

Speech at 7th Pan Asian Regulatory Summit

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A special thank you to Thomson Reuters for inviting me to speak at this conference. I am very happy to be here.

A few months ago, my family arrived at this fantastic new city and I started this challenging new role as the head of the Enforcement Division of the Securities and Futures Commission (SFC).

I was fairly tied in with the international regulatory community in my previous roles in Canada, where the SFC is seen as a very sophisticated regulator. As you can see from Ashley's new role as Chairman of the IOSCO, the SFC holds a very respected and important voice internationally.

I was well aware of the world-class reputation of the SFC's Enforcement Division before my arrival. It is well known globally for its strong enforcement approach and for putting investor protection at the top of its priorities. Upon my arrival, I was pleased to see that the SFC's capabilities are reflective of, and even exceed, its reputation. It is staffed by diligent professionals with a strong focus on investor protection and maintenance of fair and efficient markets.

As some of you may have noted, Hong Kong received the top ranking for regulatory enforcement in the 2016 CG Watch survey¹. I am glad to take credit for an excellent ranking, but the truth is, all rankings of this type invariably depend in part on the number, and not necessarily the quality, of the cases we have done. What I really want our Enforcement Division to do is to focus on quality over quantity.

Ever since my appointment, I have been considering how the SFC's Enforcement Division can further contribute to the healthy development of this large, vibrant and complicated securities market closely linked to mainland China as well as other parts of the world.

We realised the need to re-assess our enforcement focus, our organisation structure and our enforcement tools. Against this background, we carried out a comprehensive and structured strategic review of the entire Enforcement Division over the past few months.

We established a number of teams to carry out the strategic review. One team collaborated with other SFC divisions to identify the key areas of concern that should rank high in our enforcement priorities. Another focused on enforcement processes and tools – looking for ways to maximise speed and effectiveness. A third team carried out a comprehensive review of our surveillance capabilities against the latest developments around the world. We had

¹ Published by CLSA and the Asian Corporate Governance Association



two other teams that focused on enhancing collaboration with other regulators in Hong Kong and in mainland China respectively.

Focus on key risks

During the review, we identified a few key areas of concern that pose particularly serious threats to the integrity of the Hong Kong markets. The Enforcement Division will focus our efforts on these key areas. We have formed new specialised teams to tackle these threats which I will talk more about later. We will also prioritise our new cases to ensure that we allocate resources to high impact cases that address these key risk areas.

So what are the key risk areas?

Listed companies-related concerns

At the top of our priorities are listed companies-related issues. We are particularly concerned about risks posed by corporate fraud and misfeasance, market manipulation and intermediary misconduct.

Key cases of this nature have wiped out more than \$200 billion in market capitalisation from the Hong Kong stock market, and all of them involved some form of corporate fraud or misfeasance. These cases not only caused immense losses to investors, they also severely damaged the integrity and reputation of the Hong Kong markets.

Corporate misfeasance and fraud-related investigations make up a very substantial proportion of our enforcement cases. These types of investigations are usually complex, time consuming and often involve the loss of millions and sometimes billions of dollars by many investors. They often relate to companies with business operations in mainland China and most of the evidence and witnesses are in the Mainland. Despite the resource implications, we will continue to focus our enforcement efforts on these types of investigations as they pose one of the greatest threats to the interests of the investing public and the integrity of the Hong Kong markets.

You may have noticed that since 2012, we have substantially increased the number of trading suspensions imposed against listed companies. Trading suspension is a very interventionist power and we exercise it very carefully, and only upon the most compelling evidence of fraud or false or misleading information in relation to a company. Even on this basis, however, the number of trading suspensions has increased substantially since 2012.

Some of our largest and most complex enforcement actions also relate to listed company-related crimes and misconduct. In 2012, we obtained court orders against Hontex to conduct a share buy-back of its shares to remediate investors for Hontex's false and misleading financial reporting since its IPO. We managed to return over \$1 billion to aggrieved investors.

In 2013, we started proceedings to wind up China Metal Recycling and appointed provisional liquidators in response to allegations of what the court later described as fraud on an "industrial scale". The Hong Kong police laid criminal charges against people involved.

In the same year, we took action against the former chairman and CEO of First Natural Foods and two of its former directors for embezzling \$84 million from the company. We sought compensation and disqualification orders against those involved.



Also in 2013, we obtained interim injunctions to freeze assets of Qunxing Paper Holdings and its former directors for fraud in the company's financial statements since its IPO. We are currently continuing with proceedings against Qunxing to appoint interim receivers and managers.

In 2014, we obtained \$420 million compensation for GOME Electrical Appliances Holding from its former Chairman and his wife for breaching their duties as directors of the company. They caused the company to conduct a share buy-back which enabled them to sell their shareholding in the company at a higher price. They then used the proceeds to repay a substantial personal loan.

In the same year, we started proceedings against CITIC and a number of its former directors for disclosing false and misleading information which failed to mention the company's enormous mark-to-market losses on foreign currency derivative contracts. We sought orders that the company and the former directors compensate investors for their losses.

In 2015, we took the unusual step of announcing an ongoing investigation into Hanergy in response to its chairman's denial that we were investigating, as it was in the public interest for us to clarify. This investigation is still ongoing.

This year, we have sought orders to disqualify 10 senior executives of Freeman Fintech Corporation from acting as directors for failing to act in the best interest of the company and to disclose material information to shareholders that led to a \$76 million loss to the company. We conducted proceedings before the MMT in the very significant Greencool and CITIC cases and are awaiting the tribunal's decisions.

I could go on for the whole morning if I were to mention every case that we have done that relates to the quality of our stocks list. The key point that I want to drive home is that corporate fraud and misfeasance concerning listed companies has been and will likely continue to be our key enforcement focus in the near future, as they pose one of the greatest threats to the interests of the investing public and the integrity of the Hong Kong markets.

I also want to emphasise that our enforcement actions will focus on holding individual wrongdoers accountable for their misconduct. We have broad powers under the SFO to hold directors and individuals involved in the management of companies responsible for the misconduct committed by the companies they manage. We will vigorously exercise these powers where appropriate. Over the past three years, we initiated proceedings against over 50 directors and senior executives of listed companies for misconduct, breach of directors' duties and reckless or negligent conduct that contributed to their company's failings.

It should therefore come as no surprise that, going forward, we will continue to focus our enforcement efforts to combat corporate fraud and misfeasance activities.

We have received a steady stream of referral cases from our Corporate Finance Division averaging over 50 cases each year. Many of these referrals raise serious issues – in particular those involving misconduct by IPO sponsors. To put it very lightly, the conduct and the level of professionalism demonstrated by some sponsors we looked at left a lot to be desired. You can expect to see more cases in the above areas where firms and their senior management will be held accountable for their failings.



Prioritisation and enhancing efficiency

Enforcement cases have been increasing rapidly at the rate of 20% per year and are generally increasing in complexity. We could try to double our staff every five years to cope with this trend, but even if we do this, we would still be treading water. We clearly need to re-think how we perform our work. We need to move from a try-to-do-everything approach to a focused approach, targeting the key risk areas.

Under the SFO, we are required to make efficient use of our resources when pursuing our regulatory objectives. To do this, we must give priority to cases that pose the greatest threats to the interests of the investing public and the integrity of our markets. We also need to identify cases that will bring the highest impact when we achieve successful enforcement outcomes, and at same time, weed out cases that have little prospect of success as early as possible.

By doing this, we will be able to bring successful enforcement outcomes to the market while the cases are still relevant, which in turn will maximise the deterrent effect of our efforts. We will prevent misconduct before it occurs.

Specialised teams

As mentioned earlier, we will set up permanent and temporary specialised teams to focus on the key risk areas and deal with the problems of the growing complexity and increasing volume of enforcement cases.

We have set up four permanent specialised teams:

- Corporate Fraud and Corporate Misfeasance Teams – these two teams will target corporate fraud and the misuse of powers by the senior management of listed companies, and will investigate the types of misconduct and failings highlighted by me earlier. Very experienced professionals with long track records in these areas will lead these teams.
- Insider Dealing and Market Manipulation Team - The leader of this team has a strong investigation background and the team comprises specialists with expertise in market analysis and investigation. They will focus on investigating market misconduct and related offences.
- Intermediary Misconduct Team – This team will focus on misconduct by persons regulated by us. Their work includes the investigation of short selling issues, mis-handling of client orders, misappropriation of client assets and investment bank malpractice.

We have also formed four temporary specialised teams to tackle serious emerging risks. We currently have a Sponsor Team that focuses on sponsor misconduct during IPOs, a GEM Team that investigates irregularities in the Growth Enterprise Market, an AML² Team that targets KYC³/AML control failings and a Specific Products Team to deal with mis-selling of specific investment products. Temporary teams will be disbanded when they have addressed the underlying risks. New teams may be formed to deal with other areas of concern as they emerge.

² Anti-Money Laundering

³ Know Your Client



Collaboration with Mainland and Hong Kong regulators

With a large percentage of Hong Kong-listed companies having business operations in mainland China, cultivating and maintaining very close collaborative relationships with Mainland regulators – notably the China Securities Regulatory Commission (CSRC) – is critical. We are actively building long-term relationships based on trust with Mainland regulators to ensure continued success of our enforcement efforts.

We have an active executive staff exchange programme with the CSRC to enhance our mutual understanding of each other's work. We also hold regular joint training initiatives. We have just completed a very successful "Market Manipulation Conference" jointly held with the CSRC in Xi'an where we had the benefit of listening to some of the world's leading experts on how to tackle cross-jurisdictional market manipulation investigations. In appropriate cases, we also conduct joint investigations which provide excellent opportunities for officers of both organisations to build trust and establish long-term working relationships.

Locally, we are also actively building long-term relationships with other regulators. We will be collaborating with the Hong Kong Monetary Authority (HKMA) closely when investigating authorised institutions misconduct under the Securities and Futures Ordinance to improve the consistency of the experience for regulated persons involved in these types of investigations. We have learnt a lot from the HKMA on KYC and AML matters through joint training and expertise sharing, and we hope that the HKMA may also draw on our experience in securities-related enforcement. We will continue to build on this close partnership to ensure that we perform our respective regulatory functions as strategic partners in the best interest of Hong Kong.

In order to preserve the integrity of the markets, it is important to maintain a strong criminal deterrent. This depends on a close and collaborative relationship with the Department of Justice. We have recently concluded a memorandum of understanding with the Department of Justice to enhance cooperation on criminal cases. We will work closely with the Department of Justice and the Hong Kong Police Force as we continue to target securities fraud, insider dealing, market manipulation and other offences.

Concluding remarks

Enforcement is a blunt regulatory tool. By the time we act, usually the damage has been done, investors have lost their money and the reputation of our markets would have suffered. You cannot rely on enforcement alone to maintain the quality of our stocks list.

As you can see from my earlier remarks, the SFC has an aggressive, thoughtful, world-class enforcement division that is working tirelessly to sharpen its focus. It is absolutely determined to create a proper deterrent to improper or unethical behaviours. No doubt, we still have lots to do, but it has to be recognised that we are only one part of a wider supervisory framework. To effectively protect and maintain Hong Kong's world-class markets, we must develop a multi-dimensional approach to securities regulation, where all functions, such as regulatory gatekeeping, supervision and enforcement, work as a team to further our regulatory objectives.

Thank you again for having me here today. I look forward to working with industry leaders and the management team at the SFC to ensure the financial industry in Hong Kong will continue to prosper and flourish.