

# The SFC's Role in Regulating Listed Companies in Hong Kong

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Today I propose to describe the role played by the Securities and Futures Commission (SFC) in regulating companies listed on the Exchange. My talk will first cover the regulatory structure of the Hong Kong financial market, functions of the SFC and oversight of the Stock Exchange, and in particular that of the Corporate Finance Division in the SFC and our oversight of the Listing Division of the Exchange. Secondly, I will cover some of the areas that are directly regulated by the SFC. Lastly, I will touch on our relationship with our counterparts in China.

## **Regulatory Structure of the Hong Kong Financial Market**

Under current Hong Kong law, the SFC is the statutory body entrusted with the authority and responsibilities of supervising and monitoring the activities of both the Stock Exchange and the Futures Exchange, and enforcing laws and regulations relating to the securities and futures markets.

The Stock Exchange of Hong Kong (SEHK), on the other hand, is a private organisation owned by its members but has been given the privilege by the Government to operate and maintain the stock market in Hong Kong. Prior to 1992, the Exchange shared with the SFC the responsibilities of vetting listing applications and approving certain disclosable transactions of listed companies. In order to remove

regulatory duplication and as part of the SFC's efforts to restructure the Exchange, the SFC entered into a Memorandum of Understanding with the Exchange in November 1991 and devolved to the Exchange the day-to-day administration of the Listing Rules and the direct responsibilities of regulating listed companies.

Today, the Exchange is the front-line regulator of listed companies in Hong Kong.

The SFC retains a supervisory role over the Exchange and in general leaves all front-line responsibilities in listing functions to the Exchange, with the exception of matters relating to takeovers and mergers and general listing policy matters as well as any amendments to the Listing Rules. The SFC also retains its power to suspend the trading of shares under the Statutory Rules. The enforcement of other securities-related regulations such as the Securities Ordinance, the Securities (Disclosure of Interests) Ordinance, the Securities (Insider Dealing) Ordinance, the Protection of Investors Ordinance, etc., also rests with the SFC. I will go into these areas later in my talk and would like to describe for now some of the key points of the MOU between the SFC and the Exchange.

### **MOU between the SFC and the Exchange**

The MOU sets out the obligations and the listing-related functions and responsibilities each of the SFC and the Exchange. Pursuant to the MOU, a number of mechanisms were incorporated to enable the SFC to effectively discharge its function of overseeing the Exchange's performance in listing-related matters.

There are a few key points in the 1991 MOU that I would like to describe to you today.

### ***Restructure of the Listing Committee***

Previously the Listing Committee comprised a handful of members the majority of whom were executives of the Listing Division. The MOU between the SFC and the Exchange restructured the Listing Committee as a mechanism of checks and balance on the Listing Division. The MOU expanded the Listing Committee to include representatives from various market participants such as listed company representatives, merchant bankers, fund managers, lawyers, accountants as well as stock brokers. It was intended that market participants would add to the listing process their collective experience and expertise of the market and ensure that decisions by the Listing Division are made in an impartial and professional manner.

It should be noted that members of the Listing Committee are nominated by the Listing Nominating Committee which comprises three representatives from the SFC and three from the Exchange. This is to ensure that the views of both organisations are taken into account in nominating members to the Listing Committee.

I am pleased to say that the experience and result of the work of the Listing Division in the last few years has demonstrated that this system of checks and balance has worked well.

### ***Monthly report and liaising meeting between the Corporate Finance Division and the Listing Division***

Corporate Finance Division of SFC and Listing Division work closely together and our staff often meet on an ad-hoc basis to discuss matters which have policy implications. Because the SFC no longer deals with listed companies on matters under the Listing Rules, we rely on the frequent contact with the Exchange to keep us informed. In addition, the Listing Division provides us with a monthly report that outlines their key operational matters in that month and we hold monthly liaison meetings to discuss the monthly report and other specific issues.

***Periodic audit of the listing function of the Stock Exchange***

Under the MOU the SFC has the authority to conduct an annual audit on the Listing Division to ensure that the Division carries out its functions professionally and in the interest of the investing public. I am pleased to say that after the initial audit in 1993, we have found that subsequent audit could be conducted every 18 months instead of annually and that the Division staff have demonstrated maturity and professionalism in carrying out their responsibilities. The audit by the SFC is also a useful tool for the Exchange to identify areas of improvement in both policy matters and in procedures.

***SFC approval for rule changes***

To keep pace with the development of the market it is necessary for the Exchange to amend the Listing Rules from time to time. As with all other rules of the Exchange, all amendments or addition to the Listing Rules require the ultimate approval of the SFC. In practice, the Listing Division consults the Corporate Finance Division of the SFC during the process of developing any rule amendments and the SFC is in general supportive of the Exchange's initiatives.

*In summary*, the restructured Listing Committee, the monthly report by the Listing Division, the periodic audit of the Listing Division, as well as the requirement for SFC approval of all changes to the Listing Rules are all part of the checks and balance that was set into the system to ensure that the interest of the investing public and the market is properly safeguarded.

What then are the checks and balance put on the SFC, one may ask?

First of all, the SFC is a public body accountable to the Government and to the public. The Board of the SFC consists of five Executive Directors and five non-Executive Directors, all of whom are appointed by the Governor for a fixed term. The SFC reports to the Financial Secretary and is answerable to the Legislative Council (LegCo).

We are often called upon to explain matters of public interest relating to the markets we regulate in front of LegCo and have to respond to investors complaints in general.

The authority of the SFC is prescribed by statute, and the staff are subject to queries by the Commissioner of Administrative Complaints (COMAC). So far we have been able to satisfactorily answer to complaints directed to us through COMAC.

### **Matters Directly Regulated by the SFC**

Having discussed the MOU between the SFC and the Exchange, we now turn to matters which are regulated directly by the SFC.

#### ***Takeovers and mergers***

Takeovers and mergers affecting public companies in Hong Kong are regulated by the SFC through the non-statutory Hong Kong Code on Takeovers and Mergers. The primary purpose of the Takeovers Code is to give fair treatment to shareholders affected by takeover and merger transactions.

#### ***Share repurchases***

The Share Repurchases Code generally requires a share repurchase by a public company in Hong Kong to be made by way of a general offer to all shareholders or in accordance with an exemption from the general offer requirement. In almost all cases, public companies in Hong Kong use an exemption available for share repurchases made through the facilities of the Stock Exchange in accordance with the Listing Rules.

### ***The Securities (Disclosure of Interests) Ordinance***

The Securities (Disclosure of Interests) Ordinance (SDI) requires directors of listed companies to disclose to the Exchange their interest in the shares in or debentures of their company or any "associated corporation" (as defined in the SDI Ordinance).

Every director must also notify the SEHK his interests and dealings in warrants to subscribe for shares of the company. A director is deemed to be interested in shares in a wide range of circumstances. A director is interested in shares if he is the registered holder. He also may be deemed to be interested in shares based on corporate, family, trust and contractual interests.

### ***Securities (Insider Dealing) Ordinance***

As a measure of ensuring all shareholders of a listed company receive price-sensitive information on an equal basis, most jurisdictions have some sort of regulations prohibiting the dealing in shares of a listed company by persons having inside information. Hong Kong's legislation is the Securities (Insider Dealing) Ordinance and is enforced by the Enforcement Division of the SFC. Cases are referred by the Enforcement Division to the Financial Secretary and an Insider Dealing Tribunal is appointed to review each case.

### **The China Dimension - Relationship with the China Securities Regulatory Commission**

In June 1993, the SFC and the Exchange entered into a Memorandum of Regulatory Cooperation (MORC) with the China Securities Regulatory Commission, the Shanghai Stock Exchange and the Shenzhen Stock Exchange. The purpose of the MORC is to enable parties, through mutual assistance and exchange of information, to accomplish (1) the basic principles of protecting investors, (2) maintaining fair, orderly and efficient markets, and (3) to ensure compliance with each other's

laws and rules. The scope of MORC therefore covers not only issuers of securities, but also directors, officers, shareholders and professional advisers of companies listed in the PRC or Hong Kong. Also within the ambit of MORC are dealers and investment advisers operating in the PRC and Hong Kong. It also covers trading, clearing and settlement activities, insider dealing, market manipulation and other fraudulent practices on any stock market in the PRC or Hong Kong. MORC also includes the training and exchange of personnel and any other matters agreed to by the parties.

Specific areas of cooperation include company news dissemination, suspension of trading, takeovers and mergers, regulation of intermediaries and standardization of securities terms. The list may be revised as and when the need arises.

Like other memoranda of understanding between securities regulators around the world, MORC contains statements of intent which do not impose legally binding obligations on the signatories. As such, MORC has no power to override domestic laws and regulations, nor does it affect other channels of cooperation. Pursuant to the terms of MORC, the parties meet once every quarter to discuss developments in their respective markets and matters of mutual interest. These meetings have already demonstrated that frequent dialogue between the parties facilitate the understanding of each other's market and the manner in which issues of mutual concern can be handled. This is of particular help in ensuring that companies which have shares listed in both the PRC and Hong Kong, are subject to the same standard of regulation by the authorities in both jurisdictions.