Press Release

LCQ2: Misconduct of some listed companies which jeopardises rights and interests of investors

Wednesday, November 30, 2016

Following is a question by the Hon Kenneth Leung and a reply by the Acting Secretary for Financial Services and the Treasury, Mr James Lau, in the Legislative Council today (November 30):

Question:

In September this year, the Shenzhen Stock Exchange released eight sets of rules governing the Shenzhen-Hong Kong Stock Connect, including the Mandatory Provisions for the Risk Disclosure Statement for Hong Kong Connect Trading. It is mentioned in the Provisions that some poor-performing and low-priced companies with small market capitalisation listed on the Stock Exchange of Hong Kong (SEHK) have engaged in frequent share splits and consolidations and deeply discounted rights issues or placements, which may substantially dilute investors' rights and interests. Investors should pay attention to the risks that may arise. This kind of stocks is commonly referred to as "cheating shares" by local and mainland media. Besides, in an article published in September this year, the Chief Executive of SEHK said that acts involving fraudulent financial reports, insider trading, market manipulation, etc. are stringently combated by various major stock market regulators worldwide. In Hong Kong, the regulatory authorities adopt a practice which "assumes that the majority of people have good intentions and will follow the rules of market". In other words, "the regulator does not intervene in the free market as far as possible" and it focuses on "imposing mandatory disclosure requirements, ensuring shareholders' participation in the vetting and approval process as well as stepping up prosecutions after contraventions, thereby combating contraventions by way of penalties". In this connection, will the Government inform this Council:

(1) of the number of announcements made in the past five years by companies listed on SEHK in respect of "unusual share price and trading volume movements" and the number of listed companies involved;

(2) whether the authorities have assessed if the existing mechanisms for

regulating the market, vetting and approving listings, as well as investigating misconduct can effectively curb those acts of listed companies which jeopardise the interests of shareholders; if they have assessed, of the details and outcome; if not, the reasons for that; and

(3) whether the authorities have conducted investigations into or studies on the characteristics of cheating shares and the listed companies involved; if they have, of the outcome; if not, the reasons for that; whether they have assessed the impacts of the existence of cheating shares on the reputation of Hong Kong as a major financial centre and on the rights and interests of investors; if they have, of the details and outcome; if not, the reasons for that?

Reply:

President,

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

(1) The number of announcements issued by issuers in the last five years concerning unusual share price or trading volume movements and the number of issuers involved are set out at Annex.

These announcements are generally made at the request of the Stock Exchange of Hong Kong (SEHK) following unusual movements in the issuers' share price or trading volume. Under the Listing Rules, the SEHK may make enquiries and require publication of announcements to avoid the possible development of a false market (for example, arising from possible leakage of material information).

(2) and (3) As the frontline regulator of listing-related matters and issuers listed on its markets, the SEHK has published and enforced the Listing Rules in order to ensure, as far as reasonably practicable, an orderly, informed and fair market for the trading of securities listed on the SEHK. The Listing Rules set out the eligibility requirements for listing as well as the continuous listing obligations.

As the statutory regulator of the securities and futures markets, the Securities and Futures Commission (SFC) regulates the listing market through supervision of exchanges and clearing houses, as well as the dual filing regime;

and its statutory investigation and enforcement powers over matters such as disclosure and other misconduct.

While the existing regulatory mechanism has worked well, regulators have recently noted some concerning phenomena in the listing market as follows:

(a) recent cases of stocks with rapidly rising but unexplained market capitalisation in some cases affecting major stock indices, market sizes in some of these cases raising potential concerns.;

(b) the unusual speed and scale of share price hikes of certain stocks, especially where they were closely held; and a lack of transparency of the assets, businesses and controllers of those companies; and

(c) extreme price volatility of some newly listed GEM stocks, as well as high shareholding concentration and low liquidity of certain GEM stocks.

Although the types of problems outlined above only affect a small number of listed companies in Hong Kong, the SFC has in recent years stepped up its enforcement efforts directed at listed companies-related issues, such as corporate fraud and misfeasance, market manipulation and related intermediary misconduct. The number of SFC inquiries into corporate governance or disclosure issues, insider dealing and market manipulation have more than doubled in the past five years, while the number of formal proceedings commenced have increased by more than 50 per cent. Different divisions of the SFC have been working together to identify key areas of concern and the optimal regulatory approach.

In addition, a close collaborative relationship with the Mainland regulators – notably the China Securities Regulatory Commission – is increasingly critical, given the large percentage of Hong Kong-listed companies having business operations on the Mainland. The SFC has been actively building on its long-term relationship with Mainland regulators to increase the effectiveness of its enforcement work.

Reliance on enforcement alone is not sufficient as it normally comes into play only after real harm has been done to investors. Effective gatekeeping and regular review of rules for the governance of listed companies and the regulation of intermediaries who interact with them are equally important. The SEHK has tightened its listing regulation and issued a number of guidance letters, including guidance on reverse takeover transactions; cash companies; bonus issues of shares; and suitability of listing related to companies exhibiting shell characteristics. Furthermore, the SFC and the SEHK are working on an overall review of a range of listing policies, including a holistic review of GEM, backdoor listings, shells and prolonged suspensions.

As the market becomes more complex and diverse, the SFC and the SEHK strive to ensure that our listing regulation can respond to rapid developments in the market, and thus enable them to tackle various market issues in a more efficient and effective manner.

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