b>Section 2</b>	<b>6</b>
<b>Overall assessment</b>	<b>6</b>
<b>Market perception of the Exchange's performance</b>	<b>6</b>
<b>Observations on the Listing Division's performance</b>	<b>7</b>
<b>Level of activities</b>	<b>7</b>
<b>Reverse takeover transactions</b>	<b>9</b>
<b>Continuing connected transactions</b>	<b>12</b>
<b>Complaints handling</b>	<b>14</b>
<b>Structured products listing applications</b>	<b>16</b>
<b>Recommendations</b>	<b>16</b>
<b>Appendix A</b>	<b>17</b>

---



## Executive Summary

1. This report summarises the key findings and recommendations of the Securities and Futures Commission's 2013 annual review regarding the performance of The Stock Exchange of Hong Kong Limited (the "Exchange") in its regulation of listing matters during 2012.
2. We reviewed the Exchange's operational procedures and decision-making processes in each of the Listing Division's operational departments to assess whether they are adequate to enable the Exchange to meet its statutory obligation under section 21 of the Securities and Futures Ordinance (the "SFO"). The Exchange has a statutory obligation under section 21 to ensure, as far as reasonably practicable, an orderly, informed and fair market.
3. We are of the view that the operational procedures and decision-making processes reviewed were appropriate to enable the Exchange to discharge its statutory obligation under section 21 of the SFO during the period reviewed.
4. We are satisfied that the Exchange has taken steps to address the recommendations in our 2012 report. We noted that in preparation for the new sponsors regime the Exchange has published rules and guidance letters to complement that regime including revising and streamlining its initial public offer ("IPO") listing applications processes and procedures.
5. This report is divided as follows:
  - (a) Section 1 explains the purpose and focus of our review, its scope and the review process;
  - (b) Section 2 sets out our assessment and recommendations in respect of our review of the Exchange's operational procedures and decision-making processes in each of the Listing Division's operational departments to assess whether they are adequate to enable the Exchange to meet its statutory obligation under section 21 of the SFO; and
  - (c) Appendix A is a table summarising the results of a survey of the Listing Committee members' and market participants' views on the Exchange's performance.



## Section 1

### Purpose and focus of our review

6. We have a statutory duty under section 5(1)(b) of the SFO to supervise, monitor and regulate the activities carried on by the Exchange. As set out in the Memorandum of Understanding between the Exchange and the SFC dated 28 January 2003 (“Listing Matters MoU”), we have agreed with the Exchange that we should periodically review the Exchange’s performance in its regulation of listing-related matters.
7. In March 2004, the Government published its Consultation Conclusions on Proposals to Enhance the Regulation of Listing. Amongst other matters, the Government recommended that we prepare annual reports on our review of the Exchange’s performance of its listing functions and submit these reports to the Financial Secretary before publication. This is our ninth report following the Government’s recommendation.
8. As a recognised exchange under the SFO, the Exchange has a statutory obligation to:
  - (a) ensure an orderly, informed and fair market, so far as reasonably practicable, and
  - (b) act in the interest of the public, having particular regard to the interest of the investing public<sup>1</sup>.

The Exchange is also required under section 21(6)(b) of the SFO to provide and maintain competent personnel for the conduct of its business. It has also agreed in the Listing Matters MoU to maintain an adequate strength of staff in the Listing Division with an adequate level of professionalism and experience to discharge the responsibilities of the Listing Division.

9. Except for matters specifically reserved by the Listing Committee under the Listing Rules, most matters concerning the Listing Rules are dealt with by the Listing Division in the first instance. Matters dealt with by the Listing Division include processing listing applications, monitoring and enforcing listed companies’ compliance with the Listing Rules.
10. As with our previous review, we reviewed the Exchange’s operational procedures and decision-making processes to assess whether they are adequate to enable the Exchange to meet its statutory obligations under section 21 of the SFO.
11. The Exchange’s statutory obligation under the SFO is ongoing, and whether it has made necessary arrangements to comply with its obligation in the future cannot be judged merely by reference to its past compliance. Therefore we use the review process to assess whether the Exchange has taken adequate steps to meet its statutory obligation and identify issues that, in our view, should be addressed to ensure ongoing compliance.
12. During the course of our review of the Exchange’s performance, we may also make observations on current issues and changes in the Exchange’s operational procedures and decision-making processes.

---

<sup>1</sup> Section 21 of the SFO



## Our approach and scope

13. Our review focussed on the decision-making process and operational procedures in each of the operational departments in the Listing Division. We reviewed the operations of the following departments and teams under the Listing Division in the course of 2012:
  - (a) the IPO Transactions Department (the “IPO Department”) whose primary responsibility is to process new listing applications in respect of equity securities;
  - (b) the Compliance and Monitoring Department (the “C&M Department”) which is responsible for monitoring listed companies’ compliance with the Listing Rules;
  - (c) the Listing Enforcement Department (the “Enforcement Department”) which investigates suspected breaches of the Listing Rules and institutes disciplinary action before the Listing Committee for such breaches by companies and their directors; and
  - (d) the Listing Operations Department which is responsible for processing listing applications for debt and structured products, such as derivative warrants and callable bull/bear contracts and the dissemination of information concerning listing applicants/listed issuers and providing support for their regulatory filings.
14. Our review process focussed on the Listing Division’s laid down procedures and processes as a whole, supplemented by reviews of sample cases in order to understand how the division’s policies work in practice and to verify whether the division’s practices adhered to its policies.
15. Whilst we review the policies and approaches adopted generally, we did not review the quality of the Listing Division’s decisions in individual cases during the annual review process as this forms part of our regular oversight function of the Exchange under section 5(1)(b) of the SFO. We raise and discuss with the Exchange any particular matter which comes to our attention during the course of the year as and when such matter arises.
16. As part of the review process, we interviewed each of the Heads of Departments, including the Head of Listing, to obtain an understanding of their assessment of the effectiveness and efficiency of their respective department’s decision-making processes and operational procedures.
17. We also interviewed the Chairman and Deputy Chairmen of the Listing Committee to obtain an understanding of their assessment of the effectiveness of the Listing Committee’s processes and procedures and the performance of the Listing Division.
18. This year, we performed thematic reviews on the Listing Division’s processes and procedures in respect of:
  - (a) processing reverse takeover transactions;
  - (b) processing continuing connected transactions;
  - (c) processing complaints against listed issuers and new listing applicants; and
  - (d) processing structured products listing applications.



## **How we conducted the assessment**

19. In conducting our assessment, we considered:
- (a) relevant internal Exchange materials, written policies, procedures and processes documented by the relevant operational departments in the Listing Division and any general practices that have not been documented;
  - (b) sample cases, including the relevant operational departments' internal reports and case files;
  - (c) information we receive from the Listing Division in the ordinary course of our dealings with the Division, including its monthly report to us, internal reports and case data;
  - (d) the Hong Kong Exchanges and Clearing Limited 2012 annual report, the Exchange's quarterly newsletters called the "Exchange", and the 2012 Listing Committee Report;
  - (e) the Exchange's published disciplinary procedures, listing decisions, rejection letters, guidance letters, and other related documents on the HKEx website;
  - (f) discussions with senior management of the relevant operational departments in the Listing Division;
  - (g) discussions with Chairman and Deputy Chairmen of the Listing Committee;
  - (h) comments made in interviews or discussions with the relevant case officers;
  - (i) our continuing interaction with the Exchange under the Listing Matters MoU; and
  - (j) a survey of market participants' views to gauge the market's perception of the Exchange's performance in its listing-related functions.

## **Gauging market perception of the Exchange's performance**

20. As part of the review process, we conducted a survey of a number of market participants, including sponsors, legal advisers, accountants, investors, listed companies and Listing Committee members, on a private and confidential basis. The purpose of the survey is to establish how they view the Exchange's performance in its regulation of listing matters and to gauge changes in the market's perception of the Exchange's performance over a period of time.



### **The assessment process**

21. Our assessment of the Exchange's performance and our views expressed in this report are a combination of our on-site work, our consultation with market participants and Listing Committee members and our continuing interaction with the Exchange under the Listing Matters MoU.
22. We discussed our findings with the Head of the Listing Division.
23. We sought the Exchange's comments on both the factual matters set out in this report and our conclusions.
24. The field work and review process were completed in May 2013. Where relevant, we have also made observations on current issues and changes in the Exchange's operational procedures and decision-making processes in 2013.



## Section 2

### Overall assessment

25. We are of the view that during 2012 the Exchange's operational procedures and decision-making processes in each of the Listing Division's operational departments as described in the "Our approach and scope" section above, were appropriate during the review period to enable the Exchange to discharge its statutory obligation to ensure, so far as reasonably practicable, an orderly, informed and fair market.

### Market perception of the Exchange's performance

26. We sent a questionnaire on the Exchange's performance to 188 (2012: 189) Listing Committee members and market practitioners and received 57 (2012: 65) responses. The response rate is 30.3% (2012: 34.3%).
27. Respondents were asked to rate the performance of the Exchange and each of the operational departments in the Listing Division in various key areas on a scale of 1 to 5 with "5" being wholly satisfied. Please refer to Appendix A for detailed summary of the result of the survey.
28. Overall, there is no significant change in the respondents' view of the Exchange's performance. The average overall score for 2013 is 3.8 which is the same as that for 2012. Respondents are generally satisfied with the efficiency and fairness of the Exchange in its vetting process.
29. In general, Listing Committee members who responded to the survey are satisfied with the performance of the Listing Division.





## Observations on the Listing Division's performance

### Level of activities

30. The following table indicates the level of activity in the four operational departments of the Listing Division in 2008, 2009, 2010, 2011 and 2012<sup>2</sup>.

	2008	2009	2010	2011	2012
Number of listing applications accepted by the IPO Department	137	123	204	247	141
Number of listing applications vetted by the IPO Department	150	179	235	286	205
Number of compliance and monitoring actions handled by the C&M Department <sup>3</sup>	33,124	38,341	39,823	39,393	48,395
Number of investigations handled by the Enforcement Department	171	147	133	142	91
Number of listing applications processed by the Listing Operations Department	9,312	12,555	14,870	12,483	12,072
- Derivative warrants	5,031	4,434	8,236	7,089	5,982
- Callable Bull/Bear Contracts (more commonly known as CBBCs)	4,281	8,121	6,634	5,394	6,090

31. The Listing Division assesses its efficiency or timeliness of its actions primarily by measuring its turnaround time. Each department has instituted performance pledges as to when they will complete a particular task to improve and ensure efficiency.

### *IPO Department*

32. The IPO Department continued to work on its initiative to simplify listing documents. In this connection, the department has published six guidance letters since January 2012 which cover various sections of a listing document, such as the "summary and highlights" section and the "business" section. The guidance letters set out the general principles on what information should be included in each of the sections of a listing document and how to present the information in a simple, concise and reasonable manner. The department also published 20 other guidance letters and 10 listing decisions in 2012 to provide further guidance on the relevant Listing Rules.

33. The IPO Department vetted 205 listing applications in 2012, a decrease of 81 listing applications or 28.3% from 2011. The average time between receipt of application and issue of first comment letter in 2012 was 15 calendar days which is comparable to that in 2011. However the percentage of applicants reviewed by the Listing Committee within 120 days was 33% in 2012 compared to 58% in 2011. The time taken before a case is reviewed by the Listing Committee is partly dependant on the time taken by applicants to

<sup>2</sup> Source: HKEx 2012 Annual Report, pages 48 - 53

<sup>3</sup> Compliance and monitoring actions include announcements and circulars vetted, share price and trading volume monitoring actions undertaken, press enquiries raised and complaints handled.



respond to queries. The department attributes the increase in the time taken to process a listing application in 2012 to the poor quality of listing application materials and the complexity of issues presented by some listing applications.

#### *C&M Department*

34. C&M Department's key initiative in 2012 was to promote listed companies' self-compliance with the Listing Rules. The department published a plain language guide on connected transactions to facilitate companies' understanding of the relevant requirements. The department also published a series of listing decisions and frequently asked questions to provide further guidance on the relevant Listing Rules.
35. Post-vetting of announcements continued to form a significant part of C&M Department's work. In 2012, 3% (2011: 4%) of the post-vetted announcements resulted in follow-up actions being taken by listed companies, mainly by publishing clarification announcements.
36. In terms of timeliness, the department commented on:
  - (a) post-vetted results announcements within one business day in 98% of the cases (2011: 99%);
  - (b) post-vetted other announcements within one business day in 100% of the cases (2011: 96%); and
  - (c) pre-vetted announcements within the same day in 90% of the cases (2011: 77%).

#### *Enforcement Department*

37. Enforcement Department continued to refine its internal decision-making structures to enable earlier identification of serious misconduct and breaches of the Listing Rules. In November 2012, the department submitted a number of proposals to the Listing Committee to improve the procedures for handling disciplinary matters to enhance the efficiency, timeliness and effectiveness of its enforcement actions. The Exchange advised that they have further soft consulted certain market practitioners in respect of these proposals and published the revised disciplinary procedures on 13 September 2013.
38. Enforcement Department handled 91 investigations in 2012 (2011: 142). The department completed 12 (2011: 9) disciplinary cases, issued 20 (2011: 42) warning or caution letters and closed a further 13 (2011: 26) cases by way of "no further action". The department attributes the significant drop in the number of investigations to the fact that in 2011 the department conducted investigations into a number of cases involving possible directors' securities dealings in breach of the Listing Rules, which accounted for a larger number of investigations being conducted and a significant proportion of the warning or caution letters being issued in 2011.

	Warning/Caution letters issued	Cases closed by way of "no further action"	Disciplinary cases	Total
2008	68	41	15	124
2009	28	41	9	78
2010	27	20	9	56
2011	42	26	9	77
2012	20	13	12	45



### *Debts and Derivatives Team*

39. Debts and Derivatives Team saw a slight decrease of 3.2% from 12,483 in 2011 to 12,072 in 2012 in the total number of derivative warrants and CBBCs listing applications processed.

### **Reverse takeover transactions**

40. The preamble of Main Board Rule 14.06(6) and GEM Rule 19.06 defines a reverse takeover as an acquisition or series of acquisitions by a listed issuer which, in the opinion of the Exchange, constitutes, or is part of a transaction or arrangement or series of transactions or arrangements which constitute, an attempt to achieve a listing of the assets to be acquired and a means to circumvent the requirement for new applicants set out in Chapter 8 of the Listing Rules (the “Definition”).
41. Rules 14.06(6)(a) and (b)<sup>4</sup> set out the bright line tests which apply to two specific forms of reverse takeover. They are:
- (a) an acquisition or series of acquisitions of assets constituting a very substantial acquisition where there is or which will result in a change in control (as defined in The Codes on Takeovers and Mergers and Share Repurchases (the “Takeovers Code”) of the listed company (Rule 14.06(a)) (see paragraph 46); or
  - (b) an acquisition or a series of acquisitions of assets, which constitute a very substantial acquisition, from the incoming controlling shareholder within 24 months after the change in control (as defined in the Takeovers Code) (Rule 14.06(b)).
42. A very substantial acquisition which falls under either of the bright line tests constitutes a reverse takeover. Where a very substantial acquisition falls outside the bright line tests, the Exchange may treat the acquisition as a reverse takeover if it falls within the Definition.
43. In practice, where there is no change in control, the Exchange applies the Definition to “extreme” cases only. In determining whether a very substantial acquisition is considered an “extreme” case, the Exchange takes into account a number of factors which include:
- (a) the size of the acquisition relative to the size of the company;
  - (b) the quality of the acquired business – whether it can meet the trading record requirements for new listings, or whether it is unsuitable for listing (for example, an early stage exploration company);
  - (c) the nature and scale of the company’s business before the acquisition (for example, whether it is a listed shell);
  - (d) any fundamental change in the company’s principal business (for example, the existing business would be discontinued or very immaterial to the enlarged group’s operations after the acquisition); and

---

<sup>4</sup> These refer to the Main Board Rules. The equivalent GEM Rules are Rules 19.06(a) and (b). For simplicity, references to a particular Rule or Chapter refer to the Main Board Listing Rules only. The GEM Listing Rules contain broadly equivalent rules. As such, our observations and comments in this report apply equally to GEM.



(e) other events and transactions (historical, proposed or intended) which, together with the acquisition, form a series of arrangements to circumvent Rule 14.06(6) (for example, a disposal of the company's original business simultaneously with a very substantial acquisition).

44. The current reverse takeover rules were adopted in 2004 following a market consultation. Since then, the Exchange has continued to review the rules and their applications at the Listing Committee policy meetings in 2005, 2007, 2008, 2009 and 2010 to improve the regulations of reverse takeovers or backdoor listings, and the major findings and results were disclosed in the Listing Committee Annual Reports. The Listing Committee noted that some of the issues on backdoor listings were being addressed through changing the Exchange's vetting approach, and the Exchange did not propose to change the reverse takeover rules. The Committee also endorsed the practice of applying the reverse takeover rules to extreme cases.
45. We reviewed the Exchange's processes and procedures in respect of its vetting of reverse takeover transactions. We also reviewed the Exchange's case files on a sample of these transactions in 2012.

*Policy intention and link to "control" concept in the Takeovers Code*

46. The concept of control in Rules 14.06(6) and (b) is referenced to the definition of "control" in the Takeovers Code. The Takeovers Code defines control to mean a holding, or aggregate holdings, of 30% or more of the voting rights of a company, irrespective of whether that holding or holdings gives de facto control. Under the Takeovers Code, voting rights means all the voting rights currently exercisable at a general meeting of a company whether or not attributable to the share capital of the company. In general the acquisition of convertible debt securities does not give rise to an acquisition of voting rights but the exercise of any conversion or subscription rights will be considered to be an acquisition of voting rights that will have implications under the Takeovers Code, including the requirement to make a mandatory general offer.
47. In 2012 listed companies issued 42 circulars relating to very substantial acquisitions. We reviewed 9 cases relating to very substantial acquisitions. In 7 of the reviewed cases the transactions were structured using convertible bonds that would, if all were exercised, result in the bond holders having a majority, ranging from 58% to 86%, of the enlarged share capital. In all these cases the bond holders' ability to exercise their conversion rights were restricted to ensure that at no time would the bond holders hold 30% or more of the enlarged issued share capital of the company thus ensuring that there is no change in control as defined by the Takeovers Code.
48. Under the Takeovers Code, in determining whether there is a change in control, the aggregate voting rights of persons acting in concert should be considered. In addressing whether there is a change in control for the purpose of Rule 14.06(6), the Takeovers Executive has been asked from time to time to confirm whether certain holders of the convertible debt securities (or shareholders as the case may be) are acting in concert. In cases where there is clear evidence to establish or rebut a concert party relationship the Takeovers Executive would be able to provide the required confirmation within the timeframe specified by the parties in order for them to proceed with the transaction. However the Takeovers Executive does not routinely grant these confirmations absent clear evidence.



49. Furthermore the Takeovers Executive often finds it very difficult to give a definitive view even after conducting an enquiry of the material facts of the case and the parties concerned without carrying out a thorough investigation. Absent a definitive view that there is a concert party it is not possible for the Listing Division to take the view that a transaction results in a change of control as defined by the Takeovers Code.
50. One policy intention behind the reverse takeover rules is to require backdoor listings to be subject to the very important gate keeping safeguards that apply to a new listing established to protect the investing public by requiring these companies to be subject to full due diligence by sponsors and full disclosure of information in their listing documents<sup>5</sup>.
51. If a transaction meets the two criteria in the preamble to the Definition, i.e. if an acquisition or a series of acquisitions is an attempt to achieve a listing of the assets to be acquired and a means to circumvent the requirements for a new listing, it should be regarded as a reverse takeover and be subject to the relevant gate keeping safeguards, including approval of the Listing Committee. Use of highly dilutive convertible debt securities can circumvent the control test in the reverse takeover rules.

#### *Application of the two criteria in the Definition*

52. As mentioned in paragraph 43 above, where there is no change in control, in practice the Exchange may treat a very substantial acquisition as a reverse takeover if it is an “extreme” case taking into account the factors outlined in paragraph 43. One of the key factors is the size of the acquisition relative to the size of the company which takes into account the magnitude of the percentage ratios under Rule 14.07.
53. In considering whether a very substantial acquisition is an extreme case, the Exchange measures the percentage ratios against a very high threshold because, in its view, this threshold appropriately reflects the significance of the size of an acquisition relative to the size of a company. Applying such a high threshold filters out many transactions from further consideration by the Exchange and the Listing Committee. The Exchange’s current approach for assessing whether a very substantial acquisition is an extreme case was endorsed by the Listing Committee.

#### *24-month “look-back” test*

54. It has been reported in the Wall Street Journal (“WSJ”) (1 July 2013) that Chinese companies, in particular, property developers, have recently resorted to backdoor listings in Hong Kong as a way of getting round the restrictions on raising funds on the mainland and a tough market for IPOs in the region. A number of Chinese property companies have allegedly been buying majority stakes in Hong Kong-listed companies that no longer have material operating assets or active business operations (shell companies) in order to gain access to global capital markets.

---

<sup>5</sup> The Exchange’s consultation paper entitled “The 1998/1999 Review of Certain Chapters of The Rules Governing The Listing of Securities on The Stock Exchange of Hong Kong Limited” (May 1999) states that a reverse takeover transaction would be treated as a new application for listing. The enlarged group or the assets to be acquired should be able to comply with the requirements for listing set out in Chapter 8 of the Listing Rules and a listing document that includes all the information required for a new listing must be provided. All the procedures and requirements for a new listing applications set out in Chapter 9 of the Listing Rules which include, among others, the submission of signed sponsor declaration in respect of the due diligence work performed must be complied with.



55. Rule 14.06(b) provides that the Exchange will scrutinise acquisitions by a company from its incoming controlling shareholder within 24 months after a change in control when considering whether there is a reverse takeover. According to WSJ, in light of this rule, incoming shareholders who intend to circumvent the reverse takeover rules would hold off injecting assets into shell companies or raising funds until after the 24-month “look back” period has expired.
56. In light of our findings discussed in paragraphs 46 to 55 above, we recommend that the Exchange conducts a general review of the application and administration of the reverse takeover rules to ensure that the policy intention behind these rules is preserved.

### **Continuing connected transactions**

57. Chapter 14A of the Main Board Listing Rules and Chapter 20 of the GEM Listing Rules set out the requirements in respect of connected transactions, which can be one-off transactions or continuing transactions. Continuing connected transactions are transactions involving the provision of goods or services or financial assistance which are carried out on a continuing or recurring basis and are expected to extend over a period of time. They are usually transactions in the ordinary and usual course of business.
58. Under Rule 14A.35 of the Listing Rules, non-exempt continuing connected transactions are subject to the following requirements:
  - (a) A written agreement which:
    - (i) covers a fixed period not exceeding three years;
    - (ii) must set out the *basis of the calculation* of the payments to be made. Examples of bases of calculation of the payments to be made include the sharing of costs, price per unit for on-going purchases, annual rental for a lease, and percentage of total construction cost for a management fee (emphasis added); and
    - (iii) must reflect normal commercial terms;
  - (b) A monetary maximum aggregate annual value (“annual cap”) of each connected transaction should be set, the basis of which should be disclosed;
  - (c) Reporting and announcement requirements;
  - (d) Independent shareholders’ approval, where appropriate. A circular will be despatched disclosing details of the transaction, recommendation of the independent board committee and opinion from an independent financial adviser;
  - (e) Annual review by independent directors to confirm that the transactions have been entered into:
    - (i) in the ordinary and usual course of business,
    - (ii) on normal commercial terms; and
    - (iii) in accordance with the agreement on terms that are fair and reasonable and in the interest of the shareholders as a whole; and



- (f) Annual review by auditors to confirm that the transactions:
  - (i) have been approved by the board of directors,
  - (ii) have been conducted in accordance with the pricing policy of the company;
  - (iii) have been entered into in accordance with the agreement; and
  - (iv) have not exceeded the annual cap.

59. We reviewed the Exchange's operational processes and procedures in respect of vetting continuing connected transactions. We also reviewed the Exchange's case files on a sample of continuing connected transactions vetted in 2012. In particular we reviewed continuing connected transactions for which framework agreements have been used.
60. The Exchange vets continuing connected transactions announcements and circulars to determine whether these transactions comply with the Listing Rules requirements. We noted that the Exchange's vetting normally focuses on the following areas:
- (a) the nature of the transaction and the reasons for entering into the transaction;
  - (b) the size of the transaction - independent shareholders' approval is required if the size of the transaction exceeds certain thresholds;
  - (c) the basis in arriving at the annual cap; and
  - (d) the duration of the agreement governing the transaction - where the agreement covers a period of more than three years, the Exchange requests the independent financial adviser to explain why a longer period for the agreement is required and to confirm that it is normal business practice for the subject contracts to be for such duration.
61. We noted in our review that the disclosure of the pricing policy in respect of continuing connected transactions under framework agreements varied significantly. Some companies provided specific details about their pricing policy, for example:
- (a) x% mark-up on external price;
  - (b) y% loan guarantee fee; and
  - (c) annual rental of HK\$ z.
62. Other companies provided disclosure in general terms, for example:
- (a) "the transactions shall be priced by reference to the prevailing market rates charged by independent third parties for providing similar services and the stipulated standards prescribed by the relevant governmental authorities"; or
  - (b) "the transactions shall be conducted in the usual and ordinary course of business of the company and on normal commercial terms".
63. Where disclosure is made in general terms as described in paragraph 62(a) above, there is normally no explanation as to how prevailing market rates or independent third parties would be determined.



64. In the cases we reviewed, we noted that the Exchange seldom asked for more detailed disclosure of pricing policy which was disclosed in general terms. This approach appears to be inconsistent with Rule 14A.35 which requires the disclosure of the basis of the calculation of the payments to be made. The note to Rule 14A.35 provides examples of the bases of calculation that should be disclosed (as set out in paragraph 58(a)(ii)) above) and the examples cited are specific and measurable.
65. The Exchange normally asked questions about the basis in arriving at the annual cap. In response to our questions, the Exchange's staff explained that, in their view, the size of the annual cap is an important safeguard for protecting shareholders' interest in respect of the continuing connected transactions. They explained that companies may find it difficult to disclose specific pricing terms for transactions under a framework agreement which have not yet been crystallised at the time the announcement is made.
66. The policy intention for setting an annual cap was explained in the Exchange's May 1999 consultation paper "The 1998/1999 Review of Certain Chapters of The Rules Governing The Listing of Securities on The Stock Exchange of Hong Kong Limited". The paper explained that the annual caps are set to obtain a point of reference for continuing transactions with a connected person to enable shareholders to gauge the size of such transactions. The annual caps provide information to investors and independent shareholders on the extent to which a listed company's business relies on connected transactions.
67. Where the size of the continuing connected transactions exceeds certain thresholds<sup>6</sup>, the transaction would be subject to independent shareholder approval. This would enable shareholders to vote on the termination of agreements for continuing connected transactions which are not in their interests. The safeguard afforded by an independent shareholders' vote would only work if shareholders are given sufficient information about the subject transaction.
68. One of the key principles behind the Listing Rules is for investors to be given sufficient information to enable them to make properly informed decision. There are concerns whether the current disclosure of framework agreements in general terms would provide shareholders with sufficient information about the pricing policy of the continuing connected transactions to enable them to make properly informed decisions.
69. In April 2013, the Exchange consulted the market on the sufficiency of disclosure of information provided to shareholders regarding continuing connected transactions conducted under framework agreements. Respondents generally considered that the current compliance framework for CCTs is appropriate. We will monitor developments in this regard. We understand that the Exchange proposes to publish a guidance letter on the disclosure of pricing terms for continuing connected transactions. We support the Exchange's efforts in clarifying and reinforcing the relevant rule requirements.

### **Complaints handling**

70. As part of its monitoring of compliance with the Listing Rules, the Exchange handles complaints made against listing applicants and listed issuers. In assessing these complaints, the Exchange primarily focuses on (i) possible breaches of the Listing Rules and (ii) practices which undermine investor confidence.

---

<sup>6</sup>A continuing connected transaction on normal commercial terms is subject to the independent shareholders' approval requirements where each or all of the percentage ratios (other than the profits ratio) is (i) 5% or more or (ii) 25% or more and the annual consideration is HK\$10 million or more.





71. The Exchange's policy in handling complaints is posted on the HKEx website and is available at: <http://www.hkex.com.hk/eng/global/contact.htm#2>. The Exchange adopts a risk based approach in handling complaints. It reviews and evaluates each specific set of facts and circumstances to determine an appropriate course of action.
72. The Exchange takes no further action on complaints which have one or more of the following features:
  - (a) the complainant is anonymous or where the contact details provided are insufficient or inaccurate and the Exchange cannot contact the complainant to seek substantiation of the alleged matters;
  - (b) the factual details provided to substantiate the complaint are insufficient or inaccurate;
  - (c) the complaint appears groundless or trivial.
73. Upon receipt of a complaint the Exchange will issue an acknowledgement to the complainant. Thereafter, it is the Exchange's general policy not to comment on individual cases.
74. The Exchange explained that the key reasons for adopting this approach are to maintain public confidence in the regulation of the market or to maintain a fair, orderly and informed market for the trading of securities; to protect investors; to prevent widespread malpractice; or, help the investigation process.
75. To ensure that the Exchange meets its statutory obligation to maintain confidentiality it does not respond to complainants with an account of how their concerns have been addressed. Where, following its assessment of a matter, the Exchange takes regulatory action which results in a public statement made by either the Exchange or a company, the complainant would have knowledge of the outcome.
76. We reviewed the Exchange's processes and procedures in respect of complaints handling. We also reviewed Exchange's case files on a sample of complaints handled in 2012.
77. For all the complaint cases which we have reviewed, we noted that acknowledgement letters were sent to complainants within five business days of receipt. However, the Exchange did not communicate further with the complainants to inform them of the results of its assessment.
78. The Exchange would normally advise the complainant that it will look into the concerns raised and consider, in the circumstances, what is the most appropriate regulatory action to take. There will be circumstances where the Exchange takes no action. To ensure that the Exchange meets its statutory obligation to maintain confidentiality it ordinarily will not respond to complainants with an account of how matters have been addressed.
79. One market commentator has commented that the Exchange's processes and procedures in handling complaints lack transparency. Where a complaint does not result in any public action, the complainant would not know how the complaint has been dealt with.
80. We are of the view that the Exchange should communicate more with complainants to improve transparency of its actions.



81. In cases where the Exchange has investigated a complaint the Exchange should consider, subject to statutory secrecy provisions, whether it is appropriate to inform complainants of the outcome at the conclusion of its investigations.
82. We recommend that the Exchange reviews its complaints handling policy to improve transparency of its actions. In this regard, we note the Exchange has recently started to review its complaints handling processes and procedures.

### **Structured products listing applications**

83. In 2011, the Exchange conducted a review of the regulation of the structured products market. In this connection, the Exchange and the staff of the SFC worked closely with the market on proposals to enhance the regulation of the structured products industry.
84. As a result of the review, the Exchange published a “Guide on enhancing regulation of the listed structured products market” on 27 July 2012. The Guide covers a number of regulatory enhancement measures in the following areas:
  - (a) Improvement of liquidity provision services levels;
  - (b) Standardisation of listing documents;
  - (c) Management of issuers’ credit risks; and
  - (d) Enhancement of issuers’ internal controls.
85. In respect of document standardization, the Exchange published standardized templates of supplemental listing documents for derivative warrants and CBBCs in July 2012. These templates enhance readability and facilitate clear comparison of competing product offerings. They also use common definitions and standard terms to avoid confusion due to varying practices adopted by different issuers.
86. The Exchange required all issuers of listed structured products to adopt the standardized templates for new issuance involving local equities and indices as underlying by 31 October 2012.
87. We reviewed the Exchange’s processes and procedures in processing structured products listing applications which reflect the new requirements for standardized templates. We noted the Exchange pre-vetted all supplemental listing documents to ensure that the disclosure complies with the standard template. In general, issuers’ compliance with the new requirements for standardized templates was satisfactory.

### **Recommendations**

88. We recommend the following:
  - (a) As regards reverse takeover transactions, the Exchange should conduct a general review of the application and administration of the reverse takeover rules to ensure that the policy intention behind these rules is preserved.
  - (b) As regards complaints handling, the Exchange should review its policy in relation to feedback to complainants with a view to improving transparency of its actions. We note the Exchange has recently started the review of its complaints handling processes and procedures.



## Appendix A

The table below sets out the weighted average scores given by the survey respondents. Respondents were asked to rate the Exchange's performance in various key areas on a scale of 1 to 5 with "5" being wholly satisfied and "1" being wholly dissatisfied. Some questions were asked starting from the 2011 survey and hence the scores for previous years are stated "N/A".

		2009	2010	2011	2012	2013
<b>Views on the Exchange's performance in its regulation of listing related matters</b>						
1.	Communications to the market of the Exchange's policies and practices under the Listing Rules as regards their clarity, adequacy and timeliness	3.7	4.0	3.8	3.9	4.0
2.	Timely response to the market developments	3.5	3.7	3.5	3.6	3.7
3.	Acting in the interests of the investing public	3.8	3.9	3.9	3.8	3.9
4.	Provision of a fair, orderly and efficient market for the trading of the securities	3.9	3.9	4.0	4.0	4.0
5.	Success in ensuring that the disclosure of price sensitive information made by listed companies is on a timely basis	3.8	3.8	3.7	3.7	3.8
6.	Equal and fair treatment of all holders of listed companies	3.7	3.8	3.8	3.7	3.7
7.	Quality of companies listed	3.6	3.7	3.3	3.4	3.3
<b>Views on the Listing Division's performance</b>						
8.	Consistency in interpretation and application of the Listing Rules	3.6	3.7	3.8	4.1	3.9
9.	Impartiality	3.8	3.9	4.0	4.2	4.1
10.	Timeliness of responses	3.6	3.8	4.1	4.1	4.0
11.	Pertinence of enquiries and comments raised during the vetting process or investigation process	3.5	3.6	3.9	4.0	3.9
12.	Experience and knowledge of the Listing Rules as regards its understanding of the policy issues behind the Listing Rules	4.0	4.0	4.0	3.9	4.1
13.	Experience and knowledge of the Listing Rules as regards its understanding of the requirements of the relevant provisions in the Listing Rules	4.1	4.1	4.2	4.3	4.2



		2009	2010	2011	2012	2013
<b>Views on the various aspects of the IPO and C&amp;M Departments' work</b>						
14.	Handling general enquiries	3.6	3.9	4.1	4.1	4.0
15.	Handling requests for guidance on the application of a particular Listing Rule	3.6	3.8	4.0	4.0	3.9
16.	Processing applications for waivers	3.7	3.7	3.8	4.0	4.0
17.	Processing listing applications	3.7	3.9	4.0	4.1	3.9
18.	Clearing draft announcements, circulars and other corporate information	3.7	3.9	4.1	4.1	4.1
19.	Handling complaints	3.5	3.6	3.5	3.7	3.9
20.	Handling short term suspension	3.7	3.8	3.9	3.9	3.6
21.	Handling long term suspension	3.6	3.4	3.5	3.7	3.5
22.	Handling of pre-IPO enquiries	N/A	N/A	4.0	3.9	3.7
<b>Views on the quality of disclosure documents vetted by the Exchange</b>						
23.	Clarity of prospectuses, announcements, circulars and other corporate information	3.6	3.6	3.6	3.7	3.7
24.	Adequacy of information in these documents to enable investors and shareholders (where relevant) to make properly informed assessment of the relevant issuer	3.7	3.7	3.8	3.8	3.8
25.	Ease of understanding of these documents	3.5	3.4	3.5	3.4	3.5
26.	Timeliness of issue of announcements and circulars	3.8	3.9	3.9	3.8	3.8
<b>Views on the Exchange's performance in monitoring compliance with and enforcement of the Listing Rules</b>						
27.	Success in monitoring compliance with the Listing Rules by listed companies and directors	3.6	3.7	3.7	3.8	3.9
28.	Timeliness of disciplinary action taken against listed companies and directors	3.0	3.2	3.3	3.3	3.3
29.	Transparency of policy on disciplinary actions	3.3	3.4	3.4	3.7	3.4
30.	Consistency in approach taken in disciplinary cases	N/A	N/A	3.8	3.6	3.3



		2009	2010	2011	2012	2013
<b>Views on the Exchange's performance in conducting consultations</b>						
31.	Comprehensibility of the issues and proposals in the consultation papers	N/A	N/A	3.9	3.9	4.0
32.	Adequacy of the consultation period to consider and respond to the consultation papers	N/A	N/A	3.9	3.8	3.8
33.	Adequacy of guidance and measures to facilitate transition to amended rules	N/A	N/A	3.7	3.7	3.8
34.	Adequacy of publicity to raise awareness of new or amended rules	N/A	N/A	3.7	3.6	3.7
35.	Adequacy of explanation and discussion of the issues raised, the arguments and the proposals in the consultation papers	N/A	N/A	3.6	3.6	3.7
<b>Overall average scores</b>		3.6	3.7	3.8	3.8	3.8