

Agenda Item V – Cross border enforcement mechanisms in relation to listed companies.

Q1. How the Hong Kong regulatory authorities exercise oversight in various respects over companies domiciled overseas and listed in Hong Kong, including:

A. The accuracy of the information submitted in the pre-listing application process

Response**Responsibility for the content of a prospectus*****Companies Ordinance requirements***

1. To ensure appropriate investor protection, the Companies Ordinance provides that the directors of the company issuing a prospectus are collectively and individually responsible for the accuracy of the information contained in the prospectus, together with any persons that ‘authorise’ the issue of that prospectus.
2. Section 40 and 40A of the Companies Ordinance respectively establish the basis for civil and criminal liabilities for misstatements in a prospectus of a Hong Kong incorporated company. Section 342E and 342F of the Companies Ordinance respectively extend the aforesaid responsibilities to every public offering here of a company incorporated outside of Hong Kong.
3. The following persons bear civil liability for any misstatements in a prospectus under Sections 40 and 342E of the Companies Ordinance:
 - Every person who was a director of the company at the time the prospectus was issued;
 - Every person who has agreed to be named in the prospectus as a director or who has agreed to become a director;
 - Every person who is a ‘promoter’ of the company; and
 - Every person who has authorised the issue of the prospectus (excluding the SFC and the Exchange).

This includes an expert who has given his consent to the issue of the prospectus; however the expert’s liability is limited to the extent he made the untrue statement in the prospectus.

4. Sections 40A and 342F of the Companies Ordinance impose criminal liability for untrue statements in prospectuses. These sections provide that any person who authorises the issue of a prospectus containing any untrue statement shall be liable to imprisonment and a fine, unless he proves either that the statement was immaterial or that he had reasonable grounds to believe and did up to the time of the prospectus believe that the statement was true.
5. The SFC’s functions under the Companies Ordinance to authorise prospectuses relating to shares or debentures of a company approved for listing on the Exchange have been transferred to the Exchange by order of the Chief Executive in Council pursuant to section 25 of the Securities and Futures Ordinance (the “Transfer Order”). Under the terms of the Transfer Order the Exchange shall vet every

prospectus which relates to shares and debentures approved for listing on the Exchange.

The Securities and Futures Ordinance (SFO) requirements

6. In addition to the misstatement offences in the Companies Ordinance, the intentional or reckless disclosure of materially false or misleading information that is likely to induce another person to acquire, or subscribe for securities is, subject to exceptions, civil market misconduct under section 277 of the SFO or a criminal offence under section 298 of the SFO. The market misconduct offence would arguably be committed by a person who provided false or misleading information in a prospectus in an IPO. Such conduct may also be a potential breach of section 384 of the SO (see paragraph 17 in the answer to Q1.B.)

Listing Rules¹ requirements

7. The legal provisions regarding a director's responsibility in the Companies Ordinance are also reflected in the Listing Rules.
8. Rule 19.01 clearly states that "*the Exchange Listing Rules apply as much to overseas issuers as they do to Hong Kong issuers*". Rule 2.13 states that the information contained in the document must be accurate and complete in all material respects and not be misleading or deceptive. Rule 11A.01 of the Listing Rules also states the prospectus of an issuer must comply with the Companies Ordinance.
9. To conduct a public issue and to list its shares in Hong Kong, an issuer must comply with the Listing Rules and register its prospectus, regardless of whether it is incorporated in Hong Kong or overseas.
10. Therefore, the requirements of the Listing Rules and the Companies Ordinance apply both to local and overseas companies, and accordingly, responsibilities for accuracy are the same for Hong Kong incorporated companies and companies incorporated overseas.
11. As a commercial entity, the Exchange has limited sanctioning powers as the Listing Rules do not attract statutory sanctions since they are based on its contractual relationship with each issuer. The Exchange also does not possess statutory investigation powers. It is intended that these limitations will be addressed by the Government's initiative to provide statutory backing for the more important listing rules.

¹ "Rule" and "the Listing Rules" refers the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Main Board Listing Rules"). Although we have only made references to the Main Board Listing Rules, these requirements apply equally to The Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited.

The role sponsors play in the listing application process

12. Professional intermediaries, including sponsors play a key role in the listing application process. The involvement of a sponsor and the underwriters in the issue of securities at the IPO enhances the marketability of the securities, because the public relies on the integrity, independence and expertise of these professionals.

Under the Listing Rules

13. The Listing Rules expect the listing applicants' sponsors to be closely involved in the preparation of the new applicants' listing documents during the listing application process (Rule 3A.11). Rule 3A.04(2) states that a sponsor must use reasonable endeavours to ensure that all information provided to the Exchange during the listing application process is true in all material respects and does not omit any material information and, to the extent that the sponsor subsequently becomes aware of information that casts doubts on the truth, accuracy or completeness of information provided to the Exchange, it will promptly inform the Exchange of such information.
14. Sponsors are expected and required to critically assess and examine the accuracy, completeness of statements and representations made, or other information given to it by the new applicant or its directors under the Listing Rules. Rule 3A.11 of and Practice Note 21 to the Listing Rules, require sponsors to conduct reasonable due diligence inquiries as may be necessary until it can reasonably satisfy itself in relation to the disclosure in the listing document. Practice Note 21 provides that, in undertaking its role a sponsor should, among other matters, examine with professional skepticism the accuracy and completeness of statements and representations made, or other information given, to it by the new applicant or its directors.
15. As stated above, given the requirements under Rule 19.01, the due diligence responsibilities apply equally to the sponsor with a Hong Kong incorporated client and the sponsor with an overseas incorporated client. However, the reliance on sponsors does not detract from the important principle that the listing applicant's directors are collectively and individually responsible for the accuracy of the information contained in the prospectus. (See section on "Responsibility for the contents of a prospectus".)

Under the Companies Ordinance

16. Whether a sponsor is liable for the contents of a prospectus under the Companies Ordinance depends on whether the sponsor is a "promoter" or a person who has authorised the issue of the prospectus (see paragraph 3 above). This is a question of fact and is a matter for the courts to determine. To date the courts have not heard a case dealing with this issue.

17. In the SFC's September 2006 paper "Consultation Conclusions on Possible Reforms to the Prospectus Regime in the Companies Ordinance", we set out the SFC's reasons for concluding that "at this stage, it would be premature to impose prospectus liability on sponsors".

Under the SFO

18. A sponsor is subject to all relevant codes, guidelines and regulations prescribed by the Commission and the Listing Rules issued by the Stock Exchange; and is expected to meet the standards set out in these rules, codes, guidelines and Listing Rules.
19. Practice Note 21 of the Listing Rules sets out the standards of sponsors' due diligence work in respect of initial listing applications which enable the sponsor to make the declaration as required under Chapter 3A of the Listing Rules. Chapter 3A.04 of the Listing Rules requires the sponsor to use reasonable endeavours to ensure that all information provided to the Exchange during the listing application process is true in all material respects and does not omit any material information and that it would promptly notify the Exchange if it becomes aware of information that casts doubt on the truth, accuracy or completeness of information provided to the Exchange.

The role of the regulators in the listing application process

20. Listing applications are reviewed by the Exchange and the SFC. The Exchange and the SFC do not investigate or verify the accuracy or completeness of the information in the draft prospectus nor do they check the sources of the information or verify those sources.

The Exchange's role

21. The Exchange assesses if a listing applicant meets the listing criteria under the Listing Rules on the basis of the draft prospectus and the submissions provided in support of the listing application. It reviews all the relevant information to ensure that valid concerns are reasonably and properly addressed. Where necessary, the Exchange asks questions about such information, obtains additional assurances from relevant professional advisers and seeks additional disclosure in the prospectus. In anticipation of the commencement of the SFO on 1 April 2003, a MOU was signed on 28 January 2003, which reaffirms the Exchange's status as the frontline regulator of all listing-related matters, and lays down the arrangement and procedures for dual filing.
22. The Listing Division is the primary point of contact for all listing applicants and their advisers. The Listing Division vets materials submitted by listing applicants for compliance with Listing Rules and prospectus requirements under the Companies Ordinance and together with the Listing Committee administers the listing approval process. Under the dual filing regime, the Exchange passes copies of materials submitted by listing applicants to the SFC.

23. As discussed above, the Listing Rules also apply to overseas companies. According to Rule 11A.10, the Exchange will review a prospectus for compliance with the Listing Rules concurrently with the review of the prospectus for compliance with the relevant provisions of the Companies Ordinance.

The SFC's role

24. A listing applicant is required to file a copy of its application with the SFC under section 5 of the Securities and Futures (Stock Market Listing) Rules ("SMLR"). The SFC may within a prescribed period by notice to an applicant and the Stock Exchange object to a listing if it appears to the SFC that, among other matters, the application is false or misleading as to a material fact or is false or misleading through the omission of a material fact (section 6 (2) of the SMLR). In deciding whether to object to a listing application, the SFC will review the disclosure in the draft prospectus for reasonableness and raise queries on the submissions where appropriate.

- B. How to ensure compliance with listing rules and legislation when a company has been listed?

Response

How the Exchange monitors compliance with the Listing Rules

1. The Exchange is a company incorporated under the Companies Ordinance. It is a recognized exchange company under the SFO. It operates the stock market in Hong Kong pursuant to the authority conferred by section 19 of the SFO, and is the primary regulator of companies listed on the Exchange.
2. By section 19 of the SFO, the Exchange is under a duty "*to ensure... so far as reasonably practicable, an orderly, informed and fair market*" acting "*in the interest of the public, having particular regard to the interest of the investing public*".
3. The Exchange is empowered to make rules including rules for the regulation and efficient operation of the market and the regulation of exchange participants and holders of trading rights. Express power is granted to make rules for laying down standards of conduct, imposing sanctions for breach of rules and establishing procedures (section 23 of the SFO). Pursuant to these provisions, the Listing Rules have been made. The Listing Rules comprise both requirements which have to be met before securities may be listed and also continuing obligations with which an issuer must comply once listing has been granted.
4. Rule 2A.03 makes it clear that, in the discharge of their respective functions and powers of the Listing Committee and the Listing Division, the paramount interest is that of the market and the public. Therefore, the Listing Committee and the Listing Division is required to administer the Listing Rules, and otherwise to act, in the best interests of the market as a whole and in the public interest.

5. The Exchange's listing-related functions are discharged by the Listing Division and the Listing Committee and fall into two broad categories: (a) the establishment and promulgation of rules (the Listing Rules) prescribing listing requirements for listing applicants and listed companies; and (b) the fair and impartial administration of the Listing Rules.
6. The Listing Committee comprises: (i) at least eight individuals who the Listing Nomination Committee considers will represent the interests of the investors, (ii) nineteen individuals who the Listing Nominating Committee considers will be a suitable balance of representatives of listed companies and market participants including lawyers, accountants, corporate finance advisers and Exchange Participants or officers of Exchange Participants, and (iii) the Chief Executive of the Exchange acting as ex officio member. The Committee members are independent of the Exchange and are appointed by the Listing Nomination Committee which comprises three Non-Executive members of the board of the Hong Kong Exchanges and Clearing Limited and the Chairman and two Executive Directors of the SFC.
7. Prior to its listing, each issuer agrees with the Exchange (by way of executing an undertaking) to comply at all times with all of the requirements of the Listing Rules from time to time in force, for so long as any of its securities are listed on the Exchange. At the same time, each director of a listed company must execute a written undertaking to the Exchange by which the director undertakes, amongst other matters, that, in the exercise of his powers and duties as a director of the company, he shall comply to the best of his ability with the Listing Rules from time to time in force, and use his best endeavours to procure the company and any alternate of his to comply with the Listing Rules.

Continuing obligations for listed companies

8. All listed companies are subject to continuing obligations after listing. Through these continuing obligations the Exchange seeks to promote full and accurate disclosure by listed companies to the market of all relevant information on a timely basis. The same continuing obligations apply to all listed companies, subject to the additional requirements and modifications mentioned below which are designed to bridge the gap between corporate governance requirements imposed on Hong Kong incorporated companies and those incorporated in other jurisdictions.
9. The primary continuing obligations concern disclosure and the requirement for prior shareholder approval and independent financial advice to be provided in specified circumstances. The disclosure requirements cover the timing and content of disclosures in respect of price sensitive information, periodic financial information and certain prescribed notifiable transactions and equal dissemination of those disclosures. It is a requirement that the information disclosed to the market is accurate and complete in all material respects, and is not deceptive or misleading. The Exchange may also seek additional disclosure from a listed issuer in appropriate cases.
10. One of the ways in which the Exchange addresses its statutory duty is to seek to ensure compliance by listed companies and their directors with the provisions of

the Listing Rules. The Exchange adopts a number of practices to achieve this including: monitoring share price and volume movements and media coverage; vetting important draft announcements and documents; monitoring financial reporting; reviewing complaints about companies and/or their management; and setting and monitoring standards and guidance on corporate governance for listed companies.

11. By way of illustration, where there are unusual price and/or volume movements in the shares of a listed issuer, the Exchange will enquire with the listed issuer as to whether its directors are aware of any matters which may have relevance to such movements, and, in appropriate circumstances, to issue an announcement as soon as practicable to inform the investing public. The listed company is required to respond promptly to such enquiries made by the Exchange. This will keep shareholders and other investors informed as soon as reasonably practicable of any information relating to the group which is necessary to enable them to appraise the position of the group, which is necessary to avoid the establishment of a false market in its shares, or which might be reasonably expected materially to affect market activity in and the price of the shares.
12. The question of timing of the release of an announcement to the market is important, having regard to its possible effect on the market price of the shares of a listed company. If necessary, the trading of a company's shares will be suspended until a formal announcement is made.

Responsibilities of Listed Companies, Directors and Compliance Advisers

13. The board of directors of a company is collectively responsible for the management and operations of the company and is accountable to the company's shareholders. Compliance with the Listing Rules requires directors to fulfil their fiduciary duties and to exercise due skill, care and diligence in carrying out their duties. Such standards are established by Hong Kong law and by similar laws overseas. It is implicit that in order to comply with the disclosure obligations placed on listed companies, the board must ensure that the company has adequate financial and compliance reporting procedures in place. The directors are required by their undertaking to the Exchange to use their best endeavours to procure that the company complies with the Listing Rules, and the directors themselves are required to comply with the Listing Rules to the best of their ability.
14. All new applicant companies are now required to appoint a Compliance Adviser to provide advice on compliance with the Listing Rules. The appointment starts from the date of listing of the listed company, and for a Main Board company, until it dispatches its annual report with its annual accounts for the first full financial year after its listing, and for a GEM issuer, until it dispatches its annual report with its annual accounts for the second full financial year after its listing.
15. The Compliance Adviser's role is of particular importance to the successful operation of the Exchange since the Compliance Adviser is expected to advise the company on its responsibilities under the Listing Rules and to guide and assist such company to comply with and discharge its responsibilities.

Responsibility for Enforcement of the Listing Rules

16. The Exchange has the sole responsibility for investigating suspected cases of non-compliance with the Listing Rules and, where appropriate, initiating formal disciplinary action. This will be explained in detail below (see Section 1.(D) below). As to the scope of the Exchange's powers, see paragraph 11 in the response to Q1.A. above. Where a case involves suspected breaches of criminal or civil laws or codes of conduct of other professions, the Exchange will refer the matter to an appropriate statutory agency or the relevant professional bodies, and provide cooperation as requested.

How the SFC monitors compliance with the SFO

17. A person commits an offence under section 384 of the SFO if, in purported compliance with the requirement in section 7 of the SMLR, he provides information to the SFC which he knows is, or he is reckless as to whether it is, false or misleading in a material particular. There have been successful prosecutions for breach of section 384 since it came into force in 2003 (two companies and one director of each), but the burden of proving intention or recklessness to the criminal standard has been too heavy in other cases.
18. Section 7 of the SMLR requires any documents issued by a listed company to the public pursuant to the Listing Rules to be filed with the SFC within one business day following the day on which such document is made or issued, and thereby make issuers potentially liable for intentional or reckless false or misleading information. However, the SFC cannot take action against listed companies for failure to make disclosure.
19. The SFC takes a risk-based approach when monitoring compliance with the SFO and liaises closely with the Exchange and monitors corporate disclosure generally. When the SFC becomes aware of a potential breach, we will open a Section 179 inquiry or a Section 182 investigation.

- C. Explanations to set out existing rules and legislation governing listed companies which have extraterritorial effects and how the enforcement agencies may detect breaches and enforce such legislation.

Response

Application of Listing Rules

1. The Listing Rules apply to all Hong Kong listed companies whose equity or debt securities are listed on the Exchange, whether incorporated in Hong Kong or otherwise. The Listing Rules have no territorial effect. It is a matter of contract between the Exchange and a listed company. Compliance and enforcement of the Listing Rules is based on a contractual relationship between the Exchange and a listed issuer. It is a private arrangement between the parties. Detection,

investigation and enforcement processes (including disciplinary processes) operate in the same way for all listed companies regardless of the place of incorporation.

2. The concept of extra-territoriality is in our view applicable to legislation but not to rules of the character of the Listing Rules. As the Listing Rules are not statutory, the concept of extra-territoriality is therefore in the Exchange's view not relevant to the administration and enforcement of the Listing Rules.
3. However, additional requirements may be imposed as a condition of listing if the company is incorporated overseas. Currently, four jurisdictions of incorporation are prescribed for the purpose of eligibility for listing by the Listing Rules, namely Hong Kong, the People's Republic of China, Bermuda and the Cayman Islands. The Listing Committee in October 2006 also approved Australia and Canada (British Columbia) as acceptable jurisdictions. Applicants not incorporated in the recognized jurisdictions seeking a primary listing on the Exchange are currently assessed on a case-by-case basis and have to demonstrate they are subject to appropriate standards of shareholder protection, which are at least equivalent to those required under Hong Kong law.
4. The Listing Rules apply as much to Hong Kong companies as they do to the PRC and overseas companies that are listed here.
5. When a listed company breaches the Listing Rules, the Exchange may impose a range of sanctions against the company and its directors. The range includes a cold shoulder order (i.e. an order that the facilities of the market be denied for a specified period to that listed company and to prohibit dealers and financial advisers from acting or continuing to act for that company) and suspensions or cancellation of the listing. However, the most severe sanction imposed in the last 4 years was a public censure.
6. Listed companies incorporated overseas must comply with the laws and regulations of its home jurisdiction and the Listing Rules. Where the Listing Rules and the national laws of overseas jurisdictions conflict, overseas jurisdictions' laws will prevail over the Listing Rules. However, listed overseas companies should comply with the Listing Rules requirements as a minimum.
7. Where there are gaps in the standards the Exchange attempts to bridge these gaps, as far as is reasonably practical, by requiring companies to make disclosure and incorporate additional shareholder protections in their memorandum and articles of association.
8. While the Exchange applies the same set of rules to all listed companies, there are additional requirements and modifications for companies incorporated outside Hong Kong. These additional requirements and modifications aim to ensure that similar shareholder protections to those provided in Hong Kong ordinances apply to companies in the PRC and other overseas jurisdictions. These requirements apply on application for listing and on a continuing basis. The additional requirements and modifications are set out in Chapters 19 and 19A of the Main Board Listing Rules, Appendix 13 to the Main Board Listing Rules, Chapters 24 and 25 of the GEM Rules, and Appendix 11 to the GEM Listing Rules.
9. The primary additional requirements and modifications are to ensure that broadly similar shareholders protection measures are in place. The criteria are set out in

the attachment to the joint policy statement regarding the listing of overseas companies dated 7 March 2007 issued jointly by the Exchange and the SFC, which in turn is attached to the Exchange's press release published on the same day.

Application of SFO

10. Under Hong Kong law, in the absence of express provisions to the contrary, legislation is taken not to have extra-territorial effect i.e. it does not apply to persons and matters outside Hong Kong. However, there are a number of such express provisions in the SFO which specifically apply to activities or conduct outside Hong Kong. For example, section 115 of the SFO provides that where a person markets to the Hong Kong public (in Hong Kong or from outside Hong Kong) its offshore financial services it will need to be licensed. In addition, some of the market misconduct provisions expressly apply to conduct taking place outside Hong Kong which has an effect on securities or futures contracts traded on Hong Kong markets e.g. false trading (sections 274 and 295), price rigging (sections 275 and 296), disclosure of false and misleading information inducing transactions (section 277 and 298) and stock market manipulation (sections 278 and 299).
11. It is also worth noting that certain activities of non-Hong Kong companies may constitute a contravention of the SFO. For example, section 384 of the SFO, which is the back-stop for the dual filing regime, does not have extra-territorial effect. However, the offence relates to the provision of misleading information to a specified recipient i.e. the SFC or the Exchange. Even though a company listed in Hong Kong is incorporated and has its business in the Mainland, the act of providing the information will invariably take place in Hong Kong so bringing it within section 384. In such circumstances, the issue of extra-territoriality will not arise.

D. How the authorities conduct investigation and enforce the laws in the event of any breaches of listing rules and legislation?

Response

The Listing Rules

Contractual Basis

1. The Listing Rules are not statutory rules or regulations and do not have the force of law. As discussed above, the Exchange has been given the power to make rules under section 23 of the SFO for such matters as are necessary or desirable for (i) the proper regulation and efficient operation of the market which it operates, (ii) the proper regulation of its exchange participants and holders of trading rights, and (iii) the establishment and maintenance of compensation arrangements for the investing public. When a company is listed, it undertakes and contracts with the Exchange to comply with the Listing Rules. This obligation on the part of the company is complemented by personal undertakings on the part of the directors to use their best endeavours to procure the company complies with the Listing Rules, and to comply with the Listing Rules themselves to the best of their ability.

Detection of Possible Breaches

2. Cases involving possible breaches of the Listing Rules are detected in a number of ways, including (i) in the course of ex-ante and ex-post vetting of announcements submitted or published by listed companies, (ii) in the course of reviewing the listed companies' quarterly, interim and annual reports, (iii) receiving complaints by the investing public, and (iv) referrals from other regulatory authorities and in particular, the SFC.

Investigation into Possible Breaches of the Listing Rules

3. The Exchange relies on the undertakings given by the directors to the Exchange for effective conduct of investigations. The directors have undertaken to cooperate in any investigation conducted by the Listing Division and/or the Listing Committee, including answering promptly and openly any questions addressed to them, promptly producing the originals or copies of any relevant documents and attending before any meeting or hearing at which they are requested to appear.
4. The Listing Division investigates the possible breaches mainly by inviting written submissions from the listed issuer and the directors involved in the conduct in question. They will be asked to provide relevant information and documents regarding the conduct or transaction. In some cases, it may be necessary, or would expedite or facilitate the Listing Division's investigation process, to have face-to-face meetings with the directors in which case the directors will be required to attend meetings with the Listing Division to explain their conduct.
5. After investigation is completed, the Listing Division will, based on the evidence and the available materials, form a view as to whether the conduct in question amounts to a breach of the Listing Rules. If a breach is committed but the circumstances of the matter (including the seriousness of the breach) do not warrant formal disciplinary action, a warning letter will be issued to the listed issuer, warning it of its conduct. The issue of such warning letters will form part of the listed issuer's compliance record maintained by the Listing Division.

Disciplinary Proceedings

6. In respect of breaches which warrant formal disciplinary action, a formal report detailing the breaches will be prepared for the commencement of disciplinary proceedings against the listed issuer and in certain cases, against the directors who are involved in the breaches.
7. A set of disciplinary procedures are clearly prescribed in the Listing Rules to ensure that a fair hearing will be given to all parties concerned. The parties to the disciplinary proceedings have a right to submit their written submissions in response to the Listing Division's case, and will subsequently appear at a disciplinary hearing before the Listing Committee who will make a finding as to whether the alleged breaches have been committed, and if so, the sanctions to be imposed against the listed issuer and the directors involved.

Available Sanctions

8. The available sanctions are set out in Rule 2A.09 of the Main Board Listing Rules and Rule 3.10 of the GEM Listing Rules, and they are largely reputational (issue of a public statement of criticism or a public censure). The Exchange may also direct the issuer to undertake certain remedial actions (including having the listed issuer carry out a compliance audit of its internal control systems by compliance advisers, and/or directors undergoing training on the Listing Rules).

Referral to Other Regulatory Bodies

9. The Listing Division may also refer the conduct and/or the breaches in question to other regulatory authorities. For instance, under the Memorandum of Understanding Governing Listing Matters between the SFC and the Exchange dated 28 January 2003, the Exchange shall use its best endeavours to refer to the SFC any complaint received or any alleged or suspected misconduct that relate to the SFC's regulatory functions. Under section 23(8) of the SFO, the Exchange shall refer breaches of the Listing Rules which are alleged to have been committed by a solicitor or professional accountant in private practice, and which may also constitute a breach of duty imposed by law or by virtue of rules of professional conduct, to The Law Society of Hong Kong or the Hong Kong Institute of Chartered Public Accountants for determination of whether to make a finding, impose a penalty or sanction or take other disciplinary action. In this connection, the Exchange has entered into a memorandum of understanding with each of (i) The Law Society of Hong Kong and (ii) The Hong Kong Institute of Chartered Public Accountants, which respectively provides a framework for referral of appropriate cases. In respect of overseas professional advisers, the Exchange may refer cases to overseas securities regulators and/or professional societies for appropriate action.
10. Whilst the Exchange does not have statutory power, if there is a material breach of the Listing Rules, the relevant parties may also have breached relevant applicable law or conducted the company's affairs in a manner prejudicial to the interests of investors. In such cases, the law enforcement bodies such as the SFC, the CCB and the ICAC may prosecute them for relevant offences pursuant to their respective statutory powers and, where appropriate, seek remedial action to protect investors.

The SFO

11. In general terms, unless market misconduct is involved, the SFC's power to inquire into the affairs of listed companies is limited to those situations and circumstances described in section 179 of the SFO. They are where it appears:
 - the business is conducted with intent to defraud creditors or other persons or for any fraudulent purpose or in a way that is oppressive to the members;
 - the company was formed for a fraudulent or unlawful purpose;
 - those concerned with the company's listing have engaged in defalcation, fraud, misfeasance or misconduct;

- those involved in the management of the company have engaged in defalcation, fraud, misfeasance or misconduct towards the company or its members;
 - the members have not been given all the information with respect to the affairs of the company that they might reasonably expect.
12. The power to investigate these circumstances does not give rise to any specific criminal remedies in the SFO. Instead, the SFC is given a broad capacity to seek civil orders from the court under section 213 e.g. injunctions and section 214 e.g. disqualification of persons from being directors of companies or otherwise taking part in their management for up to 15 years.
 13. The SFC has recently brought two such actions, one of which led to a 4 year disqualification order being imposed (see media release dated 30 March 2007, 'SFC Seeks Disqualification Orders Against Former Directors of Failed Listed Company' and media release dated 30 May 2007 'SFC Secures First Disqualification of Director for Misconduct').
 14. However, there are limitations to the SFC's power to seek orders under section 213 in this context as it requires that a breach of the SFO or Parts II or XII of the Companies Ordinance has occurred, is occurring or may occur. If a company is on the verge of collapse the SFC may have difficulty proving such a breach in time to prevent a director fleeing the jurisdiction. A power to seek urgent injunctive relief to assist the regulator carry out an investigation without the risk that necessary evidence, money or relevant persons will go missing would help to close this gap.
 15. The SFC routinely refers cases of suspected criminal misconduct involving listed companies to the Hong Kong police for criminal investigation.
 16. In addition, the SFC is able to investigate listed companies that file false or misleading information and the SFC is able to prosecute contraventions. The SFC has previously provided information to the Panel about dual filing enforcement results.
 17. The SFC's main enforcement relationship with PRC agencies is with the CSRC. Under arrangements that were agreed earlier this year, the CSRC is able to exercise its information-gathering powers to assist the SFC where evidence is needed from mainland sources. This new process is working well and is cemented with regular meetings between SFC enforcement officers and the CSRC. The SFC and the CSRC also run a regular secondment program in which staff from both agencies are transferred to one another's office. (This program has been running successfully for many years).
- E. Where a company is ordered to be taken over by an administrator, how to ensure the administrator so appointed is able to take over its assets located in the mainland?
1. As pointed out by the Secretary for Security in his response to the question raised by Hon Albert Ho at the LegCo sitting on 30 May 2007, cross-boundary insolvency proceedings is a complex subject involving the recognition of other jurisdiction's insolvency proceedings and the enforceability of rights and claims under that jurisdiction's domestic legal regime. In general, a liquidator should

comply with all the legal requirements of the jurisdiction concerned. The Administration notes the difficulties facing each and every jurisdiction, including Hong Kong, Mainland and other jurisdictions, and will continue to monitor international legal developments to promote greater co-ordination and co-operation among jurisdictions to address effectively instances of cross-boundary insolvency, and the recognition of liquidators and receivers from other jurisdictions.

Q2. The SFC's regulation of sponsors, including

A. Regulatory measures applicable to sponsors under the existing legislation

Response

1. Sponsors must be licensed under the Securities and Futures Ordinance and comply with all relevant codes and guidelines issued by the Commission such as Code of Conduct and CFA Code. In addition, sponsors must meet the eligibility criteria set out in the Sponsor Guidelines. These include the obligation to ensure sufficient expertise and resources to handle sponsor work, appoint at least two Principals in supervising the transactions team(s) and ensure proper management supervision as well as effective systems and controls are in place. With effect from 1 August 2007, all sponsors are required to have minimum paid-up capital of HK\$10 million under the Securities and Futures (Financial Resources) (Amendment) Rules 2006.
2. Sponsors that meet the eligibility criteria must remain fit and proper and comply with the specific on-going compliance requirements of the Sponsor Guidelines. These include the requirements to adequately supervise and manage its staff, to maintain effective communication with the operational staff such that they are kept abreast of any key issues and risks relating to the firm's sponsor work and to conduct annual assessment of the firm's internal control systems.
3. Sponsors, like other licensed corporations, are subject to the on-going supervision of the Commission where inspections will be conducted from time to time to assess their compliance with the relevant regulations. If a sponsor fails to remain fit and proper to remain so licensed, the Commission will take appropriate action, including disciplinary sanctions, against it.

B. In dealing with the failings committed by sponsors, what are the principles on which the SFC decides to pursue prosecution against or settlement with sponsors?

Response

1. We assume the question is directed towards disciplinary cases against sponsors. The SFO does not mention the word "settlement". Instead, under section 201(3) of the SFO, the SFC may enter into agreements in disciplinary cases and, where such an agreement is struck, the statutory requirements of procedural fairness and due process contained in section 198 of the SFO are waived. Section 201(3) of the SFO makes it clear that the SFC is able to negotiate agreed solutions directly rather than follow the process set out in section 198 in a laborious or mechanical way.

2. An agreement under section 201(3) can lead to more expedient results not only for the SFC and the affected party but also for the market. There is one key principle involved in the decision to enter into an agreement under section 201(3) and that is whether the result achieves the SFC's key regulatory objectives in an appropriate way in the interests of the investing public or in the public interest. In many cases, the flexibility in outcomes that can be achieved through section 201(3) is important. A key example of that is last year's agreement with Towry Law which led to record compensation payments for investors (keeping in mind the SFC has no ability to otherwise secure compensation for victims).
3. The SFC has entered into agreements under s201 (3) against sponsors in four cases. Each of these cases involved mainland listings. In each case, while there was cogent evidence for the SFC to rely on, the SFC took a pragmatic approach given some issues that arose in relation to the state of evidence obtained from the mainland. The SFC considers the agreement struck earlier this year with the CSRC concerning the CSRC using its own powers to gather evidence for use in SFC investigations will help the SFC to obtain reliable evidence in the mainland with greater frequency and efficiency. While the SFC expects there will remain challenges in obtaining evidence in the mainland (compared with obtaining evidence in Hong Kong), the SFC's current position is substantially improved because of the current arrangement with the CSRC.

C. Whether such practices would affect the interests of retail investors, including their chances of filing civil claims for their investment

1. The actions by the SFC would not affect rights of the investors to pursue civil claims.

3. Statistics

A. Ever since the implementation of the Securities and Futures Ordinance in 2003, the number of applications for listing in the Main Board and Growth Enterprise Market, the number of applications rejected and the reasons therefor, and out of such refusals, how many applications were rejected on the ground that "the listing application was false or misleading as to a material fact or was false or misleading through the omission of a material fact".

Response

Applications rejected by the Exchange (From January 2003 to April 2007)

Listed	Rejected
291	29

Since December 2004, the Exchange has adopted a practice of posting all letters to

rejected applicants online (<http://www.hkex.com.hk/listing/staffint/rejection.htm>).

Applications rejected by SFC

In six cases SFC determined and advised the Exchange that it would object to the listings on the grounds that the listing application was false or misleading as to a material fact or was false or misleading through the omission of a material fact. Four of these applicants' listings did not proceed, due to rejection by the Listing Committee or the Exchange as they also failed to fulfil some of the requirements under the Listing Rules. The other two cases did not proceed due to the failure by the applicant to address the regulators' concerns and hence expiration of the relevant application.

B. Ever since the implementation of the Securities and Futures Ordinance in 2003, have the SFC and HKEx ever commenced investigations into breaches of the Securities and Futures Ordinance or listing rules committed by listed companies? If so, please set out the statistics by places of domicile of the companies involved and matters under investigation.

Response

Investigations by Exchange

1. Whilst the Exchange has tried to collate data in the form requested there are considerable difficulties in providing reliable material. Caution must therefore be exercised when using the following data. This is because, given that there may be a variety of different elements and breaches under investigation, it is difficult to categorize with exact precision the investigations by reference to the nature of the breaches. What the Exchange has done is to try and categorise cases by the dominant element of a particular investigation. However, those described as "miscellaneous" do not have any dominant element and defy attempts to reliably assign a lead category. Furthermore, the Exchange does not keep statistics by reference to the place of incorporation of the listed companies, which does not have a bearing in respect of the Exchange's decision on whether to take enforcement action against the listed companies and their directors.
2. Table A below shows the number of cases investigated by the Exchange in relation to breaches of the Listing Rules since 2003, by reference to the nature of the breaches.

Table A – Number of cases investigated by the Exchange

		<u>Number of investigated cases</u>			
	Nature of Breaches	2003	2004	2005	2006
Main Board					
A	Continuing Disclosure Obligations	18	34	40	21
B	Connected Transactions	33	30	54	41
C	Notifiable Transactions	4	2	11	9
D	Financial Reporting	27	34	26	19
E	Miscellaneous	61	42	65	61
Sub-Total		143	142	196	151
GEM					
1	Continuing Disclosure Obligations	2	4	10	5
2	Connected Transactions	3	6	12	9
3	Notifiable Transactions	2	2	6	0
4	Financial Reporting	2	12	16	11
5	Miscellaneous	19	24	45	31
Sub-Total		28	48	89	56
TOTAL (excluding sponsor cases)		171	190	285	207
	Sponsors	9	5	10	8
TOTAL (including sponsor cases)		180	195	295	215

Investigations by SFC

Table 1 shows the total number of enquiries in relation to listed companies conducted by the SFC since 2003. Tables 2 and 3 provide breakdown of the closed cases in terms of place of incorporation of the listed companies involved and the nature of enquiries.

Table 1 - SFC's enquiries in listed companies during the period from 1 Jan 2003 to 31 May 2007

	Jan-Mar 2003	2003/04	2004/05	2005/06	2006/07	Up to 31/5/07	Total
Case b/f	6	5	11	14	18	17	
Case opened	2	10	12	13	8	4	49
Case closed	3	4	9	9	9	2	36
Case c/f	5	11	14	18	17	19	

Table 2 – Breakdown of closed cases by nature of enquiries

	Jan-Mar 2003	2003/04	2004/05	2005/06	2006/07	Up to 31/5/07
Company inspection	3	3	5	5	8	1
Misleading statements		1	2	4	1	1
Insider dealing			1			
False accounting			1			

Table 3– Breakdown of closed cases by place of incorporation of the listed companies

	Jan-Mar 2003	2003/04	2004/05	2005/06	2006/07	Up to 31/5/07
Bermuda	1	4	5	4	4	
PRC			1	4	2	
Hong Kong	2					1
Cayman Islands			3	1	3	1

Ever since the implementation of the Securities and Futures Ordinance in 2003, have the SFC and HKEx ever taken action against breaches of the Securities and Futures Ordinance or listing rules committed by listed companies and been successful in substantiating the breaches, thereby leading to reprimands, warnings, prosecution or any enforcement action against such companies by the enforcement agencies? Please set out the statistics by places of domicile of the companies involved and matters under investigation.

Response

Enforcement action taken by the Exchange

Table B below shows the enforcement actions taken by the Exchange since 2003.

Table B – Enforcement actions taken by the Exchange since 2003

	2003	2004	2005	2006
Number of Public Censure	4	5	10	9
Number of Public Statements of Criticism	8	14	8	11
Number of Private Reprimands	3	3	3	2
Number of Warning/ Caution Letters	134	161	109	96

Enforcement action taken by SFC

Table 4– Actions taken by the SFC during the period from 1 Jan 2003 to 31 May 2007

	Jan-Mar 2003	2003/04	2004/05	2005/06	2006/07	Up to 31/5/07
Police	2	6	9	7	5	1
ICAC						
SEHK						
NFA	1	2	2	5	2	1
Prosecution			2			

Securities and Futures Commission

June 2007