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# FSDC Publishes Recommendations for Positioning Hong Kong as a Preferred International Listing Venue

## Background

On 18 June, 2014 the Financial Services Development Council (**FSDC**) released a research report titled “[Positioning Hong Kong as an International IPO Centre of Choice](http://www.fsdc.org.hk/sites/default/files/IPO4-2%20(Final%2017-6-2014).pdf)” (the **Report**) ([see archive](Positioning-Hong-Kong-International-IPO-Centre-research-report.pdf)) setting out key areas for review and possible reform if more international companies are to be attracted to list on the Hong Kong Stock Exchange (**HKEx**). This newsletter provides a summary of the principal issues raised by the Report.

Aspects of Hong Kong’s IPO regime which the Report considers to merit detailed review and possible reform include:

* regulations or requirements that may discourage international companies from choosing to list on the HKEx;
* certain distortive IPO practices which may dampen investor confidence;
* challenges faced in cross-border enforcement and in enabling public investors to take action against corporate wrongdoing; and
* problems caused by the absence of a scripless (or dematerialised) securities holding system and proper market segmentation.

When the paper was released, FSDC Chairman Mrs Laura Cha said, “We believe the recommendations in the report will help focus the efforts of the Government, regulators, HKEx and other stakeholders in making Hong Kong a preferred centre for listing and fundraising”.[[1]](#footnote-26)

The FSDC believes that the Shanghai-Hong Kong Stock Connect pilot program to be launched in October 2014 will provide opportunities for Hong Kong to strengthen its importance as an IPO centre and that Hong Kong shnumould take advantage of these opportunities. It recommends that policy-makers review the legal and financial landscape to identify ways Hong Kong may further its internationalisation. In the meantime, the FSDC encourages market regulators to be proactive and flexible in their administrative practices to demonstrate improvements to the market that do not require lengthy consultation or rule-making processes.

The FSDC proposals are intended to make Hong Kong more attractive by reducing regulatory burden. This is to be achieved by streamlining regulatory processes and making structural changes to the market that will still ensure market integrity and shareholder protection. The changes considered are intended to attract good quality potential listing candidates that are “agnostic” in their market preference but may have been deterred from coming to Hong Kong by systemic concerns. This would result in more types of enterprises listing and diversify the range of companies in the market.

## Section 1 - Introduction

Hong Kong is a leading capital market and is currently ranked sixth worldwide and second in Asia in terms of total market capitalisation. Its advantages include:

* its regulatory regime including its robust legal framework based on English common law and adoption of International Financial Reporting Standards;
* financial policies creating an open market;
* its strategic location as a gateway for foreign investors to invest in China: Hong Kong is the international listing venue of choice for companies incorporated in China; and
* its positioning as a gateway for foreign companies to access capital funding and raise brand awareness in China and other Asian countries.

### HKEx’s Status as an International Market

While the number of international companies listing on HKEx has increased in recent years, HKEx’s continuing reliance on PRC companies undermines its position as an ‘international’ market and could hamper the market’s development in the long term. As at the end of April 2014, H Share, red chip and Mainland private enterprises accounted for 55.8% of the market capitalisation and 70.2% of the equity turnover of HKEx.[[2]](#footnote-31)

### Refusal of Alibaba IPO

A recent article prompted by the regulators’ refusal of Alibaba's proposed shareholder structure portrayed Hong Kong as a ‘one-dimensional market’ as financial and property firms dominate the market and PRC state owned enterprises account for 38% of the Hang Seng Index.[[3]](#footnote-33) Alibaba wanted to ensure that 28 partners kept control while owning only about 10% of the company.[[4]](#footnote-34) This is contrary to the HKEx’s fundamental concept of the ‘one share one vote’ rule which is discussed below. One argument put forward is that the governance structure should be disclosed and the market should be allowed to make its own decision by pricing the stock.[[5]](#footnote-37) Another option could be to allow special rights to the controlling group at listing only and not allow them the ability to pass on these rights.[[6]](#footnote-40) Alibaba will instead list on the NYSE which will allow its dual class structure. The listing, projected to raise over US$20 billion, could be the world’s largest ever IPO, if the final fund raise surpasses the US$22.1 billion raised by Agricultural Bank of China in 2010.

## Section 2: An Overview of Overseas Company Listings On HKEx

In 2011, overseas companies raised 52% of total funds raised in Hong Kong, but this trend did not continue and only two overseas companies listed in 2012[[7]](#footnote-42) and only 1 in 2013.[[8]](#footnote-43) The diversity of countries has increased with overseas companies accounting for half the number of the top ten IPOs in terms of capital raised from 2009-2011. Between 2006 and 2008, the top ten IPO fundraisers on HKEx were all PRC companies. While this shows an encouraging trend, companies incorporated or based in the PRC still accounted for 56.2% of market capitalization as at end of May 2014.[[9]](#footnote-44)

### Secondary Listings

There are currently only 10 secondary-listed companies on the HKEx. Six of these were listed with no capital raising and four were listed by global offering. Trading in these stocks has generally not been very active after listing.

### Listed Hong Kong Depositary Receipts

There are only five listed Depositary Receipts for four listed issuers on the Main Board.

### Market Comparisons

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

In terms of total market capitalisation of listed issuers, the HKEx is approximately four times the size of the SGX. However, of the 239 cross-border IPOs in Asia-Pacific between 2002 and 2011, 130 companies listed on the SGX.[[10]](#footnote-51) As of December 2012, international companies accounted for 39% of SGX’s total market capitalisation, compared to 6% for HKEx (PRC companies are regarded as domestic companies).[[11]](#footnote-52)

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

The LSE was the leading listing venue for international companies from 2002 to 2011 accounting for 41% of the world’s cross-border IPOs compared to Hong Kong’s 2%. The LSE has a diversified base of key foreign issuers, including companies from Russia (45 issuers), the United States (62 issuers) and India (32 issuers).

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

The NYSE was the world’s second most international exchange from 2002 to 2011 accounting for 23% of the world’s cross border IPOs. There is however less country diversification and PRC companies made up 51% of its cross-border IPOs. These companies listed mainly via backdoor listings, a route to listing which may no longer be available following increased regulatory scrutiny of backdoor listings in the wake of a number of financial reporting scandals involving PRC companies.

## Section 3: Hong Kong’s Regulatory Regime

Companies incorporated in the ‘Recognised Jurisdictions’ of Hong Kong, Bermuda, the Cayman Islands or the PRC were traditionally the only companies able to list on HKEx. In recent years, the HKEx Listing Committee has approved a further 21 acceptable jurisdictions of incorporation known as ‘Acceptable Jurisdictions’ which has opened up the market to more issuers.

### Joint Policy Statements

The Joint Policy Statement, first issued by the HKEx and Securities and Futures Commission on 7 March 2007 (**2007 JPS**), with a new edition issued in September 2013 (**2013 JPS**), provides the basis for this opening up of the market. The JPS’s key requirement on the acceptability of an overseas listing applicant is that its jurisdiction of incorporation must provide standards of shareholder protection which are at least equivalent to those of Honk Kong, such as rights to appoint and remove directors, voting rights at general meetings and rights upon winding-up.

Under the 2007 JPS, approvals were assessed on a case-by-case basis making the process complex and lengthy since it generally required a line-by-line comparison of laws. In addition, comparisons of different legal systems (e.g. common law with civil law systems) often afford little real basis for comparison.

This process became simpler when regulators adopted 2 key concepts:

* “Piggybacking”: once a jurisdiction has been accepted, new applicants from the same jurisdiction need not repeat the comparison process for the same matters, but can simply follow the methods adopted to achieve equivalence of shareholder protection standards by the first company from that jurisdiction to be listed.
* Cross-benchmarking: once accepted, a jurisdiction can be used as a comparison benchmark for applicants from new jurisdictions. This can provide significant savings in time and costs between jurisdictions of the same legal system or language.

The 2013 JPS provided further clarification on the requirements for overseas listing applicants:

(A) Applicants from an existing or prospective Acceptable Jurisdiction must explain how their domestic laws and regulations in combination meet the shareholder protection standards required by the HKEx. Country Guides have been produced for existing Acceptable Jurisdictions to help applicants in the process. The major concerns to be addressed include:

* matters requiring a super majority of votes;
* a requirement for individual members to agree to increased members’ liability;
* provisions for the appointment, removal and remuneration of auditors; and
* proceedings at general meetings.

(B) For applicants whose place of incorporation and place of central management and control are outside Hong Kong, the securities regulator in those jurisdictions must be a full signatory of the IOSCO MMOU,[[12]](#footnote-57) a document for international cooperation among security regulators. Otherwise, those regulators must have entered into a relevant bilateral agreement with the SFC for mutual assistance. The HKEx may make exceptions to this requirement on a case-by-case basis which also requires the consent of the SFC.

(C) If an applicant uses auditing standards not already accepted by the HKEx,[[13]](#footnote-58) it must apply for them to be recognised. If the proposed accounting standards are not already accepted,[[14]](#footnote-59) but they do not differ significantly from IFRS or there are proposals for the standards to converge, the HKEx may accept the standard proposed. A number of standards have been accepted.[[15]](#footnote-60) Under the Listing Rules and the Companies (Winding Up and Miscellaneous Provisions) Ordinance, reporting accountants are required to be professionally qualified in Hong Kong but a waiver may be sought from this requirement.[[16]](#footnote-61)

(D) If an applicant’s domestic laws prevent it from complying with Hong Kong’s requirements, the HKEx provides a variety of methods to meet the requirements, such as undertakings to Hong Kong regulators and internal compliance measures. Under the JPS, the nexus test requiring an applicant to show a nexus between its place of incorporation and place of principal business operations was removed.

### Analysis of 2013 JPS

The latest JPS took steps to clarify and standardise the requirements for overseas listings. A number of operational matters, such as prospectus and tax matters disclosure and the requirement for overseas applicants to have a Hong Kong register of shareholders, have been clarified. The concept of cross-benchmarking was removed in 2013, and applicants from existing and prospective Acceptable Jurisdictions are to be guided by the Country Guides published by the HKEx.

However, there has been no change in policy approach, in particular the crucial matter of how a new country is added to the list of Acceptable Jurisdictions and the requirement for applicants from new jurisdictions to demonstrate equivalence between shareholder protection standards in their jurisdiction of incorporation with those in Hong Kong.

Furthermore, no major reform occurred in the 2013 JPS with regards to opening the market to more accounting standards. The substantial time and cost to a company to prepare its accounts to an acceptable standard may force it to look elsewhere to list. While waivers are available they are generally not granted. The US market faced a similar issue with potential American Depositary Receipts issuers choosing to list on LSE due to the requirement to reconcile their accounts to GAAP for the US market. In 2009, the US Securities and Exchange Commission responded to this by accepting accounts conforming to IFRS.

### Secondary Listing

An objective of the 2007 JPS was to encourage secondary listings. Before its publication, the rules were not well-developed. Nine of the current ten secondary listings occurred after the 2007 JPS.

#### Listing requirements

While secondary listings are subject to the same requirements as primary listings, HKEx has granted extensive waivers on a case-by-case basis to secondary listing applicants where this was not materially prejudicial to the rights of public shareholders. The 2013 JPS introduced a standardised list of automatic waivers which are available to applicants seeking a secondary listing on HKEx’s Main Board which:

* have a primary listing on one of the 15[[17]](#footnote-65) exchanges specified in the 2013 JPS, where the applicant has not been waived or exempted from compliance with the rules of that market;
* have a market capitalisation of more than US$400 million and have been listed for at least five years on their primary market (although this track record requirement can be waived if the applicant is well-established and has a market capitalisation significantly larger than US$400 million). A history of legal and regulatory compliance on the applicant’s primary listed market is also normally required; and
* have a ‘centre of gravity’ outside China. While this term is not defined, factors taken into account by the HKEx include location of the applicant’s headquarters, its central management and control and its main business operations and assets, its corporate tax registration, and the residence and nationality of its management and controlling shareholders.

The FSDC commends the standardisation and increasing transparency of the waiver process under the 2013 JPS, noting that uncertainty in the secondary listing process has been greatly reduced as a result. An applicant incorporated outside a Recognised Jurisdiction must also comply with the requirements in (A) and (B) above.

### Hong Kong Depositary Receipts (**HDRs**)

The HKEx introduced the HDR regime in July 2008 to facilitate the listing of companies from jurisdictions which restrict the movement of shares abroad or prohibit the maintenance of an overseas share register or splitting of the share register.

The availability of a DR structure can be significant in diversifying a listing market. For example, the availability of a GDR option enabled the listing of Russian companies on the LSE. The listing requirements and continuing obligations applicable to issuers listing ordinary shares apply equally to issuers listing HDRs.

The Listing Committee has specified the review of the HDR regime as an item in its policy agenda for 2014 and beyond.[[18]](#footnote-67)

## Section 4 - Recommendations and Observations

### Procedural Initiatives

#### Public Filing Safe Harbours

Under new listing requirements effective from 1 October 2013, two draft disclosure documents are required to be disclosed to the public via online publication. These are the ‘Application Proof’ (the version of the prospectus accompanying the listing application) which must be substantially complete and another version, the post-hearing information pack (**PHIP**) which is issued after the Listing Committee hearing and before the earlier of the issue of the ‘red-herring’ prospectus or the commencement of book-building.

##### Impact on overseas companies listing

The above requirements mean that listing applicants must disclose large amounts of possibly sensitive business information to the public before they are assured of a listing. In response, the Hong Kong regulators provided for a restricted safe harbour for public filing of the Application Proof for applicants that have already been listed on a recognised overseas exchange for not less than five years and have a market capitalisation of not less than US$400 million or such higher value as determined by the HKEx. There is no safe harbour from the requirement to publish the PHIP. While waivers are also available for the Application Proof for applicants who are spun-off from overseas listed parents, these again do not apply to the PHIP.

##### Proposal

The FSDC believes that these requirements may lead overseas companies with no natural nexus with the Hong Kong market to opt for other listing venues which enable information to remain confidential until it is certain that the listing will go ahead. The Report therefore suggests that regulators keep this in mind and reconsider the scope of the safe harbour and the conditions for waivers or modifications to the requirements for public release of the Application Proof.

#### Placing and Price Discovery Mechanisms

The share allocation and price discovery processes for Hong Kong IPOs are relatively inflexible compared to other advanced markets. The IPO price discovery process in the New York and London exchanges have a shorter settlement cycle, while Singapore’s is comparable.[[19]](#footnote-76) Hong Kong’s aftermarket performance has also trailed behind these other markets in recent years.[[20]](#footnote-77) FSDC believes that this situation has been aggravated by the inflexibility of the Hong Kong IPO price discovery process and the constraints this imposes on market participants. The inflexibilities identified include the requirements for a retail offer, the fixed clawback mechanism, the long settlement cycle and resultant negative effect on pricing, cumbersome price adjustment mechanisms, under-regulation of cornerstone investment, and inadequate guidance on placing and allocation.

#### Mandatory Retail Offer

Most Main Board listings include a 10% retail tranche and an international placing tranche of the remaining 90%. A listing on the Growth Enterprise Market (**GEM**) Board can have a larger placing component and many GEM Board listings are conducted by way of placing only – i.e. without the participation of retail investors. Although Main Board listing by way of placing is technically possible, in practice virtually every IPO on the HKEx’s Main Board will have a retail offer. This is not the case on other major international equity markets. The mandatory clawback from the international placing tranche to the retail tranche is unique to Hong Kong and creates a degree of inflexibility.

The FSDC argues that while retail market participation may be desirable, the system requires a greater amount of built-in flexibility to accommodate prospective IPOs which do not suit a typical retail investment profile – e.g., applicants with a high-risk business or corporate profile, or proposed deal structures that do not provide all the normal protections to shareholders equally. It proposes that regulators work with stakeholders to introduce more flexibility while still ensuring protection and opportunities to retail investors. Market segmentation is also raised as a possible solution where fair treatment of retail investors is a concern and this is discussed further below.

#### Fixed clawback mechanism

The FSDC argues that the mandatory clawback requirements should be reviewed, with particular focus on:

* the relationship between the size of the mandatory clawback and the level of over-subscription for shares in the retail tranche; and
* possibilities of fine-tuning to provide for specific circumstances, other than the existing route of specifically applying to HKEx for waivers or modifications.

#### Long Settlement Cycle and Negative Effect on Pricing

A Hong Kong IPO typically has a settlement cycle of 5 days between determination of the offer price and commencement of trading of the shares on HKEx. Hong Kong’s T+5 settlement cycle is largely the result of specific limits imposed by Hong Kong Securities Clearing Company Limited. The London and New York settlement cycles are usually 3 days while Singapore’s is comparable to Hong Kong. Some markets allow for ‘when issued trading’ which is the trade of authorised but not yet issued shares, conditional on their final issue. Hong Kong’s longer settlement cycle exposes both the issuer and underwriters to risk which is factored into the offer price.

#### Price adjustment mechanism

The HKEx imposes public disclosure procedures (including a requirement for a supplemental prospectus) and mechanisms to allow investors to withdraw applications for IPO shares where market conditions compel a revision of the offer price. This again provides an inflexible system which the FSDC argues has a negative impact on deal pricing and the Hong Kong market’s performance generally and should be modernised.

#### Under-regulation of cornerstone investment

Cornerstone investors commit to taking up a portion of shares in the placing tranche at the offer price before the IPO is launched, giving them a guaranteed allocation in exchange for a non-disposal undertaking (typically 6 months). This can benefit an IPO in a volatile market but may be distortive as it detracts from market forces. The lock-up on disposals by cornerstone investors can also lead to an illiquid ‘overhang’ of untradeable shares in the market which reduces liquidity and is at odds which the Listing Rules’ requirement for a minimum public float. The lock-up also means that trading prices are often subject to high volatility on the expiration of the lock-up.

#### Inadequate guidance on placing and allocation

The FSDC argues that the placing guidelines set out in appendix 6 to the Listing Rules are not up to date and require improvement. There are many areas of uncertainty which is exacerbated by HKEx’s practice of supplementing the rules through ad hoc guidance in the form of HKEx listing decisions and guidance letters.

#### Impact on overseas companies listing

While the inflexibilities in the Hong Kong IPO placing and price discovery processes affect all listing applicants, the danger in the case of overseas applicants with no obvious reason for listing in Hong Kong, is that these inflexibilities may lead them to list on other markets offering a more rational pricing process which is less affected by extraneous circumstances and more accurately reflects the company’s assets and profitiability, its business prospects and general market dynamics.

#### Proposals

The FSDC proposes two short term initiatives:

* the regulation of cornerstone investment should be reviewed insofar as it hinders a genuine book-building process;
* regulators should give consideration to introducing greater flexibility to the clawback requirements, possibly by codifying and clarifying the practice of granting waivers to companies with large capitalisations.

The FSDC also endorses the use technology to find an effective pricing policy such as the computerised book building facility launched by the Australian Stock Exchange in 2013.

### Infrastructural Initiatives

#### Cross-Border Regulatory Enforcement

Protection of public shareholders’ rights is fundamental to the HKEx. When an overseas company is involved, the fact that the company’s management and assets are often beyond the reach of Hong Kong law makes it difficult for shareholders to seek redress for a wrong done to them.

Regulators ensure shareholder protection by requiring the standards in the jurisdiction of the company’s incorporation to be at least equivalent to those of Hong Kong. It is also a requirement under the 2013 JPS that the statutory securities regulator of the company’s jurisdiction of incorporation, and of the jurisdiction of its central management and control (if different), is either a full signatory to the IOSCO MMOU or has entered into an appropriate bilateral agreement with the SFC.

The FSDC proposes that regulators further extend the reach of Hong Kong regulators by entering into reciprocal enforcement and cooperation arrangements with key jurisdictions.

#### Shareholders’ Recourse

Breaches of securities and company laws are rarely litigated in Hong Kong mainly due to the lack of a class action regime and the prohibition on contingency fee arrangements which preclude the possibility of action for many self-funded litigants.

##### Impact on overseas listings

The relatively limited channels of shareholders’ recourse in Hong Kong have resulted in regulators taking a ‘front end’ approach to regulation to protect shareholders. The extensive regulation and pre-vetting in the listing process can lead to overseas companies being, or perceiving themselves to be, heavily screened by regulators.

The FSDC commends the SFC’s use of sections 212 to 214 of the Securities and Futures Ordinance (**SFO**) to obtain orders providing redress for public shareholders of listed companies which breach Hong Kong’s securities laws. Section 212 was used in the case of China Metal Recycling in 2013 to apply to the court to wind up the Cayman Island incorporated company whose business was based in the PRC following allegations of overstatement of its financial position in its prospectus and annual report. Section 213 has been used successfully by the SFC to seek orders to unwind transactions in breach of the SFO that have caused loss to shareholders.[[21]](#footnote-90) Section 214 allows the court to grant orders where a company has acted in a way that is oppressive or unfairly prejudicial or involves fraud or misconduct.[[22]](#footnote-91)

##### Proposal

The FSDC proposes that the relevant authorities should in the long term look to provide shareholders with the ability to enforce their own rights directly which would be likely to reduce the need for the onerous front-end regulatory screening currently seen. They also argue that the potential for shareholders’ actions would improve investor confidence in the HKEx.

#### Uncertificated Securities Holding System

Most HKEx-traded shares are transferred through the Central Clearing and Settlement System (**CCASS**). This requires that a global share certificate is issued and deposited with CCASS. All shares deposited with CCASS are registered in the name of HKSCC Nominees and beneficial interests in the underlying shares are transferred without any alteration to the registered legal title, unless the shares are taken out of the system. Shareholder rights are exercised indirectly via an intermediary such as a broker or by instructions given from the beneficial owner to HKSCC Nominees to forward to the share registrar. If a beneficial owner chooses to vote at a general meeting, HSKCC will typically appoint the owner as proxy. This could pose a problem if the company law of the issuer provides different rights to proxies than it does to registered shareholders.

##### Impact on overseas companies listing

For companies from jurisdictions with a scripless or uncertificated securities holding and trading regime, the only suitable option for listing on HKEx may be an HDR listing. Hong Kong’s paper-based settlement and clearing system, which requires physical share certificates and the mailing of refund cheques to IPO subscribers, also exacerbates inefficiencies in price discovery.

##### Proposals

The FSDC proposes the introduction of an uncertificated holding system. Many consultations have been conducted in the past with the most recent joint Government/SFC proposal in 2013 supporting the system. The Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Bill 2014 was recently introduced to the Legislative Council.

#### Reducing the Tax Impact of Overseas Company Listings

The absence of a double taxation arrangement (**DTA**) or similar with a company’s jurisdiction of incorporation may make investment in that company expensive for Hong Kong investors.

##### Impact on overseas companies listing

Overseas jurisdictions’ taxes and levies on dividends and capital gains etc. can discourage Hong Kong investors’ investment in overseas companies listing on HKEx. For example, demand from Hong Kong retail investors for shares of Prada S.p.A was muted due to tax concerns. The absence of a DTA between Italy and Hong Kong meant that Hong Kong shareholders faced a potential capital gains tax levy of 12.5%. The CCASS system aggravates the problem as companies may not be able to determine who the underlying shareholders are to determine their exemption status.[[23]](#footnote-98)

While Hong Kong currently has 29 DTAs, the FSDC recommends increasing efforts to conclude more DTAs.

#### Market Segmentation

The HKEx is segmented into the Main Board and the GEM Board. Regulators have tended to apply rules that are retail-orientated and deviations from these usually require a waiver. A 2012-13 HKEx survey showed that domestic retail investors made up 18% of total market participation and overseas retail investors accounted for 5% of the total market.[[24]](#footnote-100) Retail investors in an IPO will usually be in the minority, subject to clawback provisions applying if demand warrants.

##### Impact on overseas companies listing

The application of the highest protection standards to all IPOs may not be necessary with regard to institutional investors who are sophisticated investors and usually make up to 90% of investors in an IPO. Companies who intend to attract these investors may find the HKEx regulations irrelevant and onerous and may choose other listing markets over Hong Kong as a result.

##### Comparison with other markets

The LSE consists of 4 markets governed by different rules. Its Main Market is further divided into three segments.

The ASX allows small and unprofitable companies to list as Commitments Test Entities (**CTEs**). Companies that fail to meet the normal listing requirements to list as a CTE, but they must come to an agreement with the ASX regarding their use of IPO funds raised.

##### Proposal

The FSDC proposes that market segmentation should be considered to cater to different types of investors and issuers. Differentiation according to investors’ experience and risk appetite could allow large reputable companies to be subject to less onerous compliance obligations, while allowing smaller companies who do not satisfy the criteria for listing to be listed on HKEx. This reform would also require segmentation of the secondary trading market to suit investors’ profiles.

#### A Hub for Specific Industries

Both the luxury goods and retail and the natural resources sectors have had strong growth on HKEx largely due to demand in the Chinese market.

The FSDC recommends that regulators focus on developing these key sectors:

##### Natural Resources

Regulators have shown their commitment to the sector by introducing Chapter 18 of the Listing Rules and further guidance letters as well as organising international conferences to promote the HKEx to resources companies. The FSDC argues that Hong Kong’s professional services infrastructure is underdeveloped in relation to mining-related experience and expertise. Policies requiring long term planning such as tertiary education, hiring policies and immigration policies could be considered to remedy this deficiency.

##### Retail and luxury

The strong demand in the PRC for this sector has allowed the HKEx to obtain a number of large listings.[[25]](#footnote-107) The proposals above apply to creating a more flexible, open environment for overseas investors and the Government should also work with market professionals to identify changes that would benefit this sector specifically.

### Corporate Governance Initiative

#### Diversification of Legal Structures

The HKEx Listing Rules are drafted on the basis of accommodating businesses that adhere to the common law type corporate structure. The rules presume:

* a capital structure consisting of shares, and returns to shareholders by dividend, distributions or return of capital;
* a distinction between ownership and management, with a governance or supervisory structure consisting of a board of directors or similar; and
* a corporate mode of exercise of owners’ rights, including the manner of receiving corporate information, attendance at members’ meetings and voting at meetings in person or by proxy.

The Listing Rules also impose the idea of ‘one share one vote’ which is seen as central to shareholder protection. Companies with shares containing different voting rights and unusual control structures may not be able to list under these rules.

##### Proposal

The FSDC proposes that the HKEx should be opened up to other types of entities which may prove beneficial to the market as a whole. This should be done gradually and follow appropriate analysis to ensure investor protection. It also proposes that the ‘one share one vote concept’ should be re-considered with the benefit of public consultation to determine to what extent, if any, modifications or relaxations may be appropriate.

## Section 5 - Conclusion

The FSDC’s proposals are aimed at reducing Hong Kong’s reliance on the PRC as the source of listing applicants. It advocates opening Hong Kong’s IPO markets to quality overseas companies. It believes the market has been restricted by a number of issues that are in need of review and possibly reform. While some of these are procedural in nature and can be improved with light policy changes others require long term planning and consultation.

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3. Back, A, “Hong Kong’s Alibaba Lament”, 18/03/2014, The Wall Street Journal [↑](#footnote-ref-33)
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5. Guy, P, 17/03/14, “Hong Kong regulators caught between rock and hard place in Alibaba IPO saga”, <http://www.scmp.com/business/money/markets-investing/article/1450172/hong-kong-regulators-caught-between-rock-and-hard> ([see archive](SCMP-Hong-Kong-caught-rock-hard-place-Alibaba-IPO.pdf)) [↑](#footnote-ref-37)
6. Ibid [↑](#footnote-ref-40)
7. Page 9 of report, “Hong Kong – Asia’s Global Market, A Destination for International Listings”, KPMG, September 2012 [↑](#footnote-ref-42)
8. Termbray Petro-King Oilfield Services Limited; Although the applicant is incorporated in the BVI and thus technically qualifies as an ‘international listing’, the company is owned and managed by Mainland residents and operating a PRC-based oilfield business. (Report p9) [↑](#footnote-ref-43)
9. HKEx Monthly Market Statistics, May 2014, <https://www.hkex.com.hk/eng/stat/statrpt/mkthl/mkthl201405.htm> ([see archive](HKEx-Monthly-Market-Statistics-May-2014.pdf)) [↑](#footnote-ref-44)
10. Page 14 of report, Baker & McKenzie, “Equity sans frontiers: Trends in cross-border IPOs and an outlook for the future”, PricewaterhouseCoopers, November 2012. Note that for this study, listings of PRC companies in Hong Kong are considered domestic, not cross-border listing [↑](#footnote-ref-51)
11. Page 14 of report [↑](#footnote-ref-52)
12. The International Organisation of Securities Commission’s Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information. [↑](#footnote-ref-57)
13. In paragraph 50 of the 2013 JPS, the HKEx sets these out as follows: (i) the Australian Auditing Standards; (ii) the Canadian Generally Accepted Auditing Standards; (iii) professional auditing standards applicable in France; (iv) the Italian Auditing Standards; (v) the Singapore Standards on Auditing; (vi) the Standards for Investment Reporting issued by the Auditing Practice Board in the UK; and (vii) the US Public Company Accounting Oversight Board auditing standards. [↑](#footnote-ref-58)
14. Under Listing Rule 4.11, these are: (i) Hong Kong Financial Reporting Standards (**HKFRS**) issued by the Hong Kong Institute of Certified Public Accountants; (ii) International Financial Reporting Standards (**IFRS**); and (iii) China Accounting Standards for Business Enterprises (**CASBE**) in the case of a qualifying PRC company. Additionally, the HKEx has accepted US Generally Accepted Accounting Principles (**GAAP**), in a case where the company was dual-listed in Hong Kong and on an overseas exchange. [↑](#footnote-ref-59)
15. These are set out in paragraph 59 of the 2013 JPS: (i) EU-IFRS for EU companies; (ii) US GAAP for companies with or seeking a dual primary listing in the US and Hong Kong; (iii) for companies with or seeking a dual-primary or secondary listing in Hong Kong (Australian GAAP; Canadian GAAP; Japanese GAAP; Singapore Financial Reporting Standards; and UK GAAP). [↑](#footnote-ref-60)
16. Paragraph 53 of the 2013 JPS requires reporting accountants and auditors to be independent of the listing applicant and Paragraph 54 states that alternative qualifications would generally be considered acceptable if the firm: (i) has an international name and reputation; (ii) is a member of a recognised body of accountants; and (iii) is subject to independent oversight by a regulatory body of a jurisdiction that is a signatory to the IOSCO MMOU. [↑](#footnote-ref-61)
17. Amsterdam Stock Exchange; Australian Securities Exchange; Brazilian Securities, Commodities and Futures Exchange; the Frankfurt Stock Exchange; Italian Stock Exchange; London Stock Exchange; Madrid Stock Exchange; NASDAQ OMX; New York Stock Exchange; Paris Stock Exchange; Singapore Stock Exchange; Stockholm Stock Exchange; Swiss Exchange; Tokyo Stock Exchange; Toronto Stock Exchange. [↑](#footnote-ref-65)
18. Listing Committee, The Listing Committee Report 2013, HKEx <http://www.hkex.com.hk/eng/listing/listcomrpt/Documents/AnnualRpt_2013dec.pdf> at 27 ([see archive](HKEx-Listing-Committee-Report-2013.pdf)) [↑](#footnote-ref-67)
19. See fig 4-2 p29 of report [↑](#footnote-ref-76)
20. See fig 4-3 p30 of report [↑](#footnote-ref-77)
21. For example, SFC v Hontex International Holdings [2012] CACV 128, SFC v Qunxing Paper Holdings Company Limited [2013] HCA 2428 [↑](#footnote-ref-90)
22. For example, compensation orders against the former chairman and executive director of Styland Holdings Limited in SFC v Kenneth Cheung Chi Sing [2010] HKCU 2560 and the former CEO of China Asean Resources (SFC v Li Wo Hing [2012] HKCU 2104) [↑](#footnote-ref-91)
23. For example, Prada S.p.A. must make a withholding on dividends of 27%. [↑](#footnote-ref-98)
24. Report p50 [↑](#footnote-ref-100)
25. For example, Prada S.p.A., Sun Art Retail Group Ltd, Samsonite International SA. [↑](#footnote-ref-107)