

## Chapter 9

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# HONG KONG

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### I OVERVIEW

#### i Sources of law

##### *Ordinances*

- a* Securities and Futures Ordinance (Cap. 571) (SFO);
- b* Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32); and
- c* Companies Ordinance (Cap. 622) (CO).

##### *Regulations*

Subsidiary legislation under the SFO, in particular:

- a* Securities and Futures (Stock Market Listing) Rules (Cap. 571V);
- b* Securities and Futures (Disclosure of Interest – Securities Borrowing and Lending) Rules (Cap. 571X);
- c* Securities and Futures (Short Position Reporting) Rules (Cap. 571AJ); and
- d* Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules (Cap. 571AL).

##### *Codes and guidelines*

- a* The Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited;
- b* codes and guidelines issued by the Securities and Futures Commission, in particular:
  - Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission;
  - Code on Real Estate Investment Trusts;
  - Codes on Takeovers and Mergers and Share Buy-backs;
  - Code on Unit Trusts and Mutual Funds;

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- The Guidance Note on Short Selling Reporting and Stock Lending Record Keeping Requirements; and
- Guidelines on Disclosure of Inside Information.

**ii Regulatory authorities**

- a* The Securities and Futures Commission (SFC): regulates Hong Kong's securities and futures markets.
- b* The Hong Kong Monetary Authority (HKMA): regulates and supervises banking business and the business of taking deposits in Hong Kong.
- c* Hong Kong Exchanges and Clearing Limited: regulates listed issuers and administers listing, trading and clearing rules; provides service, primarily at the wholesale level, to participants and users of its exchanges and clearing houses.

**iii Common securities claims**

These are:

- a* insider dealing;
- b* false trading;
- c* Price rigging;
- d* disclosure of information about prohibited transactions;
- e* disclosure of false or misleading information inducing transactions.
- f* stock market manipulation; and
- g* offences involving fraudulent or deceptive devices in transactions in securities, futures contracts or leveraged foreign exchange trading.

Sponsors are licensed by the SFC and therefore are subject to the provisions of the SFO and the various rules, codes and guidelines issued by the SFC, including the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, the Additional Fit and Proper Guidelines for Corporations and Authorised Financial Institutions applying or continuing to act as Sponsors and Compliance Advisers, the Corporate Finance Adviser Code of Conduct, the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission, as well as the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited.

As the codes and guidelines issued by the SFC do not have the force of law, any breach will not render a sponsor liable to any judicial or other proceedings. However, the SFC may take disciplinary actions against the sponsor and may impose appropriate sanctions (e.g., revocation of the sponsor's licence).

Under Sections 40 and 40A of the Companies (Winding-up and Miscellaneous Provisions) Ordinance, any person who authorises the issue of a prospectus that includes untrue statements shall be liable to pay compensation to the victims, imprisonment and a fine, unless he or she proves either that the statement was not material or that he or she had reasonable grounds to believe and did up to the time of the issue of the prospectus believe that the statement was true.

Insofar as offences of market misconduct are concerned, the general legal principles applicable to accessory liability also apply.

For disciplinary action and civil proceedings, the parties will need to prove their case on the balance of probabilities. For criminal prosecutions, the prosecution will need to prove

beyond reasonable doubt the elements of the relevant offence. Therefore, it is in general more likely that a person may be disciplined or ordered by the court to make compensation in civil proceedings.

## II PRIVATE ENFORCEMENT

### i Forms of action

Class actions are not available in Hong Kong. However, under Part 14 Division 4 of the CO, a shareholder may, with the leave of the court, bring a derivative action in the name of the company in respect of the misconduct committed against the company, or intervene in the proceedings before the court for the purpose of continuing, discontinuing or defending those proceedings on behalf of the company.

For the purpose of seeking the court's leave to bring a derivative action in the name of the company or intervene in proceedings, under Section 733 of the CO, a member needs to show that:

- a* it appears to be in the company's interests that leave be granted to the member;
- b* in the case of an application for leave to bring proceedings, there is a serious question to be tried and the company has not itself brought the proceedings; and
- c* in the case of an application for leave to intervene in proceedings, the company has not diligently continued, discontinued or defended the proceedings.

Under Section 108 of the SFO, if a person makes any fraudulent, reckless or negligent misrepresentation that induces another person to enter into or offer to enter into an agreement to acquire, dispose of, subscribe for or underwrite securities, the person who makes the misrepresentation shall be liable to pay compensation to the person who suffers pecuniary loss as a result of the misrepresentation.

Further, under Sections 281 and 305 of the SFO, if a person has engaged in or committed a market misconduct, he or she shall be liable to pay compensation by way of damages to any other person for any pecuniary loss sustained by the other person as a result of the market misconduct.

### ii Procedure

The right to bring statutory derivative actions applies to companies incorporated in Hong Kong and companies incorporated outside Hong Kong that have established a place of business in Hong Kong. Before a statutory derivative action can be brought, a member needs to first make an application to the court by issuing an originating summons to obtain leave. Once the court grants leave, the proceedings may be brought or continued in a manner similar to other civil proceedings.

To commence a civil action (including actions based on Sections 108, 281 and 305 of the SFO), the plaintiff needs to file with the court a writ of summons (if there are disputes as to facts) or an originating summons (if the facts are not in dispute).

For actions commenced by writs of summons, the parties will file pleadings in which the parties will need to state all the relevant facts and give necessary particulars.

After pleadings are closed, the parties will need to make discovery of relevant documents and prepare witness statements and expert reports (if necessary) before proceeding to trial.

For proceedings commenced by originating summons, the parties will adduce evidence by affidavits and the court will determine the matter based on that evidence. There is no automatic discovery in proceedings commenced by originating summons.

In an action before the court (whether commenced by writ of summons or originating summons), the parties may seek discovery of specific documents. A party who seeks specific discovery needs to show the existence of the document; that the party from whom discovery is sought has in his or her possession, custody or power the relevant document; that the document relates to one or more of the matters in question in the action; and that discovery of the document is necessary.

### **iii Settlements**

Derivative actions may only be discontinued or settled with the leave of the court.<sup>2</sup>

Other proceedings, such as proceedings based on contract or tort, can be settled by the parties' agreement and the agreement is not subject to review or approval by third parties. The parties are free to agree on how matters related to the action are to be disposed of, including the costs of the action.

### **iv Damages and remedies**

In general, damages are assessed to compensate the plaintiff in the action. For an action based on breach of contract, damages are payable to the plaintiff to place the plaintiff in the position as if the contract had been performed. For an action based on tort, damages are payable to the plaintiff to place the plaintiff in the position that the plaintiff would have been in had the tort not occurred.

In addition to payment of damages, the court may also grant other equitable reliefs, which include:

- a* specific performance – an order requiring the defendant to fulfil his or her contractual obligation;
- b* injunction – an order prohibiting the defendant from doing a certain act or requiring him or her to perform a certain act that he or she has failed to do; and
- c* declaration – the court declaring certain rights and obligations of the parties; for example, that the defendant has contravened a certain provision of the SFO.

## **III PUBLIC ENFORCEMENT**

### **i Forms of action**

- a* Market Misconduct Tribunal (MMT) proceedings;
- b* criminal prosecutions;
- c* SFC disciplinary proceedings; and
- d* High Court proceedings (which are remedial in nature; for example, winding up, injunction and disqualification).<sup>3</sup>

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2 CO Section 735.

3 SFO Sections 212 to 214.

Under Sections 283 and 307 of the SFO, MMT proceedings, which deal with market misconduct and are civil in nature, and criminal prosecution for market misconduct are mutually exclusive. In appropriate cases, the SFC would apply to the Court for an injunction to freeze the assets of a person who contravenes the provisions of the SFO before the MMT proceedings or criminal prosecution. This is to ensure that the relevant parties can be compensated in future.

## ii Procedure

Before enforcement action is taken, the SFC (and the HKMA – if the party being investigated is a bank) will first conduct an investigation into the matter. This involves obtaining relevant records and interviewing witnesses. If the investigation shows that there has been a contravention of the relevant legislation or any code published by the SFC, further action may be taken.

### *MMT proceedings*

The SFC may institute proceedings in the MMT concerning market misconduct by giving a written notice containing a statement.<sup>4</sup> However, the consent of the Secretary of Justice must be obtained before the institution of the MMT proceedings.<sup>5</sup>

The MMT will determine whether any market misconduct has taken place, the identity of any person who has engaged in the market misconduct and the amount of any profit gained or loss avoided as a result of the market misconduct.<sup>6</sup> The MMT may determine whether a person has engaged in market misconduct even if that person is not within the jurisdiction.<sup>7</sup>

### *Criminal proceedings*<sup>8</sup>

Criminal prosecutions for contravention of the provisions under the SFO are similar to prosecutions of other criminal offences. The defendant will first be asked to tell the court whether he or she pleads guilty or not. If he or she pleads guilty, the court will usually pass sentence the same day. If the defendant pleads not guilty, the matter has to proceed to trial.

The prosecution has the duty to provide all used and unused materials to the defendant.

A person can only be prosecuted if he or she is within the jurisdiction or is extradited from other jurisdictions.

If the defendant is not satisfied with the determination of the court, he or she may apply to review or appeal against the decision, as the case may be.

### *SFC disciplinary proceedings*<sup>9</sup>

After the SFC has completed its investigation against a person licensed with the SFC, it will decide whether to initiate the disciplinary proceeding.

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4 SFO Section 252.

5 SFO Section 252A.

6 SFO Section 252(3).

7 *Securities and Futures Commission v. C, D, E and F* (HCMP 727/2008).

8 [www.judiciary.gov.hk/en/crt\\_services/pphlt/html/mag.htm#2](http://www.judiciary.gov.hk/en/crt_services/pphlt/html/mag.htm#2).

9 SFC, 'Disciplinary proceedings at a glance: September 2011', [www.sfc.hk/web/EN/files/ENF/PDF/Disciplinary%20Proceedings%20at%20a%20Glance\\_Sept.2011.pdf](http://www.sfc.hk/web/EN/files/ENF/PDF/Disciplinary%20Proceedings%20at%20a%20Glance_Sept.2011.pdf).

If the SFC decides to bring disciplinary proceedings against a licensed person, it will issue a notice of proposed disciplinary action, which states its preliminary views on the misconduct, sanctions that the SFC is going to impose and a list of supporting documents. The regulated person will also be invited to make an explanation.

The licensed person will then have 30 days from the date of the receipt of the notice to make written representation.

Afterwards, the SFC will make its decision, which will be set out in its decision notice. The decision notice will also set out the reasoning of the decision, the effective date, the duration and the terms of any revocation, suspension or prohibition to be imposed, the terms of any reprimand under the decision and the amount of any fine that may be imposed, as well as the date by which it must be paid.

The licensed person may appeal against the SFC's decision to the Securities and Futures Appeals Tribunal within 21 days after a decision notice is served or given, otherwise the decision becomes effective after the expiry date.

For disciplinary proceedings, the licensed person who is proposed to be disciplined does not have the right to seek discovery from the SFC of documents other than those referred to in the notice of proposed disciplinary action.<sup>10</sup>

### *High Court proceedings*

Although MMT proceedings and criminal proceedings are mutually exclusive, the SFC may commence proceedings for winding up, injunction and disqualification under Sections 212, 213 and 214 of the SFO in addition to such proceedings. Proceedings under Sections 212, 213 and 214 are free-standing and not contingent or conditional on there being other substantive proceedings in train, including proceedings in the MMT or criminal proceedings before the court.<sup>11</sup>

### iii Settlements

#### *MMT proceedings*

A person who is subject to MMT proceedings may approach the SFC to seek the SFC's agreement on the facts related to the enquiry by the MMT. If both sides can reach an agreement, a statement of agreed and admitted facts will be signed, which will be provided to the MMT and the MMT will make findings based on that statement.<sup>12</sup>

#### *Criminal proceedings*

The defendant may contact the SFC (or the Department of Justice, in cases where the prosecution is conducted by the Department of Justice in the District Court or the High Court) to make a plea bargain. For example, the defendant may offer to plead guilty to particular charges in exchange for the prosecution offering no evidence in relation to other charges.

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10 *X v. Securities and Futures Commission* [2012] 4 HKLRD 296.

11 [www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=09PR74](http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=09PR74).

12 For example, see 'The Report of the Market Misconduct Tribunal into dealings in the shares of Bank of China Limited and China Construction Bank Corporation on and between 19 December 2008 to 13 January 2009', dated 7 October 2014.

*Disciplinary proceedings*

The regulated person may make a resolution proposal to the SFC and the latter has power to determine whether to accept the proposal after considering the interest of the investing public or the public interest.<sup>13</sup>

*High court proceedings*

As in other civil proceedings, the defendant may contact the SFC to discuss whether the matter can be settled. For proceedings to disqualify a director, the defendant may seek to agree with the SFC on the relevant facts. If an agreement can be reached, a statement of agreed facts will be submitted to the court for the court to decide on the length of disqualification.

**iv Sentencing and liability**

*MMT proceedings*<sup>14</sup>

The MMT may order the wrongdoer to pay to the government of the Hong Kong Special Administrative Region an amount not exceeding the amount of any profit gained or loss avoided by the person as a result of the market misconduct in question.

The MMT may also order that the person shall not, without leave of the Court of First Instance, be a director, liquidator, or receiver or manager of a corporation or acquire, dispose of or deal in any securities, etc.

Cease-and-desist and ‘cold shoulder’ orders can also be issued as civil sanctions by the MMT.

*Criminal proceedings*

If a defendant is guilty of an offence relating to dealing in securities and future contracts under Part XIV of the SFO, he or she shall be liable:

- a* on conviction on indictment to a fine of HK\$10 million and to imprisonment for 10 years; or
- b* on summary conviction to a fine of HK\$1 million and to imprisonment for three years.

In addition, the court may also order:

- a* the defendant shall not, without leave of the court, be a director, liquidator, or receiver or manager of the property or business, of a listed corporation or any other specified corporation, or acquire, dispose of or deal in any securities;
- b* any body that may take disciplinary action against the defendant as one of its members be recommended to take disciplinary action against the defendant; and
- c* the defendant pays to the government an amount not exceeding the amount of any profit gained or loss avoided by the defendant as a result of the commission of the offence in question.

*Disciplinary proceedings*<sup>15</sup>

The SFC is empowered to impose one or more of the following sanctions:

- a* revocation or partial revocation of licence or registration;

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13 SFO Section 201(3).

14 SFO Section 257.

15 Disciplinary proceedings at a glance P3.

- b* suspension or partial suspension of licence or registration;
- c* revocation of approval to be a responsible officer;
- d* suspension of approval to be a responsible officer;
- e* prohibition of application for licence or registration;
- f* prohibition of application to become a responsible officer, executive officer or relevant individual;
- g* fine (up to the maximum of HK\$10 million or three times the profit gained or loss avoided, whichever is higher); and
- h* reprimand (private or public).

#### *High Court proceedings*

Under Section 212 of the SFO, the SFC may present a petition for winding-up orders and bankruptcy orders if it appears to the SFC that it is in the public interest to do so.

Under Section 213 of the SFO, the SFC may apply to the Court of First Instance for injunctions and orders requiring the person to take such steps as the Court directs to restore the parties to any transaction to the position in which they were before the transaction was entered into.

Under Section 214 of the SFO, the SFC may apply to the Court of First Instance for an order against a person who is wholly or partly responsible for the business or affairs of a listed corporation to be disqualified and not to take part in the management of the corporation or any other corporation for a period not exceeding 15 years. The period of disqualification depends on the seriousness of the misconduct.

## **IV CROSS-BORDER ISSUES**

A number of companies listed in Hong Kong have businesses based in the PRC and their directors are also located in the PRC.

Further, under the cross-border investment channel that is known as the 'Shanghai-Hong Kong Stock Connect', investors of Shanghai and Hong Kong may trade shares listed on the other market.

The above can present difficulties to the SFC when conducting investigations against directors and other persons who may have committed wrongdoings.

In this connection, the SFC and the China Securities Regulatory Commission have signed memoranda of understanding to assist each other with their investigations.<sup>16</sup>

As mentioned above, there are difficulties in prosecuting a person who is not within the jurisdiction of Hong Kong. In such a case, the SFC may consider instituting MMT proceedings if appropriate.

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16 [www.sfc.hk/web/files/ER/MOU/ENF\\_MOU\\_October2014.pdf](http://www.sfc.hk/web/files/ER/MOU/ENF_MOU_October2014.pdf); [www.sfc.hk/web/EN/about-the-sfc/collaboration/mainland/investigatory-assistance-and-exchange-of-information.html](http://www.sfc.hk/web/EN/about-the-sfc/collaboration/mainland/investigatory-assistance-and-exchange-of-information.html).



## V YEAR IN REVIEW

According to the latest quarterly report published by the SFC,<sup>17</sup> the Enforcement Division of the SFC has undertaken the following activities for the period from April to December 2015:

<i>Enforcement activities</i>	
<i>Item</i>	<i>Amount</i>
Trading inquiries issued under Section 181	5,750
Investigations started	390
Investigations completed	327
Investigations completed within seven months (percentage)	171 (52%)
Individuals or corporations charged in criminal proceedings	12
Criminal charges laid	58
Notices of Proposed Disciplinary Action*	30
Decision Notices**	27
Individuals or corporations subject to ongoing civil proceedings	99
Compliance advice letters issued	290

\* A notice issued by the SFC, to regulated persons, that it proposes to exercise its disciplinary powers on grounds that they appear to be guilty of misconduct or not fit and proper.

\*\* A Decision Notice sets out the SFC's decision and its reasons for taking disciplinary action against regulated persons.

On 13 November 2015, the Securities and Futures (Amendment) Ordinance 2015 was passed, which:

- a* enables the SFC to provide supervisory assistance to regulators outside Hong Kong; and
- b* empowers the SFC to permit an intermediary and an individual named by the SFC to carry on essential business operations after the revocation or suspension of the intermediary's licence or registration.

<sup>17</sup> SFC, 'SFC Quarterly Report October–December 2015' ([www.sfc.hk/web/EN/files/ER/Reports/QR/201510-12/Eng/02e\\_enforcement.pdf](http://www.sfc.hk/web/EN/files/ER/Reports/QR/201510-12/Eng/02e_enforcement.pdf)), at p. 9.

**i Significant decisions**

On 6 May 2015, the SFC resolved proceedings involving the Descartes Athena Fund SPC, paving the way for about 340 overseas investors allegedly defrauded by the collapsed private hedge fund to recoup part of their investments from distribution of assets to the value of HK\$191,360,215 recovered by the SFC.<sup>18</sup>

On 27 July 2015, the SFC instituted MMT proceedings against AcrossAsia Limited, its chairman and CEO concerning late disclosure of inside information. This is the first set of proceedings in the MMT brought by the SFC in relation to the disclosure obligations imposed on listed companies under the SFO since they became effective on 1 January 2013.<sup>19</sup>

**VI OUTLOOK AND CONCLUSIONS**

The Securities and Futures (Amendment) Bill 2016<sup>20</sup> was introduced into the Legislative Council on 27 January 2016 for first reading.<sup>21</sup> The Bill aims to provide for the incorporation, registration, management, operation and regulation of open-ended fund companies.

The Securities and Futures (Short Position Reporting) (Amendment) Rules 2016 will enter into force on 15 March 2017. The amendment aims to (1) expand the scope of the short-position reporting regime to enhance the transparency and monitoring of short selling activities; and (2) empower the SFC to require daily reporting of reportable short positions by publishing a daily reporting requirement notice in a contingency situation.<sup>22</sup>

Since the statutory corporate disclosure regime under the SFO came into effect on 1 January 2013, the SFC has been proactive in investigating whether listed companies have been making timely disclosure of price-sensitive information. It is expected that in the coming year, the SFC will take more actions, in particular MMT proceedings, concerning late disclosure and non-disclosure of price-sensitive information. The SFC recently (on 29 March 2016) instituted MMT proceedings against Yorkey Optical International (Cayman) Limited (Yorkey), its chief executive officer and financial controller for late disclosure of price-sensitive information, which relates to the material losses sustained by Yorkey in the second half of 2012.<sup>23</sup>

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18 [www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/doc?refNo=15PR44](http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/doc?refNo=15PR44).

19 [www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/doc?refNo=15PR78](http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/doc?refNo=15PR78).

20 [www.legco.gov.hk/yr15-16/english/bills/b201601151.pdf](http://www.legco.gov.hk/yr15-16/english/bills/b201601151.pdf).

21 [www.info.gov.hk/gia/general/201601/15/P201601150263.htm](http://www.info.gov.hk/gia/general/201601/15/P201601150263.htm).

22 [www.legco.gov.hk/yr15-16/english/subleg/brief/2016ln039\\_brf.pdf](http://www.legco.gov.hk/yr15-16/english/subleg/brief/2016ln039_brf.pdf).

23 [www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=16PR33](http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=16PR33).

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