



**SFC's response to the follow-up questions arising from
the Legislative Council Panel on Financial Affairs meeting on 7 February 2014**

We refer to the letter dated 10 February 2014 from the Clerk to the Legislative Council Panel on Financial Affairs ("Panel") to the Secretary for Financial Services and the Treasury. Please find below our response to the follow-up questions set out in the above letter.

A. the justifications for the forecast increase of 14.8% for the expenditure on "Professional & Others" in SFC's proposed budget for 2014-2015 (i.e. page 17 of the Annex to the Administration's paper (LC Paper No. CB(1)804/13-14(04))

As stated in section 5.4.6(b) of the SFC's proposed budget for 2014-15, professional and others expenses for 2014/15 are expected to increase by 14.8% (\$13.91 million). The major increase arises from external professional fees as well as legal fees. Despite the additional headcount proposed, the volume and complexity of our work have substantially increased, therefore the demand for external professional services remains high. This is necessary in particular where special expertise is needed to carry out our regulatory functions, such as instructing external counsels in legal proceedings, accountants in investigations, or consultants to advise on systems technology.

B. the division of work between SFC and the Hong Kong Exchanges and Clearing Limited ("HKEx") in the regulation of listed companies at various stages from the initial public offering to on-going monitoring, including whether and how the regulatory regime in question will ensure no regulatory overlaps/gaps between SFC and HKEx.

Role of Regulators in the Listing Application Process

- (i) The Stock Exchange of Hong Kong Limited ("**SEHK**"), a subsidiary of HKEx, is the frontline regulator of Hong Kong-listed companies in respect of all listing-related matters.
- (ii) It is empowered by section 23 of the SFO to make rules including rules (e.g. the Listing Rules) for the listing and continued listing of securities on the SEHK and the regulation and efficient operation of the market and further rules for the regulation of exchange participants and holders of trading rights. Express power is granted to the SEHK to make rules for laying down standards of conduct, imposing sanctions for breach of rules and establishing procedures. Unless declared otherwise (by notice published in the Gazette) by the SFC, all rules (or any amendments thereto) by the SEHK must be approved in writing by the SFC under section 24 of the SFO before they shall have effect.



- (iii) All offering documents or prospectuses in respect of a public offer of shares in or debentures (other than structured products as defined in Section 1A of Part 1 of Schedule 1 to the SFO) of a company must be authorised by the SFC under sections 38B and 38D (in the case of a Hong Kong incorporated company) or section 342C (in the case of a company incorporated outside Hong Kong) of the Companies Ordinance (“**CO**”) and registered with the Registrar of Companies under the CO. However, the SFC has also transferred to the SEHK the functions conferred on the SFC for authorising prospectuses in respect of public offers of shares in or debentures of a company that will be listed in Hong Kong, subject to the reservation that the SFC is to exercise the functions concurrently with the SEHK. Under the Securities and Futures (Transfer of Functions – Stock Exchange Company) Order (Cap. 571AE), the SFC has transferred to the SEHK the powers to specify requirements applicable to and authorise the form of and any other matters relating to the publication of an extract from a prospectus and authorize the registration of a prospectus for shares or debentures to be listed on the SEHK. The MoU between the SFC, HKEx and SEHK dated 22 August 2001 and the MoU between the SFC and SEHK dated 28 January 2003 set out clearly the respective roles and responsibilities of the SFC and the SEHK in relation to listing matters. The SEHK also has the power to vet and approve listing applications which have satisfied its eligibility requirements.
- (iv) Under the provisions of the Securities and Futures (Stock Market Listing) Rules (Cap. 571V) (“**SMLR**”), the SEHK and the SFC operate the “Dual Filing Regime” under which all applications for the listing of any securities on SEHK, and any supporting information and replies to questions raised, are copied to the SFC, which has the power to require the applicant to supply further information, to object to a listing application if, amongst other things, the application is false or misleading as to a material fact or not in the public interest, or to impose such conditions on the listing as the SFC thinks fit¹. The SEHK may only list securities if the SFC has not objected to the listing and any conditions imposed by the SFC have been complied with.
- (v) Under section 384 of the SFO a person who knowingly or recklessly provides false or misleading information to the SFC or the SEHK, in purported compliance with the SMLR or the Listing Rules commits an offence and is liable to a fine of \$1,000,000 and to imprisonment for 2 years.

¹ Section 6 of the SMLR



- (vi) In anticipation of the commencement of the SFO on 1 April 2003, a MoU was signed between the SFC and SEHK on 28 January 2003 that reaffirmed SEHK's status as frontline regulator of all listing-related matters and laid down the arrangement for dual filing. To avoid administrative duplication and facilitate communication with the market, the MoU provides that the SEHK remains the frontline regulator and the key contact point for listing applicants and their advisers during the listing process², while the SFC passes its comments to the SEHK³. The SFC's review of the draft prospectuses or listing documents focuses on the sufficiency or adequacy of information in the prospectuses or listing documents in order for it to determine whether to exercise its objection power. On the other hand, the SEHK reviews a listing application and the associated prospectus or listing document to ascertain whether the listing applicant meets the eligibility and suitability for listing requirements and compliance with the Listing Rules.

Enforcement of the Listing Rules and the SFO post listing

- (i) The Listing Rules are administered and enforced by the SEHK. SEHK's powers to sanction persons under the Listing Rules are based on a contractual relationship with each issuer. Every issuer must sign a listing agreement with the SEHK agreeing to comply with the Listing Rules requirements. Its directors must sign an undertaking to the SEHK that they will comply with the Listing Rules and all applicable laws, rules, regulations and use their best endeavours to cause the issuer to comply with the Listing Rules. In addition to its powers to suspend or cancel a listing, when the SEHK finds there has been a breach of the Listing Rules, it may⁴:
- issue a private reprimand;
 - issue a public statement which involves criticism;
 - issue a public censure;
 - where a case involves suspected breaches of criminal or civil laws or codes of conduct of other professions (e.g. auditors, lawyers, licensed corporations), refer the matter to an appropriate statutory agency (e.g., the SFC, the ICAC, the Commercial Crime Bureau of the Hong Kong Police (CCB)) or the relevant professional bodies (e.g. the Law Society of Hong Kong, the Hong Kong Institute of Certified Public Accountants (HKICPA) to take further action⁵);
 - ban a professional adviser or named individual employed by a professional adviser from representing a specified party in relation to a stipulated matter for a stated period;
 - require a breach to be rectified or other remedial action to be taken

² Clause 7.8(a) of the MoU signed between the SFC and SEHK dated 28 January 2003

³ Clause 7.8(e) of the MoU signed between the SFC and SEHK dated 28 January 2003

⁴ Rule 2A.09 of the Listing Rules

⁵ According to clause 9.2(e) of the MoU signed between the SFC and SEHK dated 28 January 2003, both parties shall use their best endeavors to inform each other of, and to liaise in relation to, any complaint received or any alleged or suspected misconduct that relate to the other's regulatory functions



within a stipulated period including, if appropriate, the appointment of an independent adviser to minority shareholders;

- in the case of wilful or persistent failure by a director of a listed issuer to discharge his responsibilities under the Listing Rules, state publicly that in the SEHK's opinion the retention of office by the director is prejudicial to the investors' interests;
 - in the event the director remains in office, suspend or cancel the issuers' listing;
 - in the case of wilful or persistent failure by a listed issuer to discharge its responsibilities under the Listing Rules, order that the facilities of the market be denied to the issuer for a specified period and prohibit dealers and financial advisers from acting or continuing to act for that issuer; and
 - take, or refrain from taking, such other action as it thinks fit.
- (ii) Under section 8 of the SMLR the SFC may also require SEHK to suspend all dealings in any securities (for example, where it appears to the SFC that any materially false, incomplete or misleading information has been included in any document or it is in the interest of the investing public). A person commits an offence under section 384 of the SFO if, in purported compliance of any requirement imposed by or made under the SFO, he provides information to the relevant regulator which he knows is, or he is reckless as to whether it is, false or misleading in a material particular. This provision applies to all applications for listing by virtue of section 5 of the SMLR (which requires, and normally deems, any listing application and supporting documents to be filed with the SFC) and section 7 of the SMLR which imposes an ongoing disclosure obligation on listed issuers to file with the SFC copies of all public announcements, statements, circulars etc. The SEHK informs the SFC of, and to liaise with the SFC in relation to, any alleged or suspected misconduct that relate to the SFC's regulatory functions.
- (iii) When the SFC becomes aware of a potential breach, it may open an inquiry under section 179 of the SFO (e.g. if the SFC has cause to believe that a person might have engaged in defalcation, fraud, misfeasance or other misconduct in relation to the management of a listed company) or an investigation under section 182 of the SFO (e.g. if the SFC has cause to believe that market misconduct has taken place).
- (iv) The SFC may seek civil orders from the Court under section 213 (e.g. an injunction to freeze the proceeds of listing – as was done in the Hontex case) and section 214 of the SFO (e.g. disqualification of persons from being directors of companies or otherwise taking part in their management for up to 15 years). The SFC may refer cases of suspected criminal misconduct involving listed companies to Hong Kong Police for criminal investigation. In addition, the SFC is able to investigate and prosecute listed companies for providing false or misleading information (sections 40A and 342F of the CO; sections 107, 298 and 384 of the SFO). Section 277 of the SFO sets out the civil regime (i.e., the MMT) for disclosure of false or misleading information



inducing transactions.

Recent Developments

- (i) Part XIVA of the SFO has recently been enacted to provide statutory backing to the requirement, formerly in the Listing Rules, that listed issuers disclose price sensitive information to the public in a timely manner. Listed issuers and their officers who fail to comply with the new statutory disclosure requirement will be liable to civil sanctions. The new Part XIVA of the SFO came into effect on 1 January 2013. In connection with the implementation of the statutory disclosure regime, the Listing Rules were amended to minimise duplication and overlap with the new law. The main change was to remove the then continuing disclosure obligations in the Listing Rules that have become part of the statutory regime.
- (ii) The SFC has also recently set up a dedicated Corporate Regulation Team to take a broader and more proactive approach in overseeing corporate conduct of listed companies, which will mean more surveillance, analysis and enforcement work. This approach, an expansion of what the SFC has been doing as a statutory regulator, stems from market concerns over cases of serious corporate misconduct in listed companies and how it can be detected at an early stage to reduce damage to the market and the investing public. The SFC is working closely with SEHK to reduce any unnecessary duplication of work that may arise as a result of our new corporate regulator approach.
- (iii) In particular, SEHK reviews corporate information with the aim of monitoring compliance with the Listing Rules and to ensure that it maintains proper markets. In contrast SFC reviews corporate and financial information and make appropriate enquiries at an early stage to facilitate timely disclosure or other remedial action by listed companies and to identify errant companies for enforcement action.

Securities and Futures Commission

21 February 2014