

Press Release

LCQ5: Legal proceedings related to CITIC Limited

Wednesday, October 15, 2014

Following is a question by the Hon James To and a reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (October 15):

Question:

In 2008, CITIC Pacific Limited (currently known as CITIC Limited and hereafter referred to as CITIC) suffered massive losses incurred by its investment in leveraged foreign exchange contracts. It has been six years since the Securities and Futures Commission (SFC) and other relevant agencies commenced various investigations into CITIC's disclosure of its financial position at that time and related matters (the CITIC incident). SFC recently announced on the 11th of last month that it had instituted proceedings in both the Court of First Instance (CFI) and the Market Misconduct Tribunal (MMT) against CITIC and five of its former executive directors. SFC alleges that CITIC and the directors concerned had engaged in market misconduct involving disclosure of false or misleading information on the company's financial position. SFC is seeking orders from CFI to restore or compensate 4 500 investors who purchased CITIC shares between the date on which CITIC announced such information and the date the true financial position was disclosed (the specified period). SFC is also seeking that CITIC and the directors concerned be sanctioned by MMT. In this connection, will the Government inform this Council:

- (1) apart from the aforesaid investors, whether the authorities have plans to assist other investors who suffered losses due to the CITIC incident (including those investors who had already held CITIC shares prior to the specified period, as well as those who had purchased CITIC-related warrants or options during the specified period or had held such items prior to that period) in seeking compensations; if they have such plans, of the details; if not, the reasons for that;
- (2) whether it knows the respective scopes of the investigations carried out by agencies such as SFC, the Police and the Financial Reporting Council; when

SFC submitted its investigation results to the Department of Justice (DoJ) and the Financial Secretary, and when the Financial Secretary gave his consent to instituting proceedings; the latest progress of the investigations carried out by the various agencies concerned; as well as the expected time when decisions will be made as to whether the persons concerned will be prosecuted or penalised; and

(3) given that the authorities indicated in their replies to questions raised by Members of this Council in 2010 that in general, it was only after DoJ had ruled out criminal prosecution would SFC consider instituting proceedings in MMT, and that the Securities and Futures Ordinance also provides that if proceedings have been instituted against any person, no criminal prosecution may be instituted against that person in respect of the same conduct, whether the authorities have assessed if the current proceedings instituted in MMT by SFC have undermined the power of DoJ in instituting criminal prosecutions in respect of the CITIC incident; if the assessment outcome is in the affirmative, of the extent; if in the negative, of the justifications and how the authorities safeguard the rights and interests of minority shareholders and uphold Hong Kong's reputation as an international financial centre?

Reply:

President,

In response to Hon James To's question, we have consulted the Securities and Futures Commission (SFC), the Department of Justice (DoJ) and the Hong Kong Police Force (the Police) for comments and our reply is as follows.

(1) The SFC considers that claims by pre-existing shareholders depend on individual and personal circumstances. Their position is different to the 4 500 or so investors who made an investment choice to purchase CITIC shares between September 12, 2008 and the date of the Profit Warning.

This notwithstanding, the SFC's actions against CITIC and its former directors (the SFC actions) include proceedings before the Market Misconduct Tribunal (MMT). If the SFC is successful in the MMT, a finding of market misconduct made by the MMT can be relied upon by pre-existing shareholders and other investors to establish liability in individual actions for compensation

under section 281 of the Securities and Futures Ordinance (SFO). This will enable the pre-existing shareholders and other investors to assess the merits of their claims more accurately and help overcome problems establishing the factual underpinning of claims, including the fact of market misconduct and the identity of person(s) who perpetrated conduct constituting market misconduct.

As for investors who may have purchased warrants and futures, the SFC noted that turnover in the warrant, options and futures markets was not significant during the period between September 12, 2008 and October 20, 2008. The SFC considers that these claims also depend on uniquely individual circumstances and are more appropriately brought as individual claims under section 281 of the SFO and may be assisted by an MMT finding if the SFC is successful.

(2) The SFC conducted an investigation into the circumstances surrounding the disclosure of the CITIC's foreign exchange losses in 2008. The SFC sent the relevant evidence to the DoJ in 2009. It sought and obtained the consent of the Secretary for Justice to commence the MMT proceedings in 2014.

Police investigations into the CITIC matter on aspects outside the subject matter of the SFC's actions are still on-going. Among others, there are on-going legal proceedings on whether a large number of documents and computer exhibits seized by the police in the course of the relevant investigation are covered by legal professional privilege so as to be privileged from disclosure to and inspection by the police. Such legal proceedings will be heard before the Court of Appeal in May 2015. As the police investigations are still on-going, and appropriate follow-up actions shall be taken in the light of the appeal outcome, it is inappropriate to comment further on the case. Once the police investigations have been concluded, the DoJ will decide, as in all other cases, whether a prosecution is appropriate in accordance with the Prosecution Code.

It is the established practice of the Financial Reporting Council that it will not comment on individual cases.

(3) Article 63 of the Basic Law stipulates that "The DoJ of the Hong Kong Special Administrative Region shall control criminal prosecutions, free from any interference." The principles applicable in making a prosecutorial decision in any given case are clearly set out in the established and published

Prosecution Code and are strictly applied. The considerations are whether the available evidence supports a reasonable prospect of conviction and if so, whether it is in the public interest to prosecute. Having considered all the prevailing circumstances, the DoJ considers that the subject matter of the SFC's actions is best dealt with by way of proceedings before the MMT as well as pursuant to section 213 of the SFO before the Court of First Instance of the High Court. Any other on-going investigations and proceedings, civil or criminal, not within the scope of the SFC's actions will not be prejudiced.

We will continue to improve our regulatory framework to meet evolving market needs and protect the investors. For example, a statutory disclosure regime has been established since January 2013 whereby listed corporations are required to disclose price sensitive information in a timely manner, backed by civil sanctions for any non-disclosure. This has enhanced market transparency and quality, brought our regulatory regime for listed corporations more in line with those of overseas jurisdictions, and helped sustain Hong Kong's position as an international financial centre.

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