



# **ASIAN ROUNDTABLE ON CORPORATE GOVERNANCE**

**OFFICIAL PRESENTATION of the WHITE PAPER on  
CORPORATE GOVERNANCE IN ASIA**

## ***QUESTIONNAIRE***

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## **Questions for Asian Roundtable Workshop – HONG KONG CHINA**

**RE: Hong Kong's Securities and Futures Commission ("SFC")**

### **ACGA COMMENTARY:**

We understand that the Stock Exchange of Hong Kong Limited ("SEHK") has received your questionnaire and has passed a copy of the same to Mr. Charles Grieve of the Securities and Futures Commission ("SFC"). We also understand from Mr. Grieve that SFC may not be able to complete your entire questionnaire but that the reply of the SEHK will include some information from the SFC.

Please accept the following information from ACGA as **background information only**.

### **STATISTICS ON DISCIPLINARY ACTIONS:**

According to the SFC Annual Report 2002-2003, the Enforcement Division of the SFC was responsible for the following disciplinary actions in 2002:

- Concluded 344 investigations<sup>1</sup> of which 276 were completed within 12 months<sup>2</sup>
- Prosecuted three cases of market manipulation<sup>3</sup> and 33 entities for breaches of various ordinances
- Referred four cases of suspected insider dealing to the Financial Secretary; concluded two other cases resulting in penalties of HK \$21.3 million (about USD 2.7 million)
- Concluded 90 disciplinary inquiries and disciplined 86 registrants<sup>4</sup> or concerned persons
- Referred 15 cases of fraud and corruption to police and ICAC (the Hong Kong Anti-Corruption Commission) and an additional 32 boiler room cases to Police

As a point of reference, note that the SEHK and the SFC do not have criminal sanction powers. The SFC has civil sanction powers and the SEHK has administrative sanction powers.

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<sup>1</sup> The Annual Report does not disclose the nature of the matters investigated or the categories of person or companies investigated.

<sup>2</sup> It is also unclear how many of the investigations completed lead to further actions

<sup>3</sup> The Annual Report discloses the total costs of investigating these market manipulation cases, ie, HK \$122,650 (about USD 15,724). In 2002, the total operating expenditure of the SFC was HK \$395.6 million (about USD 50 million)

<sup>4</sup> The term "registrant" refers to registered market intermediaries.

## **SIZE OF LOCAL MARKET:**

In 2002, Hong Kong was the 11<sup>th</sup> largest capital market in the world by market capitalisation. There were 985 companies listed on the SEHK, with a total capitalisation of HK \$3,429Billion (about USD \$439.6Billion).

## **RECENT LEGISLATIVE CHANGES:**

It is important to note that the enforcement information contained in the SFC Annual Report 2002-2003 refers to regulatory powers/sanctions which have been superseded by the unification of Hong Kong's securities laws into a single Securities and Futures Ordinance ("SFO", passed March 2002, effective April 2003). In other words, the statistical information above precedes the new SFO and may not be indicative of the merit of the new SFO.

## **DIFFERENCES:**

How different are the old securities laws from the new SFO? The simple answer is that the SFO did widen the investigative and disciplinary powers of the SFC. For instance, under the SFO, the SFC has wider powers to seek explanations from listed companies on their accounting records, and to access working papers of company auditors. The SFC Annual Report 2002-2003 suggests that because the SFO requires listed companies to file with the SFC in addition to the SEHK, "we anticipate conducting considerably more investigations".<sup>5</sup>

## **WHICH AUTHORITY REGULATES LISTED COMPANIES IN HK?**

Hong Kong is currently undergoing a review of its three-tier system of regulation of listed companies. The top tier is exercised by the Financial Secretary (the equivalent of the Minister of Finance in most Western countries) of the Hong Kong Government. The Financial Secretary is responsible for formulating public policy in the financial sector and has certain investigative powers over companies. The Companies Ordinance gives power to the Financial Secretary to appoint an inspector to investigate the affairs of a company in certain circumstances. This power is very rarely exercised.

The two other tiers of regulation of listed companies are:

1. The SEHK is a de-mutualised exchange and a for-profit-organisation. It is a listed company on its own exchange. SEHK is the day-to-day supervisor of listed companies, their directors, and controlling shareholders. It does not have statutory power to discipline listed companies. Its only disciplinary powers are contractual in nature; ie, derived from the adhesion of listed companies to SEHK rules, such as the Listing Rules and the Takeovers Code.

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<sup>5</sup> The SFC Annual Report 2002-2003, p. 49

Many corporate governance standards applicable to Hong Kong listed companies meet a fairly low threshold compared to current international standards, eg, minimum of only two independent directors on the boards of listed companies. The administrative sanction powers of the SEHK are limited. These powers include the power to issue warnings, and in the most severe cases, to suspend or cancel trading of a company's shares. A consultation paper issued by the Hong Kong Government in October 2003, described the existing sanction powers of the SEHK as "not effective".

*"Currently, options available to SEHK for taking action against breaches of the listing requirements provided for in its Listing Rules are limited by the fact that those requirements are contractual obligations. **They are considered not effective in providing adequate incentive for compliance and deterring non-compliance.**"<sup>6</sup> (our emphasis)*

2. The SFC is the main regulator of the securities market in Hong Kong. It has investigative and civil sanctions powers under the SFO. The SFO is too new to make a judgement as to whether the powers it confers to the SFC are broad enough and whether the SFC will use them effectively.

Prior to the enactment of the SFO, the SFC was sometime criticised in the local press for "going after the small fishes", and for failing to obtain sufficient evidence to commence prosecution following expensive investigations. In 2002, for example, some minority shareholders and shareholder activists were critical of the SFC for failing to intervene in the approval of certain related-party transactions. The SFC answered these charges in the local press by arguing that investors also had responsibilities to police their investments and may choose to sell their shares if they were unsatisfied with a company's conduct.

Going forward, the SFC is looking to be a more active enforcement agency than in the past. The SFC Annual Report 2002-2003 states:

*"The SFO has given us new powers to pursue crimes. Throughout this Report, readers will find the range of different regulatory tools that the Commission will use: dual filing which establishes the SFC as the statutory regulator of listed company disclosure; a more transparent disclosure of interests regime; 'dual route' of possible criminal and civil action against market misconduct; proportionate sanctions on intermediaries; including heavy fines, and many others".<sup>7</sup>*

In our view, the main innovation of the SFO is the introduction of a Market Misconduct Tribunal ("MMT"). The SFC Annual Report 2002-2003 explains that:

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<sup>6</sup> "Consultation paper on proposals to enhance the regulation of listing", October 2003, Financial Services and the Treasury Bureau, p. 21, Paragraph 2.37

<sup>7</sup> The SFC Annual Report 2002-2003, p. 4

*"A Market Misconduct Tribunal (MMT) was created to handle civil cases of market misconduct. The MMT can impose a greater range of civil sanctions. As an alternative to civil proceedings, market misconduct will also be subjects to criminal prosecution which may result in more severe penalties on conviction."<sup>8</sup>*

## **RESOURCES**

The SFC Annual Report 2002-2003 says that the Enforcement Division of the SFC has 64 executives and 19 non-executives. This Division is one of many divisions of the SFC. The same Report does not breakdown the budget of the SFC by divisions.

## **CAPACITY OF COURTS**

Hong Kong has a professional and independent judiciary. Until now, however, there has been few securities law cases in Hong Kong.

Note that Hong Kong does not permit contingency fees or class actions. In the last five years, there has been a handful of derivative lawsuits, most were dismissed summarily. Access to the courts is generally judged to be far beyond the means of individual shareholders.

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<sup>8</sup> The SFC Annual Report 2002-2003, p. 55