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# Revised Approach Adopted For The Introduction Of A Statutory Listing Regime

## Introduction

The Government proposes to introduce to Legco as soon as possible a Securities and Futures Amendment Bill implementing a new statutory listing regime. This will be in line with the revised proposals for extending the SFO's market misconduct regime to breaches of new statutory listing requirements set out in the SFC's February 2007 consultation conclusions on its 2005 proposals.

The essential features of the new regime are listed below.

* A set of general principles will be included as statutory listing requirements in a new Part IIIA of the SFO. These will be the fundamental obligations with which listed issuers must comply, being statements of the standards expected by the market.
* The new regime will cover 3 core areas; financial reporting, disclosure of price sensitive information and notifiable and connected transactions which require shareholders' approval.
* Breach of the general principles will amount to market misconduct. The sanctions for serious cases will include SFC disciplinary action, Market Misconduct Tribunal proceedings and criminal prosecution.
* A new Schedule to the SFO will set out relevant definitions and the more important of the existing listing requirements as factors for consideration in determining compliance with the general principles.
* The regime's detailed requirements will be included in a new non-statutory Listing Code, the aim of which will be to assist compliance with the new regime.
* To reduce regulatory overlap, the requirements covered by the new regime will be deleted from the Listing Rules.
* The SFC will be responsible for investigating and bringing enforcement action in respect of breaches of the statutory listing requirements.
* Pre-vetting of shareholders' circulars and relevant announcements will continue under the new regime, but will be on a voluntary basis. The long-term aim is to phase out pre-vetting of documents.

The purpose of this note is to summarise the new proposals which are set out in full in the SFC's "Consultation Conclusions on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules" which is available on the SFC's website at [www.sfc.hk](http://www.sfc.hk/web/EN/index.html).

## The Consultation

In January 2005, the Government issued a consultation paper on its proposed amendments to the SFO to give statutory backing to the most important of the Exchange's listing rules. At the same time, the SFC published for consultation proposed amendments to the Securities and Futures (Stock Market Listing) Rules to codify the more important requirements of the Listing Rules as subsidiary legislation.

The aim of the initiatives was to remedy the lack of "teeth" and the limited sanctions available under the existing Listing Rules and to address the insufficient investigation powers of the Exchange. A further aim was to allow the imposition of sanctions commensurate with the seriousness of the breach.

## Market Response To The Consultation And The Revised Approach

The changes resulting from the consultation are described by the SFC as the "Revised Approach".

### The Revised Approach

Respondents to the consultation were generally supportive of the proposals, but some expressed reservations about the incorporation of detailed Listing Rules into statute, fearing that excessive detail would give lead to severe sanctions for minor infractions and that such detail could reduce flexibility and hinder effective administration of the rules in response to market needs. As a result, the Revised Approach distinguishes between general and high level principles (which will be embodied in statute) and detailed provisions (which will be incorporated as a non-statutory Listing Code and guidelines). There are three layers to the Revised Approach:

1. Statutory general principles

* The statutory listing requirements will take the form of a set of "general principles" which will be set out in a new Part IIIA of the SFO. These are the fundamental obligations of listed issuers – corresponding to the standards expected by the market and the spirit behind the Exchange's current listing requirements. Certain safe harbours will also be created that disapply the "general principles" in prescribed circumstances.
* An indicative summary of the general principles proposed to be included in the new Part IIIA is set out at Appendix 1 of the Consultation Conclusions which are available on the SFC's website.

1. Statutory ancillary provisions

* The "general principles" will be supplemented by ancillary provisions in a new Schedule to the SFO. The Schedule will complete the statutory listing requirements by adding the necessary details, including the definitions, factors for consideration to be assessed in determining compliance with the general principles, and additional exemptions. The definitions will include the classification of major transactions, very substantial acquisitions and disposals, reverse takeovers and connected transactions, and the key definitions concerning associates and connected persons.
* The factors for consideration in determining compliance will be the more important listing requirements in the three areas to be given statutory backing taken from the existing Listing Rules. An example would be the voting procedures for obtaining shareholders' approval. The Listing Rules' existing exemptions, for example the exemption from the requirement for shareholders' approval in relation to connected transactions of de minimis value, will be retained. The SFC will also be empowered to introduce additional safe harbours and class exemptions into the Schedule in future in response to market needs.

1. Non-statutory detailed and technical provisions

* The detailed and technical provisions, aimed at assisting issuers to comply with the general principles, will be set out in a non-statutory Listing Code to be issued by the SFC. The SFC may issue additional guidelines in the future to supplement the interpretation and application of the Listing Code.
* By creating a distinction between the fundamental statutory general principles and non-statutory detailed and technical provisions, the SFC expects to maintain a high degree of flexibility in the modification and interpretation of the detailed provisions in response to market needs.

### Core areas covered by the Revised Approach

The Revised Approach will cover the following 3 core areas:

1. Periodic financial reporting

* This relates to the obligation of listed issuers to disclose to the public in a timely manner their periodic financial information, including their annual and interim reports and the supplemental requirements to be complied with in relation to that periodic financial information.

1. Disclosure of price sensitive information

* This concerns listed issuers' obligation to disclose to the public as soon as reasonably practicable any information relating to the issuer which is necessary to enable the public to appraise the position of the issuer or which might reasonably be expected to have a material effect on the market activity in, or the price or value of, the issuer's securities.
* Respondents expressed concerns about making disclosure of price sensitive information a statutory obligation, as decisions to disclose such information often involve a large element of subjectivity, putting issuers and directors at risk of harsh statutory sanctions for a decision made in good faith. The SFC has clarified that SFC and MMT sanctions will only apply where directors or officers are knowingly, intentionally or negligently involved in the breach.
* Further, safe harbour provisions will be introduced in Part IIIA of SFO whereby issuers need not comply with the requirement to disclosure price sensitive information in specified circumstances. These may include:
* Disclosure of information relating to impending developments or matters in the course of negotiation (where failure to disclose is not likely to mislead the public);
* Where compliance with the requirement would be detrimental to the commercial interests of the group and strict confidentiality of such information has been maintained; and
* Specific disclosure of an event which affects the market or a sector of the market generally and which is readily apparent to the investing public.

1. Notifiable and connected transactions which require shareholders' approval

* This addresses the protection of minority shareholders from possible abuse and expropriation by insiders through certain notifiable and connected transactions. The requirements include:
* The obligation of listed issuers to obtain prior shareholders' approval for certain notifiable transactions (i.e. major transactions, very substantial acquisitions or disposals and reverse takeovers) and connected transactions;
* The obligation to provide all relevant information to shareholders to enable them to fully appraise the transaction and make an informed voting decision; and
* Excluding shareholders with a material interest in the transaction from voting.

### No duplication with the Listing Rules

To remove the risks of potential duplication and inconsistent interpretation arising from the existence of two sets of overlapping rules, the three areas of listing requirements described above will be deleted from the Listing Rules when the new statutory listing regime comes into effect. The remaining Listing Rules will continue to deal with other listing matters including entry and exit criteria and corporate governance requirements.

### Sanctions for non-compliance

#### General Principles

Non-compliance with the general principles of the SFO will constitute market misconduct. The SFC will be entitled to take appropriate action in a manner that is proportionate and reasonable in relation to the contravention, taking into account (among other things):

* the seriousness of the conduct;
* whether the conduct was reckless, intentional or negligent; and
* whether the conduct may have damaged the interest of investors or the investing public.

Serious cases would potentially be subject to one of three types of sanction:

* SFC disciplinary action;
* Market Misconduct Tribunal (**MMT**) proceedings; or
* criminal prosecution.

It is expected that there will be provisions preventing double jeopardy, so that an SFC disciplinary action could not be commenced after the initiation of MMT proceedings and vice versa.

#### Schedule Requirements

Non-compliance with the provisions of the Schedule will not of itself be regarded as a breach of the statutory listing requirements. It will however be a factor in determining compliance with the general principles in Part IIIA SFO.

#### Listing Code

Non-compliance with the detailed and technical provisions of the Listing Code would not give rise to any enforcement action, but may be of evidential value in proceedings relating to a breach of the general principles.

### Implementation

The Government will introduce the Securities and Futures (Amendment) Bill as soon as practicable in the Legislative Council. The SFC will issue the non-statutory Listing Code under Section 399 of the SFO. This will be issued in draft for public consultation.

Concerns were expressed about the interpretation of the listing requirements by a different regulator and it was suggested that waivers granted by the Stock Exchange should remain valid under the new regime unless the underlying situations have changed. The SFC has therefore proposed that any waivers or rulings granted by the Stock Exchange in writing in the five years preceding the commencement of the statutory regime will continue to be valid under the new regime.

Respondents suggested a gradual phase in of the new regime. As a result, the following administrative arrangements will be adopted:

1. Transition

* There will be a transitional period after implementation of the statutory regime to allow market participants to familiarise themselves with the requirements of the new regime. In effecting the transition, the SFC will adopt the present practices of the Stock Exchange and will work with the Government and Stock Exchange to arrive at the best transitional arrangement, including the frontline interface with market participants during the introduction of the new system.

1. Administration

* The SFC will endeavour to ensure consistency and continuity of interpretation of the statutory provisions and the Listing Code in:
* the grant of statutory waivers under the SFO;
* the issue of rulings on interpretation which will be binding on the SFC; and
* the provision of informal consultation on a non-binding basis in order to assist compliance.

1. Enforcement

* The SFC will be responsible for investigating and bringing enforcement actions in respect of breaches of the general principles. It will be able to act independently or upon referral by the Stock Exchange. The SFC intends to promote compliance by means of education, policy, guidance, rulings and other practical assurance. It will monitor issuers' conduct and provide warnings or guidance where non-compliance or suspected breaches are detected. In most cases, the SFC will seek remedial action, rectification, or other non-disciplinary measures. Serious breaches of the statutory obligations may potentially be subject to the three-pronged sanctioning regime.
* The SFC will provide guidance as to the criteria to be applied in assessing the significance and seriousness of beaches and will publish guidelines on the factors that it will consider in determining whether to bring enforcement action and, if so, which sanctions will be pursued.

1. Pre-vetting

* Although the market consensus was in favour of a move away from frontline pre-vetting to post-vetting, respondents were concerned as to whether the market is ready for the immediate adoption of a "no pre-vetting" system and suggested a phased approach. Under the new regime, the pre-vetting of shareholders' circulars and certain announcements will continue, but on a voluntary basis. Voluntary pre-vetting will become part of the informal consultation service to assist compliance by listed issuers. The SFC hopes that this interface will facilitate a smooth transition to the new regime and enable market practitioners to become familiar with its requirements and procedures. The long-term aim is to phase out pre-vetting of documents. In the meantime, it is hoped that pre-vetting should be restricted as far as practicable to comments on issues relating to the statutory listing requirements and the Listing Code, and that comments on drafting will be avoided. The SFC expects that the commenting process will be shortened and that documents will be issued more expeditiously.

1. SFC/Exchange liaison

* The SFC and the Exchange will keep in close and regular contact before and during the transition to ensure consistency of decisions and practices. Unusual price and volume movements will continue to be monitored in a manner similar to that of the Exchange under the current regime. Written rulings and waivers will be published (subject to confidentiality considerations) to ensure transparency and provide guidance to the market.

### Future Rule Changes

The majority of the specific and detailed provisions will be set out in the new Schedule to the SFO and in the non-statutory Listing Code. The SFC will be responsible for policy review and for updating the provisions of the Schedule and the Listing Code as required to accommodate market needs. The SFC will be required to consult the public in relation to any proposed amendments to the Schedule and the Listing Code and must take comments received into account before any changes are made.

This note contains a summary only of the SFC's revised proposals in relation to the implementation of a statutory listing regime as set out in its Consultation Conclusions on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules.

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