



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

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

July 2023

Contents

Section 1	3
Introduction	3
Objectives of our review	3
Scope of the 2022 review	3
How we conducted the assessment	4
Our findings	4
Summary of observations and recommendations	5
Section 2	9
The Exchange’s review of business valuations in connection with major (or larger) acquisitions and disposals	9
The Exchange’s administration of the IPO Placing Guidelines and review of the IPO placee lists	15
The Exchange’s processes and procedures in respect of (i) the Listing Operation Governance Committee, (ii) the Listing Compliance function and (iii) the management of conflicts of interest on the part of Listing Committee members and Listing Division staff in handling cases	21
Section 3	35
Follow-up from the 2019 and 2021 reviews	35
Section 4	42
Review of the operations of the Listing Division in 2021	42
Appendix	47



Section 1

Introduction

1. This report summarises the key findings and recommendations of the Securities and Futures Commission's (**SFC**) 2022 review of the performance of The Stock Exchange of Hong Kong Limited (**Exchange**) in its regulation of listing matters during 2021.
2. The Exchange is a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited (**HKEX**).

Objectives of our review

3. The SFC has a statutory duty under section 5(1)(b) of the Securities and Futures Ordinance (**SFO**) to supervise, monitor and regulate the activities carried on by the Exchange. Under the Listing MOU¹, it was agreed that the SFC would conduct periodic audits or reviews of the Exchange's performance in its regulation of listing-related matters as a means to discharge the SFC's statutory function to supervise and monitor the Exchange.
4. The First Addendum to the Listing MOU dated 9 March 2018 provides that in conducting these periodic audits or reviews the SFC will focus on:
 - (a) whether the Exchange, in carrying out its listing regulatory function, has discharged and is discharging its duties under the SFO; this includes assessing its work in developing, administering and implementing its Listing Rules² as well as the monitoring and enforcement of compliance with those rules;
 - (b) the adequacy of the Exchange's systems, processes, procedures and resources for performing its listing function; and
 - (c) the effective management of conflicts of interest within the Exchange as a regulator and as part of a for-profit organisation, including the supervisory functions performed by the Listing Committee.

Scope of the 2022 review

5. Our 2022 review covered the Exchange's regulation of listing matters in 2021 (**review period**) and focused on the following areas:
 - (a) the Exchange's review of business valuations in connection with major (or larger) acquisitions and disposals;
 - (b) the Exchange's administration of the initial public offering (**IPO**) Placing Guidelines and review of the IPO placee lists; and
 - (c) the Exchange's processes and procedures in respect of (i) the Listing Operation Governance Committee (**LOG Committee**), (ii) the Listing Compliance function and (iii) the management of conflicts of interest on the part of Listing Committee members and Listing Division staff in handling cases.

¹ The Memorandum of Understanding between the Exchange and the SFC dated 28 January 2003 (**Listing MOU**).

² Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

How we conducted the assessment

6. In conducting our assessment, we considered:
- (a) HKEX's 2021 annual report, the Listing Committee Report for 2021 and the 2021 Report on the Exchange's Review of Issuers' Annual Reports;
 - (b) the Exchange's published disciplinary procedures, listing decisions, guidance letters and other related documents on the HKEX website;
 - (c) relevant internal documents, written policies, procedures and processes of the Listing Division's operational departments;
 - (d) information received from the Listing Division in the ordinary course of our supervisory work, including its monthly reports and case data;
 - (e) case files for sample cases;
 - (f) minutes of meetings of the Listing Committee and the LOG Committee, excerpts of minutes of meetings of the respective boards of directors of the Exchange and HKEX and other relevant internal documents relating to the activities of the Listing Committee and the Listing Division;
 - (g) relevant internal documents submitted to the Listing Committee and the LOG Committee by the Listing Division in relation to the activities of the Listing Division;
 - (h) our discussions with the Chairman and Deputy Chairmen of the Listing Committee; and
 - (i) our discussions with the former Head of Listing³, the heads of the operational departments and other senior personnel of the Listing Division, and written responses to our enquiries.

Our findings

7. Below is a summary of our findings and recommendations following the 2022 review. In arriving at our recommendations, we have taken into account initiatives and proposals undertaken by the Exchange after the completion of the review period. Our findings and recommendations are set out in more detail in Section 2 of this report. We also noted that the Exchange has taken steps in response to the recommendations set out in our 2019 and 2021 review reports.
8. The Head of Listing and the Chairman of the Listing Committee have reviewed this report. We wish to thank members of the Listing Committee and the staff of the Listing Division for their assistance in the review process.

³ The incumbent Head of Listing took up the role in February 2023 after the former Head of Listing stepped down.

Summary of observations and recommendations

9. The SFC's observations and recommendations are as follows:

The Exchange's review of business valuations in connection with major (or larger) acquisitions and disposals

In 2019, the SFC noted there were recurring types of misconduct related to acquisitions and disposals by listed issuers which gave rise to concerns relating to the valuations of the underlying assets or businesses. We reviewed the Exchange's processes and procedures for reviewing business valuations included in the circulars for major (or larger) acquisitions and disposals.

- (a) In several transactions where there appeared to be material questions as to whether the considerations were fair and reasonable, we noted that the Exchange made pertinent enquiries and duly administered the Listing Rules (paragraph 40).
- (b) In a number of cases reviewed, there appeared to be significant variations in the types and quality of the information disclosed in the circulars. The Listing Rules do not specify how and to what extent the bases for the agreed consideration, including any business valuation, should be described. We recommend that the Exchange take steps to improve the disclosure and other practices among listed issuers in this regard, particularly where the transactions in question involve the use of discounted cashflows as a methodology to value closely-held businesses or companies with no public trading prices and the listed issuer has not obtained a financial adviser's opinion on the valuation (paragraphs 41 to 42).

The Exchange's administration of the IPO Placing Guidelines and review of the IPO placee lists

We reviewed the Exchange's processes and procedures for reviewing the IPO placee lists and monitoring compliance with the Placing Guidelines for IPOs by intermediaries, as well as its criteria for granting consent for share allocations to specified persons under the Placing Guidelines, including "connected clients" and the listing applicant's directors and existing shareholders or their close associates.

- (c) From our review, possible red flags were noted in connection with the placee lists in some IPOs. There was no systematic process for reviewing the IPO placee lists which would enable the Exchange to identify "problematic" (eg, controlled) placees on a timely basis. In some cases, the pertinent issues relating to the placee lists submitted to the Exchange were dealt with at a late stage in the vetting process, thereby requiring last-minute changes to the IPO share allocations. In addition, in processing applications for its placing consent, the Exchange mainly relied on confirmations of independence provided by relevant parties without further scrutiny (paragraphs 58 to 65).
- (d) In addition, the Exchange's written procedures and training materials do not contain sufficient guidance on the factors which should be taken into consideration in assessing the independence or genuineness of the placees or in processing applications for the Exchange's consent for placing to connected clients (paragraph 54).

- (e) HKEX has developed the Fast Interface for New Issuance (**FINI**)⁴ as a new online platform to streamline and digitalise the IPO settlement process in Hong Kong. Under the FINI system, the efficiency of the IPO placee list vetting process and record-keeping will be enhanced and the Exchange will be able to rely on FINI's specialised technological features and capabilities to automate the detection of errors in the placee lists and multiple applications. FINI is expected to be implemented in the second half of 2023.
- (f) We recommend that the Exchange review its internal guidance on the vetting of placee lists and allotment results announcements taking into consideration the new processes and protocols under FINI to further enhance the efficiency and effectiveness of the placee vetting process. In the longer run, the Exchange should consider whether it is possible to introduce new features in FINI to help identify notable red flags such as those revealed in past cases. The Exchange should also put in place appropriate procedures for reviewing the independence confirmations received in support of applications for placing consent. In addition, the monitoring of case progress by senior personnel of the IPO Vetting department should be enhanced. The Exchange's training materials should be updated to take account of the above changes (paragraph 70).

The Exchange's processes and procedures in respect of (i) the Listing Operation Governance Committee, (ii) the Listing Compliance function and (iii) the management of conflicts of interest on the part of Listing Committee members and Listing Division staff in handling cases

Listing Operation Governance Committee

- (g) The LOG Committee was established to assist the HKEX Board in overseeing the management and operations of the Listing Division. The former Head of Listing and the Chairman and Deputy Chairmen of the Listing Committee were of the view that the discussions at the LOG Committee meetings were effective, the HKEX Board through the LOG Committee has gained a better understanding of the Listing Division's operations and the communication between the HKEX Board on the one hand and the Listing Division and the Listing Committee on the other has been enhanced (paragraph 86).
- (h) With respect to listing policy development, the LOG Committee's terms of reference require it to provide guidance to the Listing Division and advise the HKEX Board on the discharge of HKEX's and the Exchange's obligations to act in the interest of the public. Given the short history of the LOG Committee, its track record has yet to be developed. We recommend that minutes of the LOG Committee meetings should be more detailed to provide a fair and accurate summary of the public interest considerations and issues presented to the LOG Committee by the Listing Division as well as the analysis considered and discussed and any conclusions reached (paragraph 89).

Listing Compliance

- (i) The Listing Compliance department has facilitated enhancements to the Listing Division's systems, processes, procedures and controls and has designed a monitoring and testing programme to assess the effectiveness of the processes and controls (paragraph 109).

⁴ See paragraph 66.

The management of conflicts of interest on the part of Listing Committee members and Listing Division staff in handling cases

- (j) We recommend that the Listing Committee Handbook be enhanced to provide more detailed guidance on potential conflict situations, in particular to include common examples of relationships which are not directly related to the specific matter being considered by the committee but may nonetheless be perceived as affecting the impartiality of a member (paragraph 121).
- (k) In respect of the amendment to the procedures which require members to update the Listing Committee on new conflicts that arise throughout the process of a case, we recommend that the guidance clarify that, in the context of IPO applications, a member should be excluded from receiving relevant papers or participating in committee discussions once his or her firm has commenced cornerstone investment discussions with the listing applicant. The member should also confirm to the Exchange that the investment (if entered into after the member receives the relevant papers or participates in any committee discussion of the listing application) was not based on non-public information obtained by virtue of his or her participation in the matter as a committee member (paragraph 122).
- (l) To address perception issues, we recommend that declarations of potential conflicts by the Head of Listing should be routinely referred to HKEX Group Compliance (paragraph 136).
- (m) Listing Compliance has identified a number of areas for improvement in the conflict management processes and procedures of the operational departments of the Listing Division. We understand from the Exchange that the automation of the conflict check process brought about by the upgrade to the One-stop Processing and Approval System (**OPAS**) in 2023 has resolved the issues which resulted from reliance on manual checking in the past. We recommend that Listing Compliance continue to monitor and test the effectiveness of the conflict management controls, processes and procedures of the Listing Division and the operational departments after the migration to the OPAS system (paragraph 137).

Follow-up from 2019 and 2021 reviews

- (n) We noted that the HKEX Chief Executive Officer and certain other personnel outside of the Listing Division receive non-public listing-related information through attendance at regular meetings where listing matters may be discussed. We recommend that HKEX adopt adequate procedures to ensure that non-public listing-related information be kept confidential from personnel outside of the Listing Division (paragraph 142).
- (o) A group-level “Chinese Wall” policy has been developed to incorporate objectives and principles to identify and manage actual or potential conflicts of interests which may arise between HKEX’s interests as a listed company and the proper performance of listing-related functions and responsibilities by the Exchange, while allowing oversight of the Listing Division by the HKEX Board. The Chinese Wall protocol generally prohibits the sharing of non-public listing-related information with non-Listing Division staff, subject to limited specified exceptions (paragraph 143).

- (p) We noted that the Exchange has implemented new processes, procedures and practices for the review of non-disciplinary matters to address our recommendations from the 2021 review. We recommend that the Exchange further shorten the time period for holding the rehearing after the Listing Review Committee (**LRC**) remits a case to the Listing Committee and improve the efficiency of the review hearing process in general (paragraph 153). The LRC should also ensure that when it overturns a Listing Committee decision, the key elements of the overturned decision are adequately addressed in the LRC's decision (paragraph 156). We also recommend that the Exchange take action to ensure that the LRC adheres to the Exchange's published listing guidance. For example, it may be advisable to establish an internal legal function within the Exchange's listing regulatory function to ensure, amongst other things, that decision-makers are advised of their remit and the scope of their discretion as they administer the Listing Rules on a day-to-day basis. The Exchange could also consider issuing reminder letters to LRC members and providing further training to them on the relevant Exchange rules and policies on delisting and suspension (paragraph 157).

Section 2

The Exchange's review of business valuations in connection with major (or larger) acquisitions and disposals

Introduction

10. When a listed issuer acquires or disposes of a business, its directors are responsible for determining, amongst other things, whether the terms of the transaction (including the consideration) are fair and reasonable. As part of this process, it is critical for directors to ensure that proper due diligence is conducted on the target so that the value of the business can be properly appraised. It is also important that the bases for determining the terms of the transaction, including the consideration, are disclosed with sufficient details to enable shareholders to make an informed assessment of the transaction.

SFC guidance on directors' duties for valuations in corporate transactions

11. In May 2017, the SFC issued a [Guidance note on directors' duties in the context of valuations in corporate transactions](#)⁵, to remind directors of, amongst other things, their obligations to carry out independent and sufficient due diligence when making an investment decision. The guidance note sets out the circumstances where directors should consider whether there is a need to obtain a valuation of the target business from a professional valuer⁶. On the other hand, directors' reliance on a valuation report must be reasonable and they have a duty to exercise independent judgment having regard to the advice and opinions of professionals and other experts.
12. As mentioned in the guidance note, when directors do not obtain a valuation when circumstances suggest it would be appropriate to do so or if they rely on a valuation to justify a transaction when such reliance is imprudent, the resulting transactions may cause losses to the listed issuer and its shareholders as the issuer could be buying the business or asset at an overvalue or selling it at an undervalue. The directors concerned may be in breach of their fiduciary duties owed to the issuer and its shareholders.
13. As reported in the [SFC regulatory bulletin](#) published in February 2019, the SFC has exercised its statutory powers⁷ to make enquiries or investigate cases involving proposed corporate transactions by listed issuers which gave rise to serious concerns relating to the valuation of the asset or business concerned as they may have been oppressive or unfairly prejudicial to the shareholders or potential investors or resulted in the shareholders or potential investors not having been given all the information about the issuer's business or affairs that they might reasonably expect.

⁵ Along with this guidance, the SFC also issued circulars to [financial advisers](#) and [valuers](#) in relation to the expected standard of work on valuations in corporate transactions.

⁶ Circumstances where an independent valuation may be necessary include: (a) if the directors do not possess sufficient experience or expertise in either the field of business to which the asset or target company belongs or in valuation; (b) if the target business is new or still in its infancy or the information provided in respect of the business requires professional advice or professional scrutiny in order to properly assess the merits of the investment; (c) given the investment's size relative to that of, or its significance to, the listed issuer; (d) given the risks involved in the transaction or the complexity or nature of the transaction; or (e) if any director of the acquiring company has an actual or potential conflict of interest in the proposed transaction.

⁷ Under the SFO and the statutory powers to object to a listing or impose a suspension of trading of securities under the Securities and Futures (Stock Market Listing) Rules.

14. In July 2019, the SFC published a [Statement on the Conduct and Duties of Directors when Considering Corporate Acquisitions or Disposals](#) outlining recurring types of misconduct related to acquisitions and disposals which have given rise to concerns, including the lack of independent professional valuation when it is appropriate to obtain one, the lack of independent judgment and accountability on the part of the valuers and directors and questionable selection of market comparables.
15. We have undertaken a review of the Exchange's processes and procedures for reviewing business valuations included in the circulars of major (or larger) acquisitions and disposals.

Relevant Listing Rule requirements

16. When an acquisition or disposal of business constitutes a major transaction, a very substantial acquisition or a very substantial disposal⁸, the issuer is required to publish an announcement and a circular which are both subject to the Exchange's vetting⁹.
17. Rule 2.13 requires that the information contained in issuers' announcements or circulars must be accurate and complete in all material respects and not be misleading or deceptive.
18. Pursuant to rule 14.58, announcements of notifiable transactions must disclose, amongst other things, the aggregate value of the consideration for the transaction and the basis upon which the consideration was determined.
19. For acquisitions and disposals of businesses, the Listing Rules do not specifically require the issuer to obtain an independent valuation of the target, nor is there a mandatory requirement to publish the valuation report when one is prepared. Nonetheless, the Exchange has required disclosure of the valuation where it was a primary factor forming the bases for the consideration or other material terms of the transaction¹⁰.
20. In addition, where an announcement or a circular contains a profit forecast in respect of the issuer or its subsidiary (or prospective subsidiary), the announcement or circular must set out (i) the principal assumptions, including commercial assumptions, upon which the forecast is based, (ii) a letter from the issuer's auditors or reporting accountants confirming that they have reviewed the accounting policies and calculations for the forecast and containing their report, and (iii) a report from the issuer's financial advisers (or from the board of directors if no financial adviser has been appointed) confirming that they are satisfied that the forecast has been made by the directors after due and careful enquiry¹¹. Any valuation of assets or businesses acquired by an issuer based on discounted cashflows or projections of profits, earnings or cashflows is regarded as a profit forecast¹².

⁸ A transaction is regarded as (i) a major transaction if any of the percentage ratios (ie, assets ratio, consideration ratio, profits ratio, revenue ratio or equity capital ratio) is 25% or more, (ii) a very substantial acquisition if any of the percentage ratios is 100% or more, or (iii) a very substantial disposal if any of the percentage ratios is 75% or more. See Main Board rule 14.08. The equivalent GEM rule is rule 19.08. For simplicity, references are only made to particular rules or chapters in the Main Board Listing Rules. The GEM Listing Rules contain broadly equivalent rules.

⁹ Announcements for major transactions are subject to the Exchange's post-vetting, and announcements for very substantial acquisitions or very substantial disposals and circulars for major or larger transactions are subject to the Exchange's pre-vetting. See rule 13.52.

¹⁰ FAQ Series 7, No.21 which was first issued in 2008.

¹¹ Rules 14.60A, 14.62, 14.66(2) and paragraph 29(2) of Appendix 1, Part B.

¹² Rule 14.61.

Cases reviewed

Disclosure of the bases for determining the consideration, including business valuations

21. We reviewed the circulars of a sample of 35 transactions involving acquisitions or disposals of unlisted businesses published in 2021 to assess the disclosures in respect of business valuations or (where no independent valuation was disclosed) the issuers' bases for determining the transaction consideration. We also reviewed selected case files from these 35 transactions to ascertain the Exchange's processes and procedures for vetting the disclosures. A summary of the transactions reviewed is set out below:

Transaction circulars published	With independent valuation (note)	Without independent valuation	Total
Acquisitions	33	14	47
- <i>Circulars reviewed</i>	13	5	18
- <i>Case files reviewed</i>	2	2	4
Disposals	36	31	67
- <i>Circulars reviewed</i>	11	6	17
- <i>Case files reviewed</i>	2	1	3
Total	69	45	114
- <i>Circulars reviewed</i>	24	11	35
- <i>Case files reviewed</i>	4	3	7

Note: Where a valuation report or a summary thereof was disclosed in the circular.

Transactions with independent business valuations

22. The valuation methodologies which are commonly adopted in business valuations include the income approach, the market approach, the cost approach and the asset-based approach.
23. We reviewed the circulars for a sample of 24 transactions where independent valuation was provided as the basis for the consideration. The sample was selected to cover (i) all valuation methodologies, (ii) both acquisitions and disposals and (iii) issuers with different market capitalisations. It included 14 transactions adopting the income approach (seven acquisitions and seven disposals), five adopting the market approach (three acquisitions and two disposals), one adopting the cost approach (an acquisition) and four adopting the asset-based approach (two acquisitions and two disposals)¹³.
24. There appeared to be significant variations in the types and quality of the information disclosed in the circulars. In some cases, the information relating to the business valuation was reasonably comprehensive, whilst in other cases it included only boilerplate and generic statements. Our findings are discussed below.

Income approach

25. Under the income approach, the value of an asset is determined by reference to the value of income, cashflows or cost savings generated by the asset, based on discounting future cashflows to present value.

¹³ Some transactions adopting the asset-based approach as the overall valuation method also employed other methods such as the income approach or the cost approach to determine the value of individual assets.

26. To enable shareholders to make an informed assessment of the reasonableness of valuations adopting the income approach, other than including the assumptions and bases relied upon by the board and the valuer (see paragraph 20), we consider that it is important that the circulars also disclose the quantitative inputs (and the underlying bases thereof) and a clear presentation of how the projections and valuations were calculated from the quantitative inputs. Our findings from the review of the 14 circulars are summarised below:
- (a) Sufficient disclosures were made in only two cases.
 - (b) In eight cases, the circulars disclosed the theories and mathematical formula for the income approach valuation method and some *general* assumptions¹⁴ followed by a valuation conclusion, with minimal information about the key quantitative inputs (in particular financial projections) and *specific* assumptions relating to the company or business used to support the valuation.
 - (c) In four cases, the circular disclosed some (but not all) of the quantitative assumptions underlying the valuation (such as the estimated growth rate of the sales volume of the target's products and their selling price). However, other key quantitative assumptions were lacking and no computation was presented to show how the quantitative inputs and projections translated into the final valuation.

Market approach

27. The market approach provides an indication of value by comparing the asset with identical or comparable assets for which price information is available.
28. For shareholders to assess valuations adopting the market approach, the circulars should (i) contain sufficiently detailed information on the selection criteria of the comparable companies (including quantitative benchmarks such as the percentage of the revenues or profit of the comparable companies attributed to the businesses relevant to the target), (ii) demonstrate that the selected comparables were appropriate and comprehensive and (iii) adequately explain the computation of the valuation result including any applicable adjustments (such as control premium and discount on lack of marketability). Our findings from the review of five cases are summarised below:
- (a) Adequate disclosures were made in two cases.
 - (b) In the other three cases, it was questionable whether some of the companies selected for comparison were suitable, as they either operated their businesses in different regions, had much larger market capitalisation or had seemingly different businesses and products from those of the target. In all three cases, the issuers only provided a general description to justify the selection criteria in respect of the business segments of the market comparables (such as “mainly” or “principally” engaged in certain businesses) without providing any quantitative benchmarks to support the selection.

¹⁴ For example, there will be no material change in the prevailing macro-economic situation, financial and industrial policies, tax rates and other social and economic conditions, or the main business, composition of revenues and costs, sales strategy and cost control of the appraised entities.

Cost approach

29. The cost approach provides an indication of value by calculating the current replacement or reproduction cost of an asset and making deductions for physical deterioration and other relevant forms of obsolescence.
30. Valuations adopting the cost approach should adequately disclose the quantitative inputs used to determine the costs which would be required to replace the assets, the depreciation adjustment and the computation process for the final valuation amount. In the one transaction reviewed, the disclosure appeared to be deficient, consisting merely of a brief description of the valuation method and some generic and qualitative assumptions. There was no disclosure of quantitative inputs or the calculation process showing how the final valuation was arrived at.

Asset-based approach

31. The asset-based approach provides an indication of value based on the principle that the sum of each asset and liability component represents the overall value of an entity. The value of the appraised enterprise is determined by assessing the value of all its assets and liabilities, and the value of each asset is calculated by choosing a specific valuation method in accordance with its specific circumstances.
32. For transactions adopting the asset-based approach, the circulars should clearly explain, where applicable, the material differences between the book value and the appraised value of key assets, the quantitative inputs and assumptions and the calculations used in arriving at the appraised value. The disclosures appeared insufficient in all four transactions reviewed; in particular, quantitative inputs and specific assumptions for the appraisal of key assets were generally lacking.

Transactions without independent business valuations

33. In transactions where no independent valuation was disclosed, some issuers conducted an analysis comparing certain pricing multiples (eg, price-to-earnings ratio, price-to-book ratio or price-to-sales ratio) of the target with selected comparable companies, and the result of this analysis often served as a key factor for determining the transaction consideration. In cases where no market comparable analysis was conducted, the transaction consideration was determined based on factors such as historical financial information or the considerations paid in related transactions.
34. We reviewed the circulars of a sample of 11 transactions where no independent valuation of the target was provided. The sample was selected to cover (i) both transactions for which a market comparable analysis was conducted (six) and transactions with no such analysis (five), (ii) both acquisitions (five) and disposals (six) and (iii) issuers with different market capitalisations.
35. We considered whether the circulars contained (i) an adequate explanation of the bases for determining the consideration of the transaction, (ii) sufficient and objective information to demonstrate that the selected bases were appropriate and (iii) sufficient quantitative inputs and calculations to show how the consideration was arrived at. The disclosures in five of these cases appeared to be insufficient, particularly in respect of the disclosures relating to market comparables and the assessment of quantitative factors.

Disclosure of market comparable analysis

36. In six cases reviewed, reference was made to selected market comparables. Our findings are summarised below:
- (a) In three cases, the selection criteria of the market comparables were clearly explained and appeared reasonable.
 - (b) In three other cases, the disclosed criteria for selecting the market comparables were rather generic and lacked details as to why the selected comparables were appropriate and comprehensive. In one of these cases, it was also questionable whether the bases for calculating the pricing multiples for the target and the comparable companies were consistent.

Disclosure of quantitative factors

37. In five cases reviewed, the circular contained no market comparable analysis. We assessed whether alternative meaningful information was provided in respect of the bases of the consideration. Our findings are summarised below:
- (a) In three cases, reference was made to quantitative factors such as the net asset value of the targets or the consideration paid in previous related transactions¹⁵, which adequately explained the bases of the consideration.
 - (b) In two transactions, the disclosures were limited to qualitative factors without sufficient quantitative analysis. In one acquisition, the directors considered the difference between the consideration and the net deficit of the target to be fair and reasonable given the market position of the target and the synergy effects of the acquisition. However, no quantitative analysis was provided to support the assessment. In another case, which was a disposal, the consideration was stated to have been determined taking into account, amongst other things, long-term agreements entered into by the target. However, there was no adequate quantitative disclosure of the value of the long-term agreements or their implications for the target's value.

Potential issues with the fairness of the consideration

38. In addition to the review of transaction circulars discussed above, through our ongoing monitoring of listed issuers and review of the Listing Division's monthly reports and other documents, we noted four proposed acquisitions¹⁶ where the fairness of the consideration was questionable. We reviewed the case files to assess the Exchange's handling of these cases.
39. The issuers in these cases obtained independent valuations of the targets. In three cases, it was questionable whether the bases and assumptions used in the independent valuations were valid. For example, the companies selected for the market approach valuation did not appear to be truly comparable to the target, and the valuation was based on aggressive assumptions in respect of the target's expected revenue and profit which did not appear reasonable or achievable. In another case, the agreed consideration far exceeded the indicative value of the target based on an

¹⁵ In an acquisition by a listed issuer, one of the factors for determining the consideration was the price paid by the vendor when it acquired the same target in a recent transaction on the basis of an independent valuation obtained in accordance with local regulation.

¹⁶ One disclosable transaction and three disclosable and connected transactions.

independent valuation. Following the Exchange's comments and enquiries, three of these proposed acquisitions lapsed and one was allowed to proceed on the basis of amended transaction terms, enhanced disclosures and independent shareholders' approval.

SFC observations

40. As noted above, in the four transactions where there appeared to be material questions as to whether the considerations were fair and reasonable, the Exchange made pertinent enquiries and duly administered the Listing Rules (see paragraphs 38 to 39).
41. In a number of cases, we noted that the circulars did not provide adequate meaningful disclosures in respect of the business valuations or other bases for determining the consideration. The most common deficiencies were (i) a lack of detailed, specific assumptions and quantitative inputs to support the valuation result, (ii) the absence of a computational presentation of how the valuation result was arrived at, (iii) unsuitable market comparables and unclear selection criteria and (iv) where no business valuation was obtained, the lack of an alternative quantitative analysis to justify the consideration amount (see paragraphs 24 to 37). The Exchange's vetting practices also varied from case to case.
42. The Exchange noted that, as the Listing Rules do not specify how and to what extent the bases for the agreed consideration, including any business valuation, should be described, its vetting of relevant transactions during the review period may not have consistently covered the aspects discussed in paragraph 41. In view of the observations above, we recommend that the Exchange take steps to improve the disclosure and other practices among listed issuers in this regard, particularly where the transactions in question involve the use of discounted cashflows as a methodology to value closely-held businesses or companies with no public trading prices and the listed issuer has not obtained a financial adviser's opinion on the valuation.

The Exchange's administration of the IPO Placing Guidelines and review of the IPO placee lists

Introduction

43. In May 2021, the SFC and the Exchange issued a [Joint statement on IPO related misconduct](#). It was reported that in some IPOs, the international placing tranche¹⁷ may have been used to allocate shares to controlled placees¹⁸ to artificially satisfy the initial listing requirement of at least 100 placees¹⁹. These manipulative activities give regulators and investors the misconception that there is genuine investor interest in the IPOs when in fact there may not be sufficient genuine interest. In addition, these activities could help corner the shares to facilitate market manipulation after listing and therefore undermine the development of an open, orderly and fair market.

¹⁷ Allocation of IPO shares in Hong Kong falls into two tranches: (i) a Hong Kong public offering tranche for subscription by investors in Hong Kong and (ii) an international offering or "placing" tranche which is normally allocated based on a bookbuilding process involving institutional and other investors, except for the guaranteed allocations to "cornerstone investors" disclosed in the prospectus, which are often large institutional or well-known investors.

¹⁸ Controlled placees in this context means placees controlled by the issuer or its insiders (such as the controlling shareholders) or other individuals seeking to corner shares for market manipulation post-listing.

¹⁹ See paragraph 47.

44. We have therefore undertaken a review of the Exchange's processes and procedures for reviewing the IPO placee lists and monitoring compliance with the Placing Guidelines for IPOs by intermediaries. We have also reviewed the Exchange's processes and criteria for granting consent for share allocations to certain specified persons under the Placing Guidelines, including "connected clients" and the listing applicant's directors and existing shareholders or their close associates.

Relevant Listing Rule requirements

45. Rule 2.03(2) provides that the issue and marketing of securities should be conducted in a fair and orderly manner and potential investors be given sufficient information to enable them to make a properly informed assessment of an issuer.
46. After the listing document is published and the IPO price is fixed, the sponsor submits the placee lists for the international placing tranche and other relevant documents to the Exchange's IPO Vetting department for review.
47. Appendix 6 to the Main Board Listing Rules (**Placing Guidelines**) provides that there must be an adequate spread of holders in the securities to be placed. In general, there should be at least three holders for each HK\$1,000,000 of the placing and a minimum of 100 holders²⁰.
48. Under the Placing Guidelines which were in force during the review period²¹, a listing applicant is restricted from allocating shares to the following parties without the Exchange's prior written consent (**placing consent**)²²:
- (a) "connected clients"²³ of the lead broker or of any distributors;
 - (b) directors or existing shareholders of the applicant or their close associates, whether in their own names or through nominees unless exempted under certain conditions; or
 - (c) nominee companies unless the name of the ultimate beneficiary is disclosed.
49. In 2016, the Exchange published a guidance letter²⁴ (**Placing Guidance Letter**) stipulating that the Exchange may grant placing consent to permit share allocations to

²⁰ Paragraph 4 of the Placing Guidelines.

²¹ The Placing Guidelines were last updated in April 2022.

²² Paragraph 5 of the Placing Guidelines.

²³ Paragraph 13 of the Placing Guidelines provides that "connected client" in relation to an Exchange Participant means any client of such member who is:

- (1) a partner of such Exchange Participant;
- (2) an employee of such Exchange Participant;
- (3) where the Exchange Participant is a company,
 - (a) any person who is a substantial shareholder of such Exchange Participant; or
 - (b) a director of such Exchange Participant;
- (4) the spouse or infant child or step child of any individual described in (1) to (3) above;
- (5) a person in his capacity as trustee of a private or family trust (other than a pension scheme) the beneficiaries of which include any person in (1) to (4) above;
- (6) a close relative of any person in (1) to (4) above where his account is managed by such Exchange Participant in pursuance of a discretionary managed portfolio agreement; or
- (7) a company which is a member of the same group of companies as such Exchange Participant.

²⁴ The guidance letter published in 2016 has subsequently been updated and superseded. The Placing Guidance Letter in place during the review period was the March 2021 version. The latest version is [Placing to connected clients, and existing shareholders or their close associates, under the Rules](#), HKEX-GL85-16 (January 2016) (Updated in February 2018, April 2020, March 2021 and August 2022).

connected clients, existing shareholders and their close associates subject to certain conditions including:

- (a) the listing applicant, each sponsor, bookrunner, connected distributor and the relevant connected client, as the case may be, giving confirmations that no actual or perceived preferential treatment has been nor will be given to the connected client or the existing shareholder or its close associates in the IPO allocation; and
- (b) for connected clients holding securities on a discretionary basis, the listing applicant and each bookrunner and connected distributor confirming that the connected distributor has not participated, and will not participate, in the decision-making process as to whether the connected client will be selected as a placee.

Vetting of the placee lists

- 50. According to the IPO Vetting department's written procedures for IPO placing and allotment, the IPO Vetting case team reviews the IPO placee lists by checking the *completeness* of each list and the independence confirmations from the placing brokers and keeps a proper record of all placing documents. The case team also reviews the allotment results announcement in accordance with the Exchange's internal memorandum (including the vetting procedures to follow when there is suspected "headcount planting"²⁵)²⁶. Upon completion of the review of the placee lists, the case team will issue a "no comment letter" to the sponsor in respect of the allotment results announcement.
- 51. Each IPO Vetting case team reviewing the placee lists generally consists of three members: an assistant vice president, an associate and a research associate. Material issues identified by case officers are escalated to and discussed with vice presidents, senior vice presidents and the co-heads of the IPO Vetting department.
- 52. We were informed by the IPO Vetting department that, given the short time between the submission of the placee lists to the IPO Vetting case team and the publication of the allotment results announcement (generally two business days), comments or questions are usually provided orally to the sponsors or placing brokers and there is normally no time to document this communication. Where appropriate, the sponsors or placing brokers may submit revised documents, including revised placee lists.
- 53. We were also informed by the IPO Vetting department that its staff members receive annual training on vetting of the placee lists. During the review period, staff training was conducted in March 2021. The training materials cover, amongst other things: (a) the relevant rule requirements governing the placing tranche, (b) guidance relating to cornerstone investments and placings to connected clients, (c) the documents and information required to be submitted by listing applicants and (d) issues that the case

²⁵ In general, "headcount planting" refers to the splitting of the shares allocated to the same beneficial shareholder into a large number of placements to different placees, each receiving only a small number of shares (eg, five board lots or less), as a means to artificially meet the minimum number of public shareholders requirement.

²⁶ The internal memorandum provides that, when there is suspected "headcount planting", the IPO Vetting case team should require sponsors to include in the allotment results announcement, amongst other things, the number of placees and percentage of shares allotted to the placees taking five or less board lots and the level of indications of interest for shares in the placing tranche in numerical form. The case team should also request the applicant or sponsor to demonstrate an open market in the applicant's securities and whether the high shareholding concentration will potentially be detrimental for the market.

team should pay attention to during vetting, such as inconsistent information provided by the placing brokers and their sub-placing brokers and the allocation of shares to connected clients or existing shareholders without prior consent from the Exchange.

54. We noted that the written procedures and training materials do not contain sufficient guidance on the factors which should be taken into consideration in assessing the independence or genuineness of the placees or in processing applications for the Exchange's consent for placings to connected clients, including noteworthy issues encountered in the past (eg, placees which appear repeatedly in different IPOs taking up only a few board lots in each case²⁷) or common red flags (eg, placees which were previously identified as nominees of or being controlled by insiders).

Cases reviewed

55. We selected 23 IPO cases from 2021 based on the size and complexity of the IPO for detailed review to assess the Exchange's procedures for vetting the IPO placee lists. In 18 out of these 23 cases, the Exchange received applications for its consent for placings to the specified persons as mentioned above and we reviewed the Exchange's handling of these applications.
56. The Exchange's case files mainly contained the placee lists submitted by the placing brokers or their sub-placing brokers, which included relevant information about each individual placee such as its name, address and the number of shares allocated, as well as the responses from the sponsors and independence confirmations from the placing brokers.
57. In most of the cases reviewed, there was no documentation²⁸ of the work performed by the IPO Vetting department in reviewing the placee lists, for example, to identify issues or red flags or make follow-up enquiries or of the ensuing decisions or actions taken. We therefore do not have sufficient information to assess the IPO Vetting department's work in reviewing the placee lists and related documentation and assessing the independence and genuineness of the placees. In some cases, we noted brief notes in the files recording the work which had been undertaken by the case team, the issues identified and how they were addressed, but this information was insufficient to enable us to form a view about the vetting process. We also interviewed the Exchange's IPO Vetting personnel and the SFC's IPO team handling these cases to ascertain the pertinent issues underlying the cases and follow-up action taken.

SFC observations

Delay in following up on possible issues

58. From our review and discussions, in some cases possible red flags were noted in connection with the placee lists. In most of these cases, the sponsors or placing brokers either replaced the "problematic" placees and revised the placee lists or provided explanations to address the questions raised by the IPO Vetting case team. However, we noted that in at least one case, the IPO Vetting case team could have identified and followed up on potential issues relating to the placee lists submitted in a more timely manner.

²⁷ These include placees who receive only a small number of the listing applicant's shares in numerous IPOs and are suspected to have enabled the relevant applicants to artificially meet the minimum number of public shareholder requirements under the Listing Rules (ie, "headcount planting").

²⁸ See paragraph 52.

59. For example, in one case, a prospective cornerstone investor was a close associate of the controlling shareholder of the listing applicant and, as such, the Exchange's placing consent had to be obtained (see paragraph 48).
60. Although the background information relating to the cornerstone investor and the controlling shareholder of the listing applicant was disclosed in the draft listing document vetted by the IPO Vetting case team *before* the Listing Committee's hearing, the issue was not raised with the sponsors until *after* the hearing when the SFC's IPO team discussed the matter with the Exchange. The IPO Vetting case team subsequently made two enquiries with the sponsors on the issue. Ultimately, given the close relationship between the cornerstone investor and the controlling shareholder, the placing consent was not granted. The prospective cornerstone investor eventually had to be removed and the placing brokers had to secure new placees at a late stage.
61. We were informed by the IPO Vetting case team that although the issue noted above was one of the red flags which would require the IPO Vetting department to raise further enquiries, these enquiries would normally be made *after* the sponsors confirmed the details of all the cornerstone investors in the bulk-print proof prospectus.

Reliance on independence confirmations

62. In respect of the Exchange's handling of applications for its placing consent, we noted from our review of the internal memorandum in the cases selected that the Exchange would grant the placing consent after receiving the requisite "independence confirmations" (see paragraph 49). In the cases reviewed, with the exception of one case discussed below, the IPO Vetting department's handling of applications for the Exchange's placing consent appeared to have operated as intended.
63. In one case, a prospective IPO placee was a member of the same group of companies as the sole global coordinator, and therefore was a connected client²⁹. To support its application for the Exchange's placing consent³⁰, the sole global coordinator provided a confirmation that it had not participated in the decision-making process or the discussions relating to the selection of this connected client as a placee. It was questionable how the confirmation could be given since the sole global coordinator would have been involved in the discussions and decision-making relating to the selection of placees.
64. This issue was neither raised with the sponsors nor discussed with senior personnel of the IPO Vetting department. After the SFC's IPO team raised concerns about the reasonableness of the confirmation, the matter was escalated to the co-heads of the IPO Vetting department and enquiries were subsequently made to clarify the issue. As the issue was not addressed to the Exchange's satisfaction, the placing consent was not granted and regulatory clearance of the allotment results announcement was delayed. In response to our enquiry, the IPO Vetting personnel informed us that in processing placing consent applications, the team would usually ensure that the requisite confirmations are submitted and would rely on them without further scrutiny.
65. Based on our review of the case files, we noted that there is no systematic process for reviewing the IPO placee lists that would enable the IPO Vetting case team to identify "problematic" (eg, controlled) placees on a timely basis. We also noted that in some

²⁹ See footnote 23.

³⁰ See paragraph 49.

cases³¹, the Exchange dealt with potential issues at a late stage in the vetting process, thereby requiring last-minute changes to be made to the IPO share allocations. In addition, relying on the independence confirmations provided by the relevant parties without further scrutiny could lead to connected placees going undetected and permitted to take up IPO share placements when they should be disallowed. These circumstances could affect the efficiency, fairness and orderliness of the IPO process.

Subsequent developments

66. HKEX has developed the Fast Interface for New Issuance (**FINI**) as a new online platform to streamline and digitalise the IPO settlement process in Hong Kong. This will shorten the settlement cycle between IPO pricing and the start of trading from T+5 to T+2³². FINI is expected to be implemented in the second half of 2023.
67. Through FINI, placing brokers, share registrars, IPO sponsors, lawyers, underwriters, distributors and regulators will be able to execute their respective roles using this new digital platform and coordinate the various IPO workflows, including listing initiation, subscription, pricing, submission of placee lists, allotment, payment, regulatory approval and stock admission processes.
68. Since all communications between the regulators and the various participants in an IPO can be conducted via FINI, the vetting process and record-keeping for the IPO placee lists is expected to become more efficient. In addition, the Exchange will be able to rely on FINI's built-in technological features and capabilities³³ to automate the detection of errors in placee lists and multiple applications.
69. We appreciate that, in reviewing the placee lists and placing information, the Exchange's staff will be operating within a much shorter timetable after FINI is launched. However, the streamlined communication and built-in verification capabilities enabled by FINI should help reduce some of the administrative burden on the Exchange's staff in handling the placee lists received from different distributors, subsequent revisions and related correspondence.
70. We recommend that the Exchange review its internal guidance on the vetting of placee lists and allotment results announcements taking into consideration the new processes and protocols under FINI to further enhance the efficiency and effectiveness of the placee vetting process. In the longer run, the Exchange should consider whether it is possible to introduce new features in FINI to help identify notable red flags revealed in past cases³⁴. The Exchange should also put in place procedures for reviewing the independence confirmations received in support of applications for placing consent. We also suggest that the monitoring of case progress by senior personnel of the IPO Vetting department should be enhanced. The Exchange's training materials should also be updated to take account of the above changes.

³¹ See paragraphs 58 to 60.

³² "T" refers to the pricing day (which is expected to take place one day after the close of the public offer).

³³ FINI will capture details of each public offer subscriber and placee. FINI can automatically generate relevant statistics based on the placee lists submitted by distributors and determine placee and subscription concentrations in terms of the number of shares held by different categories of placees. To further facilitate and streamline the process, the FINI system will also have some new workflow features to help reduce the need for manual reconciliation (eg, to identify suspected or actual duplicate of a prospective placee or successful public offer subscriber in the same IPO).

³⁴ See examples in paragraphs 59 and 63.

The Exchange's processes and procedures in respect of (i) the Listing Operation Governance Committee, (ii) the Listing Compliance function and (iii) the management of conflicts of interest on the part of Listing Committee members and Listing Division staff in handling cases

Listing Operation Governance Committee

71. The Exchange is a recognized exchange company under the SFO and a wholly-owned subsidiary of HKEX, a recognized exchange controller under the SFO.
72. Section 21 of the SFO imposes certain obligations on the Exchange, as a recognized exchange company, to:
 - (a) act in the interest of the public, having particular regard to the interest of the investing public; and
 - (b) ensure that the interest of the public prevails where it conflicts with the interest of the recognized exchange company.

As a recognized exchange controller, HKEX is subject to similar obligations under section 63(2)³⁵ of the SFO.

73. The board of directors of HKEX (**HKEX Board**), being the governance body of HKEX, has a duty to supervise the Exchange in the discharge of its statutory functions. In the [report](#) of our 2019 review of the Exchange's listing regulation (**2019 review report**), we recommended that the HKEX Board enhance its oversight of the listing regulatory function. In response, the HKEX Board established the Listing Operation Governance Committee (**LOG Committee**) in June 2021 to assist the Board in overseeing the management and operations of the Listing Division.
74. In accordance with its [terms of reference](#), the LOG Committee currently consists of five members comprising (i) three non-executive directors appointed by the HKEX Board and (ii) the Chairman and one Deputy Chairman of the Listing Committee. The terms of reference provide that the LOG Committee shall meet at least four times every year, and its Chairman shall report regularly and formally to the HKEX Board.
75. The Head of Listing acts as the Secretary to the LOG Committee. Other regular attendees of the LOG Committee meetings include the HKEX Chief Executive Officer³⁶ (**CEO**), the HKEX Group Chief Risk Officer, the HKEX Group Chief Compliance Officer, the HKEX Group General Counsel, the Listing Division Head of Policy and Secretariat Services and the Head of Listing Compliance.
76. The LOG Committee held two meetings in 2021 and four in 2022. At the HKEX Board meetings since October 2021, the LOG Committee Chairman (who is a non-executive director of the HKEX Board) regularly briefed the full board on the major topics reviewed by the LOG Committee, and the LOG Committee meeting minutes were tabled.

³⁵ Section 63(2) of the SFO provides that, "[i]n discharging its duty under subsection (1)(a), (b) or (c), a recognized exchange controller shall—(a) act in the interest of the public, having particular regard to the interest of the investing public; and (b) ensure that the interest of the public prevails where it conflicts with the interest of the recognized exchange controller."

³⁶ The HKEX CEO attended three of the six LOG meetings in 2021 and 2022.

77. According to the terms of reference, matters subject to the oversight of the LOG Committee include listing policy projects, the Listing Division's regulatory activities, structural changes such as appointments and removals of the Head of Listing and Listing Division department heads, human resources and other operational requirements, training, performance evaluation, staff conduct issues or incidents and division-specific risk and policy matters.

Supervision of listing policy development

78. The terms of reference provide that the LOG Committee shall receive and review updates from the Listing Division on major listing policy changes, initiatives or reforms proposed by the Listing Division, provide guidance and comments to the Listing Division considering HKEX's and the Exchange's obligations to act in the interest of the public and advise the HKEX Board on these matters as the LOG Committee considers appropriate.
79. From our review of the minutes of LOG Committee meetings, listing policy projects were presented by the former Head of Listing to the LOG Committee members, followed by questions and discussion. We noted that in 2021 there were discussions as to how the LOG Committee was to discharge its responsibility to provide guidance and comments to the Listing Division in respect of listing policy matters considering the public interest obligations. The LOG Committee considered that it should not replace the role of the Listing Division or the Listing Committee and, in considering policy initiatives, the LOG Committee's focus should be on *specific aspects to be highlighted by the Listing Division* (emphasis added).
80. In the LOG Committee meetings in 2022, when the Listing Division presented policy projects to the LOG Committee members, the former Head of Listing verbally reported the public interest considerations which had been deliberated by the Listing Division and the Listing Committee. There was no record in the meeting minutes of the guidance or comments given by the LOG Committee members in respect of public interest considerations. The HKEX Board meeting minutes also did not describe the details of the reports made by the LOG Committee Chairman to the HKEX Board on these matters.
81. The former Head of Listing explained that the discussions at the LOG Committee meetings focused less on substantives issues, and more on whether governance and due process had been observed in the development of listing policy initiatives and whether the policy initiatives had been duly deliberated by the Listing Committee. According to the former Head of Listing, the LOG Committee members had raised questions on public interest considerations in respect of certain consultations³⁷.

Supervision of Listing Division's management and operations

82. The LOG Committee supervises the management and operations of the Listing Division mainly through receiving reports from the Listing Division and discussing the reported matters at LOG Committee meetings. The former Head of Listing and the Chairman of the Listing Committee informed us that the LOG Committee Chairman also had ad hoc meetings and discussions with the former Head of Listing and separately with the Chairman of the Listing Committee.

³⁷ For example, the former Head of Listing informed us that in the [consultation on the listing regime for specialist technology companies](#), the LOG members inquired whether the Listing Division had considered the risk of expanding the listing eligibility to pre-revenue companies and how a balance was to be struck between allowing retail investor participation in the listings and ensuring proper price discovery for these companies.

83. During 2021 and 2022, the LOG Committee received monthly reports submitted by the Listing Division, which covered statistics and other summary information about its business operations and regulatory operations. In addition, the LOG Committee received thematic reports³⁸ relating to the Listing Division's operational procedures and regulatory and management oversight (eg, enhancements to the Listing Division's procedures and staff-related matters).
84. The meeting minutes showed that LOG Committee members and other attendees raised comments and enquiries about some of the topics reported. For example, during a discussion on the enhancements to the Listing Division's procedures, the HKEX Group General Counsel suggested that the elements of an independent regulatory mindset should be built into staff training programmes. LOG Committee members suggested that, in view of the new hires from the investment banking community, training programmes should be designed to highlight specific areas of focus and include discussion of conduct-related issues.
85. On another occasion, the Listing Division reported to the LOG Committee on the update to the division's complaint handling procedures. LOG Committee members commented that the updated procedures should be subject to HKEX group's internal audit and unusual complaints received by the Listing Division should be highlighted to the LOG Committee.

SFC observations

86. In relation to the supervision of the management and operations of the Listing Division, the former Head of Listing and the Chairman and Deputy Chairmen of the Listing Committee were of the view that the discussions at the LOG Committee meetings were effective, the HKEX Board through the LOG Committee has gained a better understanding of the Listing Division's operations and the communication between the HKEX Board on the one hand and the Listing Division and the Listing Committee on the other has been enhanced³⁹.
87. With respect to listing policy development, we recommended in the past that listing policy development by the regulatory function should remain independent from the influence of the commercial goals, interests and objectives of HKEX. Any views and suggestions provided by the HKEX business side on policy proposals where HKEX has a legitimate commercial interest must be considered and assessed independently and objectively by the regulatory function. But they must also take into account the Exchange's duty to prioritise the interest of the public when it conflicts with the interest of the Exchange and HKEX⁴⁰.
88. The LOG Committee was established to provide guidance to the Listing Division and advise the HKEX Board on the discharge of the Exchange's and HKEX's duties under

³⁸ In relation to (i) enhancements to the Listing Division's procedures (see paragraphs 92 to 94), including, amongst other things, the development of the HKEX "Chinese Wall" policy in respect of the listing regulatory function, (ii) the results from the regular monitoring and testing programme of the Listing Division (see paragraphs 101 to 104), (iii) Listing Division employee conduct incidents, (iv) the Listing Division's annual budget, key human resourcing, system support and other operational needs, performance evaluation and staff training plan, (v) reviews of the Exchange by the SFC and other law enforcement agencies and (vi) the appointment of members to the Listing Committee, the LRC and the HKEX Biotech Advisory Panel.

³⁹ For example, the non-Listing Committee members of the LOG Committee have given suggestions to the Chairman and Deputy Chairmen of the Listing Committee for the topics to be covered in their semi-annual presentation to the HKEX Board. The LOG Committee also requested the former Head of Listing to explain the rationale for certain listing policy initiatives to the HKEX Board.

⁴⁰ See paragraphs 38 to 41 of the 2019 review report.

sections 21 and 63(2) of the SFO. Given its short history, the LOG Committee's track record has yet to be developed. Our review of the LOG Committee's work in supervising the discharge of these duties relied mainly on the former Head of Listing's verbal replies to our questions as the relevant work reports of the Listing Division and the meeting minutes of the LOG Committee generally do not record these matters in sufficient detail.

89. We recommend that the minutes of the LOG Committee meetings should be more detailed. The record need not be verbatim but should contain sufficient details to provide a fair and accurate summary of the public interest considerations and issues presented to the LOG Committee by the Listing Division as well as the analysis considered and discussed and the conclusion reached (if any).

Listing Compliance

90. In July 2020, the Exchange established the Listing Compliance function within the Listing Division to oversee the Listing Division's compliance, internal controls and risk management. Listing Compliance is responsible for designing the division's policies and procedures and conducting necessary approvals to ensure compliance with its obligations under the relevant legislation and rules. In addition, Listing Compliance participates in formulating operating protocols to ensure that policies and procedures are understood and implemented.
91. During the review period, the Listing Compliance department was headed by a senior vice president and had one vice president and two assistant vice presidents.
92. In August 2020, HKEX and the Exchange commenced a programme to enhance the Listing Division's governance and procedures to address comments and recommendations in the SFC's 2019 review report. Within the Listing Division, the implementation of the programme was led by Listing Compliance.
93. The programme comprised four key workstreams:
- (a) enhancing the governance structure of the listing regulatory function (see paragraphs 95 to 98);
 - (b) strengthening the compliance and monitoring framework (see paragraphs 99 to 104);
 - (c) tightening the record-keeping standards and practices for (i) the maintenance of case files and (ii) the documentation of decision-making and supervision; and
 - (d) fostering on-going compliance and a risk-focused culture through training and enhanced communication of compliance obligations.
94. The Exchange informed us that with the exception of the update to the HKEX "Chinese Wall" policy⁴¹ and the regular ongoing initiatives (such as the monitoring and testing programme discussed in paragraphs 101 to 104), the other measures required under the Listing Division procedures enhancement plan were completed by the end of 2021.

⁴¹ See paragraphs 96 and 143.

Enhancement of the governance structure of the listing regulatory function

95. The enhancement of the governance of the listing regulatory function comprised reforms at three levels: (i) enhancing HKEX Board's oversight of the Listing Committee, the Head of Listing and the Listing Division, (ii) strengthening the Listing Committee's oversight of the Head of Listing and the Listing Division and (iii) reinforcing the Head of Listing's oversight of the Listing Division.
96. At the board level, the LOG Committee was established to assist the HKEX Board in the supervision of the Listing Division (see paragraphs 71 to 89). A group-level "Chinese Wall" policy has been developed to incorporate objectives and principles to identify and manage actual or potential conflicts of interests while allowing proper oversight of the Listing Division by the HKEX Board (see paragraph 143). The Listing Committee Chairman and Deputy Chairmen continue to report to the HKEX Board semi-annually on the Listing Committee's work.
97. At the Listing Committee level, protocols were updated to govern the Listing Division's escalation and reporting to the Listing Committee of (i) pre-IPO enquiries, (ii) complaints received, (iii) approved and rejected waiver applications and (iv) enforcement cases and decisions⁴².
98. Measures to enhance the Head of Listing's oversight of the Listing Division included, amongst other things, the establishment of the Listing Compliance function and formalising agenda items for the Listing management team meetings to ensure coverage of human resources, management and other issues.

Strengthening the compliance and monitoring framework

99. To strengthen the compliance and monitoring framework of the Listing Division, Listing Compliance (i) redesigned and enhanced a number of the Listing Division's processes and (ii) developed the compliance monitoring and testing programme.

Redesign and enhancement of key processes

100. Process enhancement included:
- (a) the development of a real-time central portal for managing staff declarations of conflicts of interest⁴³;
 - (b) review of the conflict management procedures for the Listing Committee and the LRC,
 - (c) the introduction of a centralised complaint handling procedure, pursuant to which (i) the complaint handling processes of the operational departments were aligned into a consistent divisional procedure, (ii) Listing Compliance acts as the central function to classify all complaints received through multiple channels⁴⁴ into the appropriate categories for further handling in accordance with the

⁴² See paragraph 176 of the [report](#) of the SFC's 2021 review of the Exchange's listing regulation (2021 review report).

⁴³ See paragraph 127.

⁴⁴ Including formal HKEX channels (General Enquiries and Complaints, Listing Complaints Unit and Regulatory Compliance Whistleblowing), complaints sent directly to the Listing Division and referrals from other parties.

divisional procedure⁴⁵, (iii) complaint handling and record-keeping are reviewed periodically⁴⁶ and (iv) responses to complaints are standardised to the extent appropriate⁴⁷; and

- (d) a review and update of the operating procedures and process for the IPO Vetting department to enhance the control, efficiency and transparency of the IPO vetting process.

Monitoring and testing programme

101. Listing Compliance established the monitoring and testing programme in April 2021 to assess the internal controls and processes in the Listing Division. Under this programme, Listing Compliance personnel carry out periodic reviews⁴⁸ and thematic reviews⁴⁹ for process controls.
102. In 2022, HKEX group's internal audit function tested some of the reviews carried out by Listing Compliance under the monitoring and testing programme from April 2021 to May 2022. While the audit results were considered satisfactory, the report noted that Listing Compliance had not formalised the methodology which outlines the various considerations and bases for the monitoring and testing programme. These included the identification and assessment of key risks faced by the Listing Division as well as the justification for the approach to cover certain key risks and any sampling strategy adopted.
103. Listing Compliance explained that when the monitoring and testing programme first commenced, it focused on areas where weaknesses were identified by various reviews including the SFC's 2019 review report. Subsequently, the testing topics were selected based on a number of factors including, amongst other things, recent listing policy development, complaints received, internal audit findings and input from the Listing Liaison Forum⁵⁰, the Head of Listing and the department heads. The testing plans during the review period were proposed by Listing Compliance and discussed with the former Head of Listing.
104. Listing Compliance informed us that HKEX Group Risk Management is designing a group-level risk management framework including a methodology for monitoring and testing. The Listing Division's monitoring and testing programme continues to evolve and adjustments will be made to align with the group-level methodology.

⁴⁵ Complaints are categorised as either non-staff complaints (which are handled by the relevant departments within the Listing Division) or staff complaints (which are coordinated by Listing Compliance for further handling by, depending on the allegations and the subject complained of, HKEX Group Legal and Compliance, the Head of Listing together with the Head of Listing Compliance or the relevant department head).

⁴⁶ See footnote 48.

⁴⁷ See paragraphs 182 to 185 of SFC's 2021 review report.

⁴⁸ Including, amongst other things, periodic reviews of personal account dealings, data leakage prevention, complaint handling, conflict declaration and IPO case files.

⁴⁹ Including, amongst other things, thematic reviews of the conflict management procedures of the operational departments.

⁵⁰ The Exchange's Listing Liaison Forum is attended by the Chairman and Deputy Chairmen of the Listing Committee, the HKEX CEO and the Head of Listing. It is intended as a forum for the Chairman and Deputy Chairmen of the Listing Committee to raise operational matters with the HKEX CEO and the Head of Listing (and vice versa) (see page 31 of the [2022 Listing Committee Report](#)).

Governance and reporting

105. The Head of Listing Compliance reports to the Head of Listing. During the review period, Listing Compliance was performing both the first-line and second-line control functions⁵¹ for the Listing Division, and the Head of Listing Compliance also had a “dotted” reporting line to the HKEX Group Chief Risk Officer and the Group Chief Compliance Officer⁵². Since August 2022, some of the second-line control functions have been transferred from the Listing Compliance department to the HKEX Group Compliance team (see paragraph 107).
106. Listing Compliance prepares the following regular reports to the Listing Liaison Forum and the LOG Committee:
- (a) lists of reviews conducted or to be conducted by Listing Compliance and summaries of findings and recommendations of completed reviews;
 - (b) notable compliance, risk and control matters;
 - (c) staff complaint statistics and summary of notable staff complaints; and
 - (d) periodic updates on the Listing Committee’s oversight of the Listing Division, including the list of reserved matters for the Listing Committee’s decisions under the Listing Rules and the list of regular reports or materials that the Listing Division provides to the Listing Committee⁵³.

Subsequent developments

107. In August 2022, the HKEX Group Compliance team recruited a senior vice president to assume the role of second-line defence for the Listing Division. Since then, the HKEX Group Compliance team has taken up from Listing Compliance the oversight responsibilities in certain areas related to operational compliance with HKEX group policies, including, amongst other things, information barrier management and the personal account dealings of Listing Division staff.
108. After the transition, the function of the Listing Compliance department has become the first-line control focusing on quality assurance and self-monitoring of the controls within the Listing Division to assist the Head of Listing in identifying areas for improvement in business and operational procedures. Listing Compliance continues to perform the reviews under the monitoring and testing programme. In February 2023, the Listing Compliance department has been renamed as “Listing Operational Risk & Control” and the team now has one managing director, one vice president, four assistant vice presidents and two associates.

SFC observations

109. Since the establishment of the Listing Compliance department, enhancements have been made to the Listing Division’s systems, processes, procedures and controls. The

⁵¹ Based on information provided by the Exchange, within the HKEX group the first-line control function performs day-to-day operational controls and rests with the operational divisions, which have the primary responsibility to own and manage risks associated with its day-to-day operational activities and to design, operate and implement relevant controls. The second-line control function is responsible for defining group standards and providing compliance advice and oversight in the form of frameworks, policies, tools and a monitoring system.

⁵² The Group Chief Compliance Officer joined HKEX in September 2021.

⁵³ Such reports are provided to the Listing Liaison Forum only.



Listing Division informed us that it plans to further align its control systems and processes with those of the HKEX group to facilitate HKEX's oversight of the Listing Division.

Management of conflicts of interest on the part of Listing Committee members and Listing Division staff in handling cases

110. The Exchange, as a recognized exchange company, has an obligation under the SFO to act in the interest of the public, having particular regard to the interest of the investing public, and to ensure that the interest of the public prevails where it conflicts with the interest of the recognized exchange company.
111. The Exchange is also a public body listed in Schedule 2 to the Prevention of Bribery Ordinance (**POBO**) and Listing Committee members and the staff of the Listing Division are regarded as "public servants" for the purpose of the POBO. They have a duty to adhere to high standards of professional and ethical conduct and should always place public interest above private interest and avoid and (if unavoidable) declare relevant interests which may conflict or be seen to conflict with their official duties.
112. We reviewed the policies, processes and procedures for the management of conflicts of interest on the part of Listing Committee members and Listing Division staff who handle cases.

Listing Committee members

Guidance and principles

113. According to the Listing Committee Handbook in effect during the review period, members will be regarded as being conflicted in the following circumstances:
 - where they or, to their knowledge, a family member, has (or in aggregate, have) a shareholding or economic interests of 5% or more⁵⁴ in companies or other entities which have or will have dealings with HKEX or its subsidiaries. In such cases the members should not participate in Listing Committee discussions involving these companies or entities;
 - where a company, firm or entity that they are associated with derives a financial benefit from their being members;
 - where they, in their professional capacity, advise a company, firm or individual on any dealing with the Listing Committee;
 - where they are (and for the twelve months after ceasing to be) directors or employees of companies, or partners in or proprietors of firms, which propose to have any dealing with the Listing Committee, such as acting as sponsors for IPO applications; or
 - where they have a substantial interest in a significant competitor to a listing applicant or listed company with a matter before the Listing Committee.

⁵⁴ This 5% threshold is a reference figure only. A member may have material interest in a transaction with a company even if he or she is interested in no more than 5% of that company's issued shares. A member shall declare an interest when the member considers that it is material.

114. In respect of IPO transactions, the handbook provides that a member will not necessarily be regarded as conflicted if there is a likelihood that the member, or their firm, will subsequently receive an allocation in an offering of securities that is being considered by the Listing Committee. Members may participate in the discussion of the listing application on the condition that, at the time of the committee's consideration of the matter, the allocation is contingent upon the *occurrence of future events* that may or may not subsequently occur (eg, the allocation amount and pricing). If, on the other hand, members receive (or their firms receive) a guaranteed allocation in an offering which is being considered by the committee (eg, their firms act as cornerstone investors to IPOs), they would be regarded as conflicted on that matter.
115. The handbook states that although the above guidelines are drafted to cover a wide range of likely scenarios, a prudent approach should be taken if a member is uncertain as to whether a matter falls within their terms. As a general principle, members should declare the interest although they may not be aware of any actual or potential conflict of interest but are aware (or the circumstances so appear) that a matter may give rise to a perception of bias or non-independence. The Listing Committee Chairman informed us that the majority of the committee members as experienced market participants have sound understanding of the principle of conflicts of interest and apply a conservative mindset in deciding to make conflict declarations in situations not explicitly set out in the handbook⁵⁵.

Processes and procedures

116. On appointment to the Listing Committee, members are required to make an initial declaration of interests. They are also required to immediately update the declarations should any change arises and confirm the accuracy of their declarations every six months.
117. Before each regular meeting or hearing, the Listing Committee Secretariat obtains from the Listing Division conflict check information in respect of the cases to be discussed and cross-checks that information against information in the members' conflict declarations and biographies to screen out possible conflicts of interest. The conflict check information is then sent to members for them to raise any additional conflicts not identified by the initial screening. If the Secretariat has any doubts as to whether a member is conflicted, they should seek confirmation or decision of the Chairman (or the next senior committee member if the Chairman is conflicted on the relevant matter under consideration)⁵⁶.
118. Members who are materially interested in a matter to be discussed at a meeting are obligated to declare this interest to the Secretariat prior to the meeting or to those present at the meeting and return or destroy all relevant papers as soon as they become aware of the conflict.
119. Subsequent to the review period, to enhance members' conflict discipline, the handbook was reviewed and amended in 2022 to require members to update the

⁵⁵ For example, the Chairman informed us that if the Listing Committee is considering a matter involving an entity or individual and a member (or his or her family member) is associated with a professional firm which advises that entity or individual on matters unrelated to the case currently before the committee, then the practice is for the member to declare a conflict in this situation although it is not explicitly mandated by the handbook.

⁵⁶ We were informed by the Listing Committee Chairman that the committee normally takes a conservative approach and members will be excluded from attending a meeting if there is a risk that they may have a conflict.

Listing Committee of any new conflicts which arise *after* the committee meeting at which the relevant matter was considered. In the context of IPO applications, this obligation applies up until the date of listing. For example, if a member's employer enters into cornerstone investment discussions with the listing applicant after its Listing Committee hearing, the member should inform the Secretariat as soon as he or she becomes aware of these discussions. When the cornerstone investment is confirmed, a member with such an interest will be excluded from receiving the relevant papers after the Listing Committee hearing.

SFC observations

120. The Listing Committee Handbook sets out some guidance as to the circumstances which may give rise to conflicts of interest on the part of committee members. The situations set out in the guidance mainly involve a direct relationship between the member and the matter being considered by the committee (eg, the member in his or her professional capacity advising a client on the matter before the committee). As to scenarios not specifically set out in the handbook, we understand that the committee relies on members' professional judgment to adhere to the principle of prudence and maintain the integrity of the committee's process and decision making⁵⁷.
121. The [Sample Code of Conduct for Members of Public Bodies](#) published by the Independent Commission Against Corruption provides guidelines for declarations of interests by members of public sector advisory and statutory bodies, which may also be referred to by other public bodies. The guidelines set out a range of situations potentially involving conflicts of interest⁵⁸. We recommend that the Listing Committee Handbook be revised to provide more detailed guidance on potential conflict situations, in particular to include common examples of relationships which are not directly related to the specific matter being considered by the committee but may nonetheless be perceived as affecting the impartiality of a member (such as a separate business relationship between a member's professional firm and a party involved in a case before the committee).
122. In respect of the amendment to the procedures which requires members to update the Listing Committee on new conflicts which arise throughout the process of a case⁵⁹, we recommend that the guidance clarify that, in the context of IPO applications, a member should be excluded from receiving relevant papers or participating in committee discussions once his or her firm has commenced cornerstone investment discussions with the listing applicant (not when the investment is confirmed). The member should also confirm to the Exchange that the investment (if entered into after the member receives relevant papers or participates in any committee discussion of the listing application) was not based on non-public information obtained by virtue of his or her participation in the matter as a committee member.

⁵⁷ See paragraph 115 and footnote 55.

⁵⁸ Including: (i) pecuniary interests in a matter under consideration by the committee, held either by the member or by any close relative, (ii) a directorship, partnership, advisory or client relationship, employment or other significant connection with a company, firm, club, association, union or other organisation which is connected with, or the subject of, a matter under consideration by the committee, (iii) friendships which might be so close as to warrant declaration, (iv) a member who, as a barrister, solicitor, accountant or other professional adviser, has personally or as a member of a company, advised or represented or had frequent dealings with any person or body connected with a matter under consideration by the committee and (v) any interest likely to lead an objective observer to believe that the member's advice might have been motivated by personal interest rather than a duty to give impartial advice.

⁵⁹ See paragraph 119.

Listing Division staff

Guidance and principles

123. HKEX Code of Conduct requires all staff to manage and mitigate risks associated with conflicts of interest by (i) avoiding conflicts of interest (direct or indirect, actual or potential) which may compromise their integrity and put HKEX's interests and reputation at stake and (ii) where such a situation cannot be avoided, declaring conflicts of interest and (if so required by HKEX) withdrawing from any consideration of or decision on a matter in which the staff member may have an interest.
124. Listing Division's guidance on conflict management, which is supplemental to the HKEX group policy, requires all staff to timely declare any matter and relationship they are aware of which may give rise to actual or perceived bias or lack of independence. Staff members are required to assess whether the public would consider that there might be bias or lack of independence given the staff member's relevant relationship, and the prudent approach is always to make a declaration when the staff member has any doubt.
125. According to the divisional guidance, types of relationship which may lead to conflicts of interest include blood, marriage, employment and other affiliation. The guidance sets out a non-exhaustive list of common examples of relationships which would warrant declaration and may lead to exclusion of a staff from handling a particular matter, including:
- in relation to a prospective listing applicant, listing applicant or listed issuer: where a staff or an individual involved in a personal relationship with the staff occupies a senior and relevant position at the company, or is able to otherwise influence its decisions or has an interest in the company;
 - in relation to an audit firm or reporting accountant: where staff or an individual involved in a personal relationship with the staff is directly involved in the audit of a listed issuer or an engagement to act as the reporting accountant in a prospective listing application or in a material transaction by a listed issuer; and
 - in relation to a professional adviser other than an audit firm or reporting accountant: where a staff or an individual involved in a personal relationship with the staff is directly involved in an engagement to conduct the same type of work as the matter being handled by the Listing Division (such as providing advice on IPOs, ongoing compliance with the Listing Rules or Listing Rule disciplinary matters), or occupies a senior and relevant position with the professional adviser irrespective of whether the individual is personally involved in the matter⁶⁰.

Processes and procedures

126. The Listing Division's conflict management procedures consist of the following steps: (i) identification and initial declaration of the relationship by the staff, (ii) assessment by the department head to determine appropriate actions, (iii) ongoing confirmation and monitoring of the declarations and (iv) conflict management for specific tasks.

⁶⁰ In respect of new staff members who join the Listing Division from professional firms, Listing Compliance informed us that the division imposes a cooling-off period of six months during which relevant staff are not allowed to handle matters associated with their previous employers. This requirement has not been set out in the written policy, and Listing Compliance will consider the need to formalise it.

127. All staff members are required to declare their immediate previous employer, personal relationships and other conditions which may give rise to potential conflicts of interest upon first joining the Listing Division and subsequently as soon as they become aware of any new or change in relationships or conditions. They are also required to confirm the accuracy of their declarations every six months. All declarations are made on the division's online portal, which was set up by Listing Compliance in 2021 to replace the previous paper-based system.
128. Declarations made by staff members are reviewed by the department heads⁶¹ to assess whether a declared relationship constitutes an actual or perceived conflict of interest and what mitigating actions are necessary (such as restricting the conflicted staff from handling cases or accessing relevant case records)⁶². After the assessment, all confirmed conflicts and the measures to be taken are recorded on the division's central log for declarations of relationships. The Head of Listing Compliance has responsibility for oversight of the assessment process.
129. Each department within the Listing Division is responsible for conducting conflict checks for matters it handles as part of the workflow. During the review period, the conflicts management procedures varied among the operational departments.
130. Staff of the Listed Issuers Regulation (**LIR**) department are assigned to different teams each responsible for monitoring a portfolio of issuers. Before team assignments are made, LIR senior management checks the central log and any staff member conflicted with an issuer will not be assigned to the team responsible for the portfolio to which the issuer belongs. LIR has been using a One-stop Processing and Approval System (**OPAS**) for its case management since 2020 and its conflict check processes for cases have been incorporated into this system and largely automated. Case information, including the names of the parties and advisors, is automatically checked against the conflict declarations retrieved from the central log and a list of conflicted staff members is generated and displayed by the system. The system also blocks conflicted staff members from accessing the relevant case information.
131. For other departments of the Listing Division, OPAS had not been implemented during the review period and their conflict checks were conducted manually in accordance with department-specific procedures. For example, in the IPO Vetting department, a designated officer is responsible for performing conflict checks on division-wide staff members at multiple key stages of the vetting process of an IPO application. If, during the course of the vetting of an application, a staff member declares a new conflict or a conflict arises because of the addition of new parties (such as new sponsors or advisors), the conflicted staff will be required to cease handling the case and be restricted from accessing the case files⁶³.

⁶¹ Declarations made by department heads are assessed by the Head of Listing, and declarations made by the Head of Listing are assessed by the Listing Compliance Subcommittee (which is chaired by the Head of Listing Compliance and Head of Policy and Secretariat Services and may escalate matters which undermine the independence and objectivity of the Listing Division to the Listing Committee Chairman). The Exchange informed us that no declaration by the Head of Listing has been escalated to the Listing Committee Chairman.

⁶² We were informed by Listing Compliance that aside from the examples set out in the division's guidance, there are no written policies or criteria for department heads to follow when judging whether a declared relationship constitutes an actual or perceived conflict. According to Listing Compliance, the assessment is straightforward for most of the declared relationships, and any novel issue will be raised and discussed with Listing Compliance.

⁶³ In 2022, HKEX group's internal audit function reviewed the IPO Vetting department's conflicts management

Monitoring and testing

132. As part of the monitoring and testing programme, Listing Compliance assesses the effectiveness of the conflict management process and controls of the operational departments through periodic and thematic reviews, such as the timeliness of declarations and assessment, the application of mitigating actions and the departmental processes in handling conflicts.
133. The periodic reviews in 2021 detected 88 incidents, including 79 involving delays in submitting the semi-annual confirmation of staff conflict declarations, six involving failures to conduct proper conflict checks or follow conflict management procedures⁶⁴ and three involving oversight in imposing case file access restrictions on conflicted staff.
134. The thematic reviews identified a number of weaknesses in the conflict management processes and controls of the operational departments. For example, the procedures of the Listing Enforcement department, the Structured Products and Fixed Income department and the Accounting Affairs department in effect in 2021 did not explicitly require conflict checks to be conducted on team members before each case assignment⁶⁵.
135. According to Listing Compliance, policy reminders were issued for overdue conflict confirmations. A conflict checklist was developed to standardise the scope and timeline of conflict check process for the IPO Vetting department, and training was provided to staff members. The other operational departments also updated their conflict management procedures to address the weaknesses identified.

SFC observations

136. According to the Listing Division's conflict management procedures, when the Head of Listing declares a relationship that may give rise to potential conflicts of interest, the declaration is assessed by the Head of Listing Compliance and the Head of Policy and Secretariat Services⁶⁶. The Head of Listing Compliance and the Head of Policy and Secretariat Services both directly report to the Head of Listing. To address perception issues, we recommend that declarations by the Head of Listing should be routinely referred to HKEX Group Compliance.
137. Listing Compliance through its monitoring and testing programme has identified a number of areas for improvement in the conflict management processes and procedures of the operational departments. We were informed by Listing Compliance that the One-stop Processing and Approval System has been rolled out for the entire Listing Division in 2023 and the conflict check processes of all operational departments have now been automated⁶⁷, and the automation has resolved the

process and noted a delay in certain cases in imposing restrictions on case file access on staff members who reported new conflicts during the course of the vetting process. These delays arose because conflict checks were performed at several key stages of the vetting process and new conflicts reported between two stages were not picked up until the next conflict check. The issue has been solved with the implementation of OPAS for the IPO Vetting department (see paragraph 137).

⁶⁴ Including omissions to check conflicts before circulating pre-clearance meeting materials and inaccurate and incomplete conflict search results.

⁶⁵ Instead, conflict checks were required to be performed only when team members made new declarations or after case assignments.

⁶⁶ See footnote 61.

⁶⁷ See paragraph 130.



issues which resulted from the reliance on manual checking in the past. Listing Compliance informed us that the conflict management controls, processes and procedures of the Listing Division are being updated after the migration to OPAS. We recommend that Listing Compliance continue to monitor and test the effectiveness of these controls, processes and procedures.

Section 3

Follow-up from the 2019 and 2021 reviews

Follow-up from the 2019 review

138. In the 2019 review report, we reviewed the implementation of the “Chinese Wall” protocol which aimed to manage the Listing Division’s actual, potential and perceived conflicts of interest with HKEX and the Exchange.
139. We also noted that the Chairman and Deputy Chairmen of the Listing Committee met with the Head of Listing monthly at the Listing Liaison Forum during which operational matters of the regulatory function were raised and discussed. In 2018, the former HKEX CEO did not attend any of the Listing Liaison Forum meetings although he remained a member of the forum.
140. We recommended that the Exchange should tighten the protocols to enhance the independence of its regulatory function regarding, amongst other things, the sharing of non-public, non-case specific information by the Listing Division with the HKEX business side, and should conduct a thorough and comprehensive study to clarify and develop written rules, practices, policies, guidelines and procedures which are necessary and appropriate to give effect to the Chinese Wall, taking into account the listing regulatory function’s role as a public authority and its statutory duty under section 21 of the SFO.

SFC observations

Attendance by non-listing personnel at listing-related meetings

141. We noted that the matters reported to the Listing Liaison Forum and discussed at its meetings have included, in addition to operational matters of the listing regulatory function, listing policy developments and notable cases handled by the Listing Division. Although the former HKEX CEO ceased attending meetings of the Listing Liaison Forum in 2018, we noted that the incumbent HKEX CEO attends these meetings from time to time. In addition, the HKEX CEO, the Group Chief Risk Officer, the Group Chief Compliance Officer and the Group General Counsel are regular attendees of LOG Committee meetings and receive certain non-public listing-related information, although they are not LOG Committee members (see paragraph 75).
142. We recommend that HKEX adopt adequate procedures to ensure that non-public listing-related information be kept confidential from personnel outside of the Listing Division.

Chinese Wall protocol

143. A group-level “Chinese Wall” policy has been developed to incorporate objectives and principles to identify and manage actual or potential conflicts of interests which may arise between HKEX’s interests as a listed company and the proper performance of listing-related functions and responsibilities by the Exchange, while allowing oversight of the Listing Division by the HKEX Board. The Chinese Wall protocol generally prohibits the sharing of non-public listing-related information with non-Listing Division staff, subject to limited specified exceptions.

Follow-up from the 2021 review

144. In 2021, we reviewed the Exchange's performance in its regulation of listing matters during 2019 and 2020. We identified a number of areas for potential improvement and suggested recommendations for the Exchange to consider. This section discusses the steps taken by the Exchange in response to our recommendations in the 2021 review report.

The Exchange's handling of review hearings for non-disciplinary listing matters

145. We reviewed the Exchange's handling of review hearings for non-disciplinary listing matters.

146. Our key observations and recommendations were that:

- (a) in respect of time extensions sought by review applicants to make their written submissions, the LRC and the Listing Committee were recommended to review their policies and procedures to include sufficient guidance for members to evaluate and decide these requests in a more consistent manner. In particular:
 - i. to support the operation of the time-based delisting rules, these extensions should not be granted if the request is made mainly for the purpose of giving a listed issuer additional time beyond the prescribed remedial period to improve its business or the underlying matters to avoid a trading suspension or delisting, or mainly to mitigate the risk of a challenge by judicial review;
 - ii. review applicants requesting extensions on the ground of external circumstances should be asked to provide specific details to justify the request and the length of the extension should be proportionate to the amount of time required to prepare and submit a written submission (which is generally expected to be 30 days or less save in exceptional circumstances);
- (b) the Exchange should consider whether the conflict check procedures should be unified for the LRC and the Listing Committee, and improved for LRC members;
- (c) the Exchange should consider the issues associated with the review committee being asked to consider cases based on materially different facts and circumstances. We were informed by the Exchange that since 2021, a new approach had been adopted in respect of the LRC's consideration of new information submitted whereby the case would be remitted to the Listing Committee under certain circumstances;
- (d) the Listing Division should vet new information submitted to the review committee by a review applicant shortly before the review hearing and, when appropriate, consider requesting the hearing to be adjourned to allow it sufficient time to make a submission in response for the review committee's consideration;
- (e) the LRC as a review body should not appear to be deviating from or modifying the Listing Rules or published policies in *ad hoc* or arbitrary ways. We were informed by the Exchange that since 2021, the Exchange had adopted a policy whereby the LRC would remit a case to the Listing Committee (which is the decision-making body for listing policies) if it considers that the facts and circumstances of the case might justify a deviation from existing listing policies or give rise to a new policy consideration which may apply to other issuers;

- (f) when the LRC overturns a delisting decision by the Listing Committee, it should give clear directions either for trading to be resumed (if it is satisfied that all resumption conditions have been met), or for the issuer to satisfy the resumption conditions and resume trading by a stipulated date or face delisting; and
- (g) to enhance transparency and help the market understand the rationale behind the differences in the opinions of the two decision-making bodies, when the LRC overturns a decision made by the Listing Committee, the LRC decision should address the prior decision and explain the basis for the reversal with sufficient specificity.

SFC observations

147. The following table sets out the non-disciplinary review cases heard by the LRC and the Listing Committee in 2021 and 2022:

Type of cases	First decision-making body	Review body			
		Listing Committee		LRC	
		2021	2022	2021	2022
Cancellation of listing	Listing Committee	N/A	N/A	14	11
Suspension of trading for failure to comply with rule 13.24 ⁶⁸	Listing Division	13 (note)	6	14	4
Reverse takeover	Listing Division	3 (note)	0	1	1
Waiver and other application	Listing Division	2	0	0	0
Total		18 (note)	6	29	16

Note: Two cases (one involving trading suspension and the other involving reverse takeover) were rehearings by the Listing Committee upon remittance by the LRC (see paragraph 152).

148. We noted that the Exchange has implemented new processes, procedures and practices for the review of non-disciplinary matters to address our recommendations from the 2021 review. There are a number of areas where further enhancements are recommended, as discussed below.

Management of the review hearing process

149. The Exchange has adopted certain new internal guidance and procedures for the review hearing process, which incorporated the principles set out in our recommendations in respect of time extensions sought by review applicants to make their written submissions (see paragraph 146(a)) and provide a consistent set of factors for the committees' consideration when deciding whether to grant a time extension⁶⁹. According to statistics provided by the Exchange, the LRC granted time extensions in 21 non-disciplinary review cases (averaging 18 days) in 2021 and nine cases (averaging nine days) in 2022. The Listing Committee granted time extensions in 15 review cases (averaging 28 days) in 2021 and two cases (averaging 28 days) in 2022.

⁶⁸ Rule 13.24 requires an issuer to carry out a business with a sufficient level of operations and assets of sufficient value to support its operations to warrant the continued listing of the issuer's securities.

⁶⁹ Including (i) the general need to progress all proceedings without delay, (ii) the reasons given by the party applying for a time extension to support the request, (iii) the opportunity the party has already been given for compliance with the time limit, and (iv) whether an extension would cause prejudice to any other party or put at risk the hearing date.

150. In respect of conflicts check procedures (see paragraph 146(b)), we were informed by the Exchange that the procedures for the LRC have been aligned with those for the Listing Committee review hearing. The LRC secretary now obtains the conflict check information⁷⁰ from the Listing Division instead of the review applicant. The number of LRC members has also increased which mitigates the risk of hearings being delayed by insufficient quorum due to members' conflicts of interest or unavailability. The average time taken to complete conflict checks on LRC members was 27 days from the receipt of the review application for review hearings held in 2021 and 14 days for 2022.
151. According to statistics provided by the Exchange, LRC non-disciplinary review hearings were scheduled in a more timely manner in 2021 and 2022 as compared to 2020. The average time lapsed between the Listing Committee decision and the LRC hearing was 16 weeks for reviewing hearings held in 2021 and 12 weeks for 2022.

Admission and consideration of new information

152. In respect of new information submitted to the LRC (see paragraph 146(c)), the LRC remitted two cases (involving trading suspension and reverse takeover) to the Listing Committee in 2021 and one case (involving cancellation of listing) in 2022, where the review applicants submitted new information on material developments to its situation since the earlier decisions by the Listing Committee. There was also a case where the LRC considered the new information and overturned the Listing Committee's decision⁷¹.
153. In the three cases remitted by the LRC to the Listing Committee, the LRC in its decisions instructed that the cases be reheard by the Listing Committee on an expedited basis. However, the Listing Committee rehearsings did not take place until eight to 13 weeks after the LRC decisions were issued and the prolonged review process effectively gave the review applicants further time to resolve the underlying issues leading to their potential trading suspension or delisting. We recommend that the Exchange further shorten the time period for holding a rehearing after the LRC remits a case to the Listing Committee and improve the efficiency of the review hearing process in general.
154. In respect of supplemental submissions filed by review applicants shortly before the review hearing (see paragraph 146(d)), according to the Exchange there were a small number of cases in 2021 and 2022 where these submissions were made. The Listing Division did not object to the committee admitting the new information or request the hearings to be adjourned. We noted that in one of these cases the Listing Division filed a response to the applicant's supplemental submission on the next day of receipt of the submission.

⁷⁰ Including information on the issuer's (i) current directors and senior management, and directors and senior management involved in the matter, (ii) major shareholders, (iii) major subsidiaries, (iv) advisers involved in the relevant matter or stated in the issuer's annual report, and (v) other key parties involved in the matter.

⁷¹ In this case (involving a suspension of trading due to the issuer's failure to comply with rule 13.24), material new information was submitted to the LRC on the issuer's implementation of a new business plan. After the hearing, the LRC directed the issuer to submit further information and requested the Listing Division to provide its view. After considering all submissions including the Listing Division's view that the issuer had addressed the concerns under rule 13.24, the LRC overturned the Listing Committee's decision on the basis of the new development.

Decisions of the LRC and consideration of listing policy in LRC review cases

155. To facilitate the LRC's application of listing policies in review cases (see paragraph 146(e)), the training materials for LRC members have been enhanced in 2021 to include more details and examples in respect of important listing policies such as trading suspension and delisting.
156. In each of 2021 and 2022, the LRC overturned one decision of the Listing Committee in non-disciplinary cases, both involving a suspension of trading due to the issuer's failure to comply with rule 13.24. In early 2023, the LRC overturned three decisions of the Listing Committee involving cancellations of listings. In the majority of the overturned cases, we noted that the LRC addressed the prior decisions of the Listing Committee and explained the basis for the differences between its view and that of the Listing Committee. However, in one of these five cases, some of the concerns stated in the Listing Committee's decision did not appear to be adequately addressed by the LRC⁷². The LRC should ensure that the key elements of the Listing Committee's decision are adequately addressed in the LRC's decision when it overturns a Listing Committee decision.
157. In addition, in three of the overturned cases, the LRC's decisions went beyond the scope permitted by the Exchange's policy and published guidance on extending the remedial period for long suspended issuers and those on the sufficiency of operations of newly established businesses. A summary of our findings from these cases is set out in the **Appendix**. According to the Exchange's policy, if the LRC considers that the facts and circumstances of a case might justify a deviation from existing listing policies or give rise to a new policy consideration which may apply to other issuers, the case should be remitted to the Listing Committee to decide. This policy was not followed in the three cases referred to above. When the LRC deviates from the Exchange's published listing guidance in such a manner, it risks undermining the Listing Committee's delegated authority to set listing policies, which may lead to a rule-making system that is arbitrary and unclear. We recommend that the Exchange take further action to address the situation, taking into account the measures which have already been implemented in response to the SFC's 2021 review. For example, it may be advisable to establish an internal legal function within the Exchange's listing regulatory function to ensure, amongst other things, that decision-makers are advised of their remit and the scope of their discretion as they administer the Listing Rules on a day-to-day basis. In the meantime, the Exchange could consider issuing reminder letters to LRC members and providing further training to them on relevant Exchange rules and policies on delisting and suspension.
158. In response to our recommendations from the 2021 review (see paragraph 146(f)), the new internal guidance clarified that the LRC should refrain from issuing decisions which are expressed to be subject to the satisfaction of specified conditions. In one of the overturned cases, the LRC gave the issuer a designated period to complete the key transaction to fulfil the requirements of rule 13.24 and issued its final decision only upon the completion of the transaction.

⁷² See case 3 in the **Appendix**.

The Exchange's monitoring of newly-listed issuers' disclosure of their use of listing proceeds

159. We reviewed the Exchange's monitoring of newly-listed issuers' disclosures of their use of listing proceeds.
160. Our key recommendations were:
- (a) with respect to post-vetting of issuers' announcements, the Exchange should review its policy and procedures for vetting disclosures and compliance surrounding the use of listing proceeds to enhance its detection of misconduct which is not as apparent on the face of the announcement but for which there are notable red flags; and
 - (b) with respect to review of disclosures in issuers' annual reports, the Exchange should (i) consider ways to better align its review process with issuers' different reporting deadlines, for example, by reviewing the annual reports of issuers with the same reporting year-end dates in the same batch soon after they are published so that follow-up action could be taken more promptly; and (ii) consider enhancing its internal guidelines and procedures and provide appropriate training to LIR staff.

SFC observations

161. We were informed by the Exchange that:
- (a) In July 2021, the Exchange pilot-launched an issuer risk profile database to capture and flag issuers using a set of predetermined risk parameters including changes to the use of IPO proceeds⁷³. We understand from the Exchange that no notable cases with potential issues related to the use of IPO proceeds have been identified so far through the issuer profile monitoring;
 - (b) For IPO cases which display red flags, the Exchange may, as a condition for listing, require the issuers to provide periodic updates to their compliance advisers and the Exchange on the use of IPO proceeds. We understand from the Exchange that this condition was imposed in one listing application which subsequently lapsed. The Exchange believes that imposing this condition could make tackling issues associated with questionable use of IPO proceeds more effective;
 - (c) The Exchange was able to identify a number of cases with potential issues related to the use of IPO proceeds by reviewing annual reports, results announcements and significant transactions⁷⁴; and

⁷³ Other parameters include, amongst other things, shell activities and director and corporate conducts. The issuer risk profile serves a broader objective to facilitate the Listing Division in implementing a risk-based approach in monitoring issuers' activities and deciding whether higher regulatory scrutiny is needed for a corporate action proposed by an issuer.

⁷⁴ For example, the Exchange was able to identify an undisclosed change in the use of IPO proceeds by an issuer by vetting the announcement of a major transaction, which was subsequently found to be funded by the IPO proceeds. The case was referred to Listing Enforcement and the SFC. In another case, the Exchange, through a review of the cash balance reported in the interim and annual report of an issuer, was able to identify an undisclosed change in IPO proceeds and requested the issuer to publish supplemental announcements to explain the changes and the reason thereof.

- (d) With respect to the review of issuers' annual reports, (i) beginning with the review of the 2021-year-end annual reports, the Exchange has aligned its review process with issuers' different reporting deadlines and the review should be completed and the results documented within three months after the publication deadline of relevant annual reports; and (ii) the Exchange has enhanced its internal guidelines and training materials to set out examples of potential issues noted from past annual report reviews and a reminder that any disclosed or identified change in the use of IPO proceeds and the team's analysis and actions should be properly recorded in a file note.

The Exchange's handling reverse takeover transactions under the amended rules

162. We reviewed the Exchange's handling of reverse takeover (**RTO**) transactions under the amended rules which came into effect in 2019.
163. Our key recommendations were:
- (a) in respect of re-sequenced transactions (a phenomenon whereby business injections were broken up into a series of smaller transactions or arrangements in order to circumvent otherwise applicable listing requirements), we noted that the Listing Division reached different conclusions in two similar cases as to whether the transactions formed part of a series of transactions and were therefore subject to the RTO rules. The Exchange should enhance its internal training programme and guidance materials to promote more consistency in applying the anti-avoidance principle of the new RTO regime; and
- (b) in cases involving an injection of a business into a newly-listed issuer by a controlling shareholder, the Listing Division should exercise heightened scrutiny as to whether IPO-standard due diligence and disclosure should be required. When the percentage ratios submitted by the issuer for the purpose of determining the size of the acquisition have been calculated based on financial figures which are more than six months old, the Listing Division should consider requesting the issuer to also provide updated financial statements and most recent management accounts and, if necessary, relevant financial forecasts to facilitate the assessment.

SFC observations

164. The Listing Division considered that it has applied the RTO rules to re-sequenced transactions in a consistent manner, and cases with distinguishable features would result in different assessments. The Listing Division has updated its internal guidance to reflect our recommendation that where appropriate, updated financial information and relevant financial forecast should be requested and considered when assessing the size of an acquisition and whether it would result in a fundamental change in the issuer's principal business.

Section 4

Review of the operations of the Listing Division in 2021

Overview

165. The following table summarises the operational activity reported by the Exchange in its listing regulation for 2017, 2018, 2019, 2020 and 2021⁷⁵.

	2017	2018	2019	2020	2021
Number of listing applications accepted for vetting by the IPO Vetting department	310	372	300	231	316
Number of listing applications vetted by the IPO Vetting department ⁷⁶	412	511	467	357	408
Number of applications for which approvals were granted in principle	216	245	209	179	153
Number of compliance and monitoring actions handled by the LIR department ⁷⁷	66,368	70,293	73,704	82,228	82,227
Number of investigations handled by the Enforcement department	86	111	112	128	164
Number of Listing Decisions published	14	3	3	6	2
Number of Guidance Letters published	0	10	7	3	1
Number of FAQs published	3 series	5 series	7 series	2 series	2 series
Number of other guidance materials published	2	2	2	7	6
Number of listing applications processed by the Structured Products and Fixed Income department ⁷⁸	21,224	38,472	33,671	50,167	59,491
- Derivative warrants	7,989	11,794	8,939	12,128	16,684
- Callable Bull/Bear Contracts (more commonly known as CBBCs)	13,235	26,678	24,732	38,039	42,807

⁷⁵ Source: HKEX 2021 Annual Report.

⁷⁶ The number comprises new listing applications accepted in the current year and listing applications brought forward from the previous year.

⁷⁷ Compliance and monitoring actions include announcements and circulars vetted, share price and trading volume monitoring actions undertaken and complaints handled.

⁷⁸ The figures refer to issues of new structured products and do not include further issues.

IPOs

166. The number of listing applications accepted for vetting by the Exchange in 2021 was 316, representing an increase of 85 (or 36.8%) from the 231 in 2020.
167. The number of listing applications vetted by the Exchange in 2021 was 408, up by 51 (or 14.3%) from the 357 in 2020⁷⁹.
168. The average time between the acceptance of a case for vetting and the issue of the first comment letter in 2021 was 18 business days (2020: 13 business days)⁸⁰. In 2021, the Exchange received 93% more listing applications under the chapters of the Listing Rules introduced in 2018 (Chapters 8A, 18A and 19C) from applicants operating in emerging and innovative sectors. In particular, the Exchange saw a 124% increase in the number of listing applications from Biotech Companies under Chapter 18A as compared to 2020. The Exchange reported that the vetting process is, on average, longer for these applications, due to their nature and complexity.
169. In 2021, the average time between the acceptance of a case and presenting it to the Listing Committee was 111 business days (2020: 133 business days), and the percentage of listing applications presented to the Listing Committee for hearing within 120 days was 40.7% (2020: 33.8%). The number of listing applications approved in principle for listing by the Exchange was 153 in 2021 (2020: 179), down by 26 (or 14.5%).
170. In 2021, the IPO Vetting department published one guidance letter⁸¹ (2020: two) and did not publish any listing decisions (2020: two).

Listed issuer regulation

171. The number of LIR actions handled by the Exchange was 82,227 in 2021 (2020: 82,228), representing a very slight decrease of 1 (or 0.001%) in 2021. The following is a breakdown of the announcements handled by the LIR department in 2021.

	Post-vetted	% of total	Pre-vetted	% of total	Total
2020	68,416	99.85	106	0.15	68,522
2021	65,228	99.87	87	0.13	65,315

172. The LIR department referred 93 cases to Listing Enforcement in 2021, up 19% from 78 referral cases in 2020. Referrals to external regulatory bodies⁸² increased from 42 cases in 2020 to 71 cases in 2021, up 69%. The increase of referrals mainly arose from cases involving (i) audit issues and (ii) material impairment made or insufficient risk assessment performed for loans granted by issuers.

⁷⁹ The number of applications vetted comprises applications accepted for vetting in the current year and “in-progress” applications brought forward from the previous year. The difference between the numbers of applications vetted and those accepted represents the number of cases brought forward from the previous year, which is affected by different factors including the number of applications received, the complexity of the cases and when the applications were received.

⁸⁰ Based on the Detailed Vetting and Administrative Procedures for IPO applications, the first comment letter is expected to be issued as soon as practicable from the date of acknowledging receipt of a new listing application. We noted that the shortest time between the date of application and the date of the first comment letter was four business days and the longest time was 40 business days.

⁸¹ Guidance Letter: “Pre-vetting for placing to connected clients in an initial public offering” (March 2021).

⁸² The SFC, the Financial Reporting Council (now known as the Accounting and Financial Reporting Council) and other regulatory bodies.

173. In terms of turnaround time, the Exchange:

- (a) post-vetted results announcements within three business days of publication in 100% of the cases in 2021 (2020: 97%);
- (b) post-vetted other announcements within one business day of publication in 99% of the cases in 2021 (2020: 99%); and
- (c) pre-vetted announcements⁸³ within the same day in 94% of the cases in 2021 (2020: 98%).

174. In 2021, the LIR department did not issue any guidance letters (2020: two) but issued two listing decision⁸⁴ (2020: four).

175. The Exchange reported that, in 2021, it continued its initiative to promote self-compliance by listed issuers with the Listing Rules. This initiative was pursued primarily through issuing listing decisions, semi-annual Listing Division Newsletters, Listed Issuer Regulation Newsletters, Enforcement Bulletins, the revised Enforcement Policy Statement and Enforcement Sanctions Statements⁸⁵ and corporate governance materials and climate disclosure guidance as well as launching e-training modules.

SFC observations

176. As noted above, the caseload of the IPO Vetting department increased by 14.3% in 2021 (see paragraph 167) while the number of LIR actions handled by the LIR department decreased slightly (see paragraph 171).

177. During the same period:

- (a) the processing time for issuing the first comment letter increased (see paragraph 168), but the Listing Division was more efficient in terms of presenting cases to the Listing Committee in 2021 (see paragraph 169); and
- (b) the proportion of results announcements vetted within three business days increased slightly in 2021, the proportion of post-vetting other announcements within one business day remained the same and pre-vetting announcements within the same day fell slightly in 2021 (see paragraph 173).

178. During 2021, the IPO Vetting department issued one guidance letter but did not issue any listing decision (see paragraph 170); while the LIR department did not issue any guidance letter but issued two listing decisions (see paragraph 174).

Investigation and enforcement

179. In 2021, the Exchange announced three priorities on which the Exchange has particular focus: (a) responsibility, (b) controls and culture, and (c) cooperation⁸⁶.

⁸³ These primarily comprised announcements made in relation to very substantial acquisitions, very substantial disposals, reverse takeovers and cash companies, which are required to be pre-vetted by the Exchange under the Listing Rules.

⁸⁴ Listing Decisions: "Whether the Exchange would waive Rule 14.06B so that the proposed acquisition of the Target Company by company A would not be classified as a reverse takeover" (July 2021) and "Whether Company A's proposed acquisition of the Target Company constituted a reverse takeover" (July 2021).

⁸⁵ See the revised [Enforcement Policy Statement](#) and revised [Enforcement Sanctions Statement](#), both published in July 2021.

⁸⁶ See footnote 85.

Replacing the enforcement themes which had been in place since 2017, these priorities describe the areas in which the Exchange is targeting its enforcement resources.

180. The Exchange reported that it handled 164 investigations in 2021 (2020: 128), up 28.1% from 2020.
181. The Exchange completed 36 disciplinary cases in 2021 (2020: 13), 35 of which were concluded with public sanctions imposed by the Exchange (2020: 13).
182. Apart from disciplinary actions, the Exchange issued:
- (a) prejudice statements⁸⁷ against 56 individuals in 2021 (2020: 8);
 - (b) 29 directions⁸⁸ (2020: 8); and
 - (c) 12 regulatory letters (2020: 9).
183. In 2021, the Exchange also took action against 185 directors⁸⁹, representing a significant increase from 2020 (59 directors).
184. Below is a summary of the number of investigations handled by the Exchange and the enforcement outcomes from 2017 to 2021:

	Investigations*	Regulatory letters (ie, warning/caution letters) issued	Cases closed by way of “no further action”	Disciplinary cases
2017	86	9	11	9
2018	111	14	13	21
2019	112	15	21	13
2020	128	9	6	13
2021	164	12	10	36

*The numbers represent cases concluded in the year and cases which remained active at year-end. At the end of 2021, the number of outstanding investigations was 61 (2020: 54) and the number of cases pending disposal or disciplinary action was 44 (2020: 45).

185. The average time taken to complete an investigation was 10.5 months in 2021 and 8.7 months in 2020.

⁸⁷ “Prejudice statements” includes sanctions in which, in addition to a public censure, the Exchange makes a statement of opinion under Chapter 2A (GEM: Chapter 3) that the retention of office by that director is or would have been prejudicial to the interests of investors.

⁸⁸ These represented directions requiring listed issuers and directors to take proactive remedial actions to rectify breaches, improve internal controls and overall corporate governance. In 2021, the Exchange issued six internal control review directions (2020: two), two retention of compliance adviser directions (2020: one) and 21 training of directors directions (2020: five).

⁸⁹ Directors are required to provide a personal undertaking to procure compliance with the Listing Rules by listed issuers.



SFC observations

186. The number of listed issuers increased 1.3% from 2020 to 2021⁹⁰ and the number of investigations of Listing Rule breaches handled by the Exchange also went up⁹¹. The number of outstanding investigations also increased from 54 in 2020 to 61 in 2021.

Debts and derivatives

187. The total number of derivative warrants and CBBCs listing applications processed by the Structured Products and Fixed Income department in 2021 (59,491) increased 18.6% from 2020 (50,167).

⁹⁰ The number of listed issuers increased from 2,538 in 2020 to 2,572 in 2021, representing an increase of 34 (or 1.3%).

⁹¹ See paragraphs 180 to 184.

Appendix

LRC decisions made in deviation from published listing guidance

Case 1

Extension to resumption deadline on the basis of “exceptional circumstances”

1. According to [GL95-18](#): Guidance on long suspension and delisting, the Exchange will cancel the listing of a long suspended issuer upon the expiry of the remedial period if the issuer has not remedied the issues causing the suspension and re-complied with the Rules. This remedial period sets a deadline referenced to the resolution of the relevant issues and resumption of trading, as opposed to submission of a resumption proposal as in the previous regime (emphasis added). To ensure the effectiveness and credibility of the delisting framework and prevent undue delay of the delisting process, the Listing Committee may only extend the remedial period in exceptional circumstances. It may do so where (i) an issuer has substantially implemented the steps that, it has shown with sufficient certainty, will lead to resumption of trading; but (ii) due to factors outside its control, it becomes unable to meet its planned timeframe and requires a short extension of time to finalise the matters. The factors outside the issuer’s control are generally expected to be procedural in nature only.
2. In this case, the issuer only submitted the resumption proposal three days before the expiry of the resumption deadline, and by the time of the LRC hearing (which was five months after the resumption deadline⁹²) none of resumption conditions had been satisfied, including (i) publication of outstanding financial results, (ii) demonstrating compliance with rule 13.24, (ii) withdrawal or dismissal of the winding-up order and (iv) re-complying with the Rule requirements in respect of independent non-executive directors.
3. Satisfaction of the resumption conditions was dependent upon the completion of a proposed financial restructuring which had not yet been approved by the issuer’s shareholders. Nonetheless, the LRC applied an expansive interpretation of the “exceptional circumstances” contemplated by the guidance letter and granted a further six-month extension of the remedial period to the issuer.

Case 2

Extension to resumption deadline on the basis of “exceptional circumstances”

4. In this case, similar to case 1, the issuer only submitted the resumption proposal three days before the expiry of the resumption deadline. It then used the five months between the resumption deadline and the LRC hearing to meet some of the resumption conditions.
5. By the time of the LRC hearing, the key outstanding resumption condition related to the demonstration of management integrity. Three former executive directors of the issuer had been arrested for suspected market misconduct and fraud. Although they had resigned as directors, two of the three former directors still held the majority of the issuer’s shares. To address the Exchange’s concern about their continued influence

⁹² In each of case 1 and case 2, the Listing Committee decision to delist the issuer was issued two months after the resumption deadline and the LRC hearing was held three months after the Listing Committee decision.

over the issuer's management and operations, they entered into agreements to (i) dispose part of the issuer's shares to an independent third party (**Disposal**) and (ii) appoint a placing agent to procure the sale of the remaining shares (**Placing**). Shortly before the LRC hearing, they also gave undertakings in favour of the issuer not to transfer their shares in the issuer other than to facilitate the Disposal and Placing and to abstain from exercising their voting rights (the **Undertakings**). The Disposal and Placing had not been completed by the time of the LRC hearing and the issuer requested further extension to the remedial period.

6. At the LRC hearing, the Listing Division submitted that, in view of the Undertakings, it had no further comments regarding the issuer's management integrity. The LRC rightly took a different view from the Listing Division and recognised that the resumption condition about management integrity could only be fully satisfied if the Disposal and the Placing were completed. The LRC also recognised that "given the placing agent's difficulties in finding investors, it remained uncertain whether the Placing could be completed by [the proposed extended deadline] (or at all)" (emphasis added). Having said that, the LRC was of the view that "but for the completion of the Disposal and Placing, [the issuer] had substantially implemented all steps that would lead to a resumption of trading in accordance with GL95-18" (emphasis added) and decided to extend the remedial period by another three months. By the time of the extended deadline, trading in the issuer's shares would have been suspended for 26 months instead of the 18 months contemplated by the Rules.

Case 3

Assessment of newly-developed business for sufficiency of operations

7. Under rule 13.24, a listed issuer has a continuing obligation to maintain a business with a sufficient level of operations and assets of sufficient value to support its operations to warrant its continued listing. According to [GL106-19](#): Guidance on sufficiency of operations, for an issuer to demonstrate the viability and sustainability of a newly-established business, the business forecast must be supported by a concrete and credible business plan, with projections based on signed contracts and supportable customer demand (emphasis added).
8. In this case, the issuer sought to rely on a newly-established business to demonstrate compliance with rule 13.24. When assessing the issuer's newly-developed business, the LRC took a more optimistic stance than that of the Listing Committee and "overall was of the general view that the [business] was promising and likely to develop in the future into a business that was of substance, viable and sustainable".
9. In arriving at this conclusion, the LRC noted a number of positive factors of the business but did not adequately address the Listing Committee's concern that this new business failed to achieve the profit forecast for the financial year of 2021 and that its profit forecast for the financial year of 2022 was not supported by committed customer orders, as required by the guidance letter.