

LCQ2: Strengthening the regulation of the capital markets

Following is a question by the Hon Lau Kwok-fan and a written reply by the Acting Secretary for Financial Services and the Treasury, Mr Joseph Chan, in the Legislative Council today (April 21):

Question:

In February this year, the Securities and Futures Commission (SFC) and the Financial Reporting Council (FRC) concluded a new Memorandum of Understanding (MoU) to promote the collaboration between the two parties, thereby strengthening the regulation of the capital markets. According to the MoU, both parties will enhance the areas of collaboration, including case referrals, joint investigations, mutual assistance and capacity building. In this connection, will the Government inform this Council:

- (1) of the circumstances under which FRC will, upon initiating a formal investigation into a listed company, refer the relevant case to SFC;
- (2) of the details of SFC's procedure for handling cases referred to it and the law enforcement actions that it may commence;
- (3) of the scope of actions that SFC and FRC may commence, and whether it includes investigating the conduct of the boards of directors of listed companies and their members, and imposing punishments on those persons involved in non-compliance incidents; if not, of the reasons for that;
- (4) given that SFC and FRC have agreed to notify each other before preparing and issuing policies or guidelines which may bring a significant impact to the regulatory functions of the other party, of the specific examples of such policies or guidelines; and
- (5) whether, apart from concluding the MoU, SFC and FRC have other specific plans to enhance the quality of financial reporting by listed companies and the quality of audit work conducted by auditors of listed companies, and to regularly conduct performance reviews on the relevant work; if so, of the details?

Reply:

President,

My response to the various parts of the question, in consultation with the Securities and Futures Commission (SFC) and the Financial Reporting Council (FRC), is as follows:

- (1) Upon the FRC's initiation of a formal investigation into a listed

company, during the performance of its duties, if the FRC notices any matter which may fall within the regulatory remit of the SFC, the FRC will refer the matter to the SFC for consideration of appropriate follow-up actions.

(2) Upon the FRC's referral of cases, the SFC may initiate an investigation if it has reasonable cause to believe that an offence or misconduct under any of the relevant provisions of the Securities and Futures Ordinance (SFO) may have been committed. The SFC will assess the information provided by the FRC and any other relevant information. If an investigation is initiated and there is sufficient evidence to substantiate the suspected offence or misconduct, the SFC may, after taking into account legal advice and any other relevant factors, decide to take appropriate enforcement actions. The SFC will consider all factors relevant to the pursuit of its regulatory objectives set out in section 4 of the SFO and the performance of its functions set out in section 5 of the Ordinance.

(3) The scope of an investigation and the resulting enforcement actions of the SFC and the FRC, if any, will depend on the circumstances of each case. If it appears to the SFC that market misconduct, such as disclosure of false or misleading information, may have taken place, it may institute proceedings in the Market Misconduct Tribunal (Tribunal) concerning the matter. The Tribunal may make an order to disqualify a person who has been identified as having engaged in market misconduct from being a director of any company in Hong Kong. The Court of First Instance may also, upon an application made by the SFC, disqualify a person from being a director of any company in Hong Kong, if the Court is of the opinion that the business of the affairs of a listed company have been conducted in certain manners, such as involving fraud or other misconduct. If a current director of a listed company is disqualified by the Tribunal or the Court, that person will cease to be a member of the Board of Directors of the company. Whether the Tribunal or the Court will impose such an order will depend on the circumstances of the case, such as the strength of the evidence and the gravity of the misconduct concerned.

The subjects of the FRC's investigation include Public Interest Entities auditors and their registered responsible persons. In addition, the FRC may refer the relevant matter to relevant regulatory bodies for consideration of investigation or disciplinary actions against directors of listed companies as appropriate.

(4) The Memorandum of Understanding (MOU) between the SFC and the FRC provides that each party, as and when it considers appropriate and to the extent practicable and subject to applicable laws, will notify the other party of any issue that the notifying party believes may have a significant implication for the other party. This may include the development and publication of policies and guidelines. Since the MOU came into force in February this year, the two parties have not come across any situation warranting relevant notifications.

(5) The SFC and the FRC hold regular meetings to discuss issues of common interests and explore co-operation initiatives. Both regulators are keen on

collaborating more closely with a view to enhancing the audit quality and financial reporting quality of listed companies and improving corporate governance of these companies.