

Press release

LCQ20: Monitoring of mainland private enterprises listed in Hong Kong

Wednesday, April 25, 2012

Following is a question by the Hon Frederick Fung Kin-kee and a written reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (April 25):

Question:

Quite a number of companies published their results in recent months, and among them many mainland private enterprises listed in Hong Kong have encountered financial and auditing problems (including resignation of auditors owing to queries about the veracity of the accounts, sharp increase in short-term debts, non-business related losses incurred from participating in financial derivative activities, or deferrals in publishing results because of unclear accounts), leading to substantial volatility of their share prices, and investors suffer losses. Further, such cases have also aroused concern of the market, alleging that the standards of corporate governance of mainland private enterprises vary, and at the same time querying whether the relevant listing threshold and regulatory mechanism, etc. are too lenient. In this connection, will the Government inform this Council:

(a) of the existing measures for regulating the mainland private enterprises listed in Hong Kong; whether it had in the past compiled statistics and conducted research in respect of the quality of corporate governance and about the situation of mainland private enterprises listed in Hong Kong encountering financial and auditing problems, etc.; if it had, of the findings; whether it has conducted investigation to understand the situation relating to the recent cases of mainland private enterprises involving in the aforesaid financial and auditing problems, etc.; if it has, of the reasons why they encountered such problems, and whether issues of violation of the Listing Rules, mismanagement, delays in the dissemination of information and having misled investors, etc. were involved; whether it knows if the Securities and Futures Commission of Hong Kong has followed up the relevant cases; and

(b) whether the authorities have assessed the impact of the successive cases of mainland private enterprises encountering problems on the stability and reputation of the financial market of Hong Kong; whether it will review if the current listing threshold, the sponsor regulatory regime, as well as the existing regulatory mechanism are too lenient, and appropriately tighten and enhance the mechanism, with a view to restoring the market's confidence in the local financial regulatory regime and the mainland private enterprises listed in Hong Kong?

Reply:

President,

My reply to the two parts of the question is as follows:

(a) All listing applicants and listed companies including Mainland private enterprises (MPEs) are subject to the regulation under the Securities and Futures Ordinance (SFO), and the Listing Rules of the Stock Exchange of Hong Kong Limited (the Exchange) as approved by the Securities and Futures Commission (SFC) under the SFO. All listing applicants including MPEs have to meet the listing eligibility requirements including those with regard to profits, market capitalisation and revenue. After listing, all listed issuers including MPEs have to comply with the continuing obligations with regard to disclosure, etc.

Under the Listing Rules, the Exchange ensures the operation of a fair and orderly market by requiring issuers to disclose all material information, have in place measures to safeguard their assets and have appropriate financial and reporting controls to ensure all material information is disclosed in a timely manner to the investing public. Matters relating to misappropriations, misleading disclosures and market misconduct are governed by Hong Kong laws, most notably the SFO. Where the Exchange becomes aware of circumstances suggesting violations of the law, it would make referrals to the appropriate law enforcement agencies including the SFC and the Police.

The Exchange defines MPEs as enterprises with origins of establishment in the Mainland, excluding H shares and red chips. Currently there are 415 MPEs listed on the Exchange.

In 2011, the listing of four MPEs was suspended by the Exchange in connection with accounting issues. Among these,

- * two cases involved possible fraudulent transactions and the Exchange has required these issuers to appoint forensic accountants to investigate the matters. These cases may involve violations of the law and would be investigated by the appropriate law enforcement agencies;

- * one case involved possible Listing Rules breaches and corporate governance issues including unreported connected transactions and pledges of company assets without proper approvals. The Exchange has required the appointment of a forensic accountant to investigate these issues; and

- * one case involved insufficient information provided to auditors.

Up to April 12 this year, the Exchange suspended the listing of seven MPEs, four of which were listed within three years, because they were unable to release their financial results for the year ended December 31, 2011. Of these seven cases, three cases involve possible fraudulent activities and false account records, and four cases involve delays in the completion of audit work or the requirement for additional work done relating to particular material transactions of the issuers. The Exchange is continuing the investigation of these cases.

The SFC has commenced investigations or court proceedings in a number of cases in relation to suspected misconduct or breaches of the SFO involving newly listed Mainland companies. In accordance with normal practice, the SFC does not comment on specific cases under investigation.

(b) In 2010, the Exchange reviewed the Profit Test and all listing eligibility requirements and compared them to those adopted in other major markets. The review showed that the initial listing criteria of the Exchange were comparable, if not higher, than international standards.

To promote good corporate governance, the Exchange amended the Listing Rules and the Corporate Governance Code in January 2012. The new rules promote a stronger and independent board of directors governing listed companies, clarify the roles and responsibilities of directors, and require shareholders' participation in the appointment and removal of auditors.

Separately, the SFC conducted a review of the work of listing sponsors and issued a report on its findings in March 2011. It revealed certain deficiencies in the work of the sponsors and inadequacies in their internal systems and controls. The SFC is reviewing the existing requirements relating to the work of sponsors, with a view to putting forward improvement proposals for market consultation shortly.

To encourage a continuous disclosure culture among listed corporations, the Government introduced the Securities and Futures (Amendment) Bill 2011 (the Bill) in June 2011 to, inter alia, oblige listed corporations to disclose price sensitive information (PSI) in a timely manner and impose civil sanctions against non-disclosure of PSI. The Bill will resume Second Reading Debate on April 25, 2012. The statutory PSI regime will further enhance the transparency and quality of our market. It will also bring our regulatory regime more in line with those of other major markets and strengthen Hong Kong's position as a premier capital formation centre. Subject to passage of the Bill by the Legislative Council, our plan is to commence operation of the statutory PSI regime on January 1, 2013.

The Government will continue to work with the Exchange, the SFC and parties concerned to ensure the quality of listing on the Exchange.

Ends