

SFC's Annual Report 2019/20: 10 things we learnt

DENTONS

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The Securities and Futures Commission has published its 2019/20 Annual Report setting out its strategy for upholding market integrity and supporting Hong Kong's development as a leading international financing centre.

The role of the SFC in supporting Hong Kong's position, along with London and New York, as one of the top three global financial centres continues to be critical. In a recent article, the Economist had this to say about the importance of the Commission's role as a "world-class, independent" regulator:

"Their rules require companies and financial firms in Hong Kong, especially big ones, to achieve a reasonable standard of corporate governance, and have accurate accounts and timely disclosure. Freedom of speech means firms and securities are subject to scrutiny, an essential part of the price-formation process in well-run markets".

The SFC, then, plays a crucial role in maintaining the confidence of investors worldwide in Hong Kong's capital markets.

Here are 10 things we learnt from its latest Report:

(1) Front-loaded regulation

The SFC continues to adopt a front-loaded approach to enforcement, addressing key risks by focusing on high impact cases. This means there are fewer investigations, but more of these are resulting in enforcement action: the number of investigations commenced fell once again, to 197, compared with 280 in 2017/18. However, over the same period the number of issued decisions increased to 46 (32 in 2017/18), and the number of individuals/corporations involved in ongoing civil and MMT proceedings also increased. Particular areas of focus remain shell companies, highly dilutive rights issues and GEM stocks which show extreme price volatility.

(2) Cooperation with SEHK

The SFC has worked closely with the SEHK to monitor the market and intervene using its statutory powers under the Securities and Futures (Stock Market Listing) Rules and the Securities and Futures Ordinance. In response to a recommendation from the Commission regarding SEHK's performance in listing matters, SEHK introduced a trading suspension requirement for listed companies with a disclaimer or adverse audit opinion on their financial statements.

(3) Misconduct by directors

The SFC continues to pursue directors personally for disqualification and compensation orders arising out of conduct which is unfairly prejudicial to shareholders (section 214, SFO). During 2019/20 this was extended to include ordering

the payment to a subsidiary of compensation caused by a director's misconduct. Disqualification orders obtained by the SFC currently range from three to six years. Hong Kong lacks a class action mechanism by which the victims of corporate wrongdoing can seek redress through the courts. The Commission's role in pursuing compensation therefore remains an important alternative.

(4) Timely disclosure of inside information

The three sets of proceedings commenced by the SFC in 2018 against companies and their directors/officers for late disclosure of inside information were heard by the MMT in 2019/20, in each case resulting in the imposition of fines.

(5) AML breaches

Notably, the Commission chose to highlight in this year's report various actions taken in respect of anti-money laundering related breaches. Sanctions ranged from licence suspensions to bans from re-entering the industry. We can expect the SFC to continue to focus on AML issues during its regular on-site inspections.

(6) Intermediaries and continued scrutiny of IPO sponsors

The SFC continues to trumpet its close scrutiny of IPO sponsors as one of the cornerstones of its front-loaded approach. Last year saw significant disciplinary actions taken against a number of sponsors arising out of failures in their gatekeeping roles. Actions continued in 2019/20 against IPO sponsors for failing to conduct adequate due diligence of listing applicants' customers, enquiring into the genuineness of transactions, and verifying identities of supplier and customer representatives. Once again, the Commission has reminded sponsors that those with a history of non-compliance will face closer scrutiny in future.

(7) Cooperation with Mainland authorities

The SFC entered into a memorandum of understanding with the Ministry of Finance and the CSRC on access to audit working papers for Hong Kong-listed Mainland companies.

(8) Restriction notices

Sections 204 and 205 of the Securities and Futures Ordinance provide the Commission with sweeping powers to impose restrictions on licensed entities from carrying on certain business, entering into transactions and dealing in property. Over the course of 2019/20, the SFC exercised these powers on a number of occasions. Usually, restriction notices are used to freeze assets contained in client accounts, and provide a simpler and more efficient way of doing so than having to apply to the courts for injunctions. The Commission has said that it intends to use all of the tools in its toolbox to combat wrongdoing: we can expect restriction notices to become increasingly common.

(9) Market misconduct

Section 213 of the Securities and Futures Ordinance empowers the Hong Kong courts to make a wide range of orders

against wrongdoers, including to restrain wrongful acts, to restore the status quo and to preserve property. It was held by the CFA in 2013 that these powers could be exercised, notwithstanding that a criminal court or the MMT had yet to make any finding of wrongdoing. During 2019/20, the Commission obtained injunctions under section 213 to freeze assets connected with suspected manipulation of shares in a listed company.

(10) Conflicts of interest

The SFC considers conflicts of interest to be a recurring regulatory concern. During 2019/20, the Commission fined one intermediary HK\$400 million for overcharging clients over a 10-year period through post-trade spread increases and excess charges. It fined another intermediary HK\$6.4 million for failing to comply with regulatory requirements for managing conflicts of interest. In May 2019, the SFC published a circular to licensed corporations following recent inspection findings related to client facilitation, reiterating that brokerage firms and their traders should obtain explicit client consent prior to each facilitation trade.

In summary, we can expect the SFC to continue to place great emphasis on its combination of early regulatory intervention in listing matters and close supervision of intermediaries with enforcement action against senior managers and gatekeepers.

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