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**Corporate Law and Corporate Governance: Stocktaking on Compliance and Enforcement**

**After corporate law and after enforcement: the regulation of corporate governance in Hong Kong listed companies**

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After the 1960s disturbances in Hong Kong British legitimacy rested on prosperity. The colonial government and its policy, law making and regulatory agencies co-operated in a corporatist arrangement with local capitalists and their professional and institutional associates. It extended to company and securities law making and the regulation of companies and securities. It displaced rule of law models of corporate law making and enforcement. It has intensified in the first 10 years of the Special Administrative Region and has been integrated into an international system of privatized law making and enforcement. Designated interest groups are consulted with in a systematic way and by negotiation are involved in policy and law making and their implementation and decision making. Without their agreement laws cannot be implemented. The network of relationships is traced, with their resulting delays, the soft forms of law and regulation produced and their effects on corporate governance.

The public is demanding greater inclusion, transparency and openness in our political development and policy making ... In this climate, business also needs to rethink how it handles such demands. The approach of business so far to politics has tended to be rather reactive, conservative and behind-the-scenes .... An atmosphere of suspicion and distrust, unfortunately, still prevails. Donald Tsang, Chief Secretary, Speech to the Hong Kong General Chamber of Commerce luncheon on 16 June 2004 quoted in Christine Loh, *Government and Business Alliance: Hong Kong's Functional Constituencies* (Civic Exchange, Hong Kong, August 2004) 23-24.

This is a map of the patterns of relationships around the Hong Kong Stock Exchange (HKEx). It is large and growing in numbers of listed companies and total amount of capitalization.<sup>1</sup> It undermines the greater

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<sup>1</sup> In 2004 the HKEx raised the second largest amount of equity of any stock exchange, reflecting its role in raising capital for Mainland enterprises. Andrew Sheng, Chair, SFC, 'Statement by Andrew Sheng, Chairman, Securities and Futures Commission, Legislative Council Panel on Financial Affairs (3 January 2005) [http://www.sfc.hk/sfc/doc/EN/speeches/speeches/05/05pr1\\_speech.pdf](http://www.sfc.hk/sfc/doc/EN/speeches/speeches/05/05pr1_speech.pdf) (3 May 2005) 2. In 2005 its market capitalisation made it the eighth largest exchange. In funds raised it ranked fourth after New York, London and Toronto. SFC, *Annual Report 2005-2006* (Hong Kong, SFC, 2006) 4. Sixty one IPOs raised HK\$81.7 billion. Of these 65 per cent were Mainland enterprises, H shares and red chips. 2003-2004 there were 75 which raised HK\$76.4 billion. SFC, *Annual Report 2004-2005* (Hong Kong: SFC, 2005), 3 (SFC(2)). In 2006 it raised the most equity, US\$41 billion in new listings including the biggest float in history, Industrial and Commercial Bank of China, when \$US22 billion was raised. The second largest float of 2006 was also on the HKEx, when the Bank of China raised US\$11 billion. The exchange's rise is closely connected to the rise of China. At the beginning of 2007 it had over 350 Mainland companies with a market capitalisation of US\$700 billion. Malcolm Maiden, "King Kong' Age (Melbourne) 13 January

accountability for other people's money that Sarbanes-Oxley imposed in global markets through the United States. It promotes the increasing global economic power of China in its role as intermediary adjusting and normalizing its politically controlled state owned enterprise by finding analogies for their systems of ownership and control. It adjusts their merger into other national and multinational corporations and conceals the political control which exists within them. For Hong Kong people it is the continuation of arrangements which have led to business having a vested interest in opposing more democratic government. For Australians it represents a major source of foreign investment which controls utilities and infrastructure.<sup>2</sup> It is also a competitor as a regional hub for financial industries and their employment in east Asia, a competition which it has at present won. In conflicts over the meaning of globalization it may represent the future of other democratic states. It does so as it represents a continuation of a particular hybrid past. It perpetuates a colonial arrangement between government and capital. The power of local people and their political and public institutions were diminished to promote the interests of business associated with the metropolitan state and their local supporters.

In particular the regulatory system around the exchange has little law or enforcement as these are understood in conventional models of the rule of law which represent law as a coercive force impartially applied. It represents a period after corporate law. Most listed companies, reflecting the colonial background and concern over Chinese influence after 1997, are incorporated elsewhere. In 2003 over 80 per cent of listed companies were not incorporated in Hong Kong. Frequently the business, assets and directors are not in Hong Kong.<sup>3</sup> Many are formally domiciled on Caribbean islands which are tax havens with opaque banking systems. The regulation associated with the exchange assumes a greater significance, particularly for local retail and institutional investors, unable to lobby government and regulators or threaten litigation.

### 1. Corporatist theories and Hong Kong listed companies

The small number of the entrepreneurs gives them always a certain superiority ... and even their organizations share in this advantage, because the small number of members makes it always possible for their deliberations to be kept secret, and because there is greater solidarity of interest ... . Franz Neumann, *The Rule of Law: Political Theory and the Modern Legal System in Modern Society* (original title *The Governance of the Rule of Law: An Investigation into the Practical Legal Theories, the Legal System, and the Social Background in the Competitive Society*) (Leamington Spa: Berg, 1986) 195

Corporatism is an older model of the abandonment of law in regulation of business. It focuses on interest group mediation in economic contexts.<sup>4</sup> Most definitions cluster around concepts of the conciliation of conflicting claims and interests.<sup>5</sup> Schmitter considers it to be:

a mode of policy formulation, in which formally designated interest associations are incorporated within the process of authoritative decision making and implementation. As such, they are officially

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2007) Business 1 and 'Hong Kong exchange's potential is stuff of dreams for isolated ASX' Age (Melbourne) 13 January 2007) Business 2.

<sup>2</sup> It is the fourth largest source of foreign direct investment with \$32 billion. Li Ka Shing had in 2005 \$7 billion invested in electricity and gas. Glenda Korporaal, 'Attractions down under' *Australian* (20 April 2005).

<sup>3</sup> Hong Kong, The Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure, *Report by the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure* (March 2003) [35] 10. <http://www.info.gov.hk/info/expert/expertreport-e.htm> (18 January 2007) . Siu Y Chan, Iain MacNeil and Alex KL Lau, 'The lawyers' perceptions on overseas incorporated companies listed in Hong Kong' (2001) 16 *Management Auditing Journal* (5) 290-296.

<sup>4</sup> Alan Cawson, *Corporatism and Political Theory* (Oxford: Blackwell, 1986) 22, 25. Peter Williamson, *Varieties of Corporatism: A Conceptual Discussion* (Cambridge: Cambridge University Press, 1985) 77. (The two factors that most clearly represent the nature of corporatist ideology are the socio-economic consensus and state licencing – *consensual licenced corporatism*.)

<sup>5</sup> Cawson, above n 4, 22, 25, 77, 119.

recognized by the state not merely as interest intermediaries but as co-responsible 'parties' in governance and societal guidance. Ostensibly private and autonomous associations are not just consulted and their pressures weighed. Rather they are negotiated with on a regular, predictable basis. Their consent becomes necessary for policies to be adopted; their collaboration becomes essential for policies to be implemented.<sup>6</sup>

It is the recognition of collaboration in the implementation of policies which is one of the distinctions between models of corporatism and pluralism. In pluralism interest groups are self-determined and autonomous. They are not limited in number or licensed to play a representative role.<sup>7</sup> Both deal with competitive interests seeking to influence the state and the policies and laws it adopts and enforces. Corporatism reveals the incorporation of some interest groups into the state.<sup>8</sup> It directs attention to the nature of the state which is often reduced to insignificance in other models, such as economic analysis of interest groups. In many liberal-pluralist studies interest groups are represented as free and unfettered by the state with good policy emerging from the struggle between contesting groups in which the branches of government play a limited role as umpire.<sup>9</sup> In public choice theories used in neo-classical economic models governments are recognised as making choices which do not promote public interest. They fail to notice how the interest groups remain to negotiate further about the implementation of the policies or that they are required to be involved in that implementation. Other models do look at the state. Regulatory theory used capture to consider the regulator rather than the policy makers and the legislative and executive governments. Contemporary regulatory theory has been shaped by rational choice and deterrence theories which also consider regulatory styles, resources, risk detection and possible penalties and by studies of business culture in order to foster values of responsible citizenship. They may fail to observe how the interest groups are constituted in the regulator and the executive and legislative governments. Or how regulatory theory is it self used to justify policies which discriminate between people in hard to justify ways. This is particularly so in Hong Kong where political parties are unstable and parliamentary institutions are weakened by the executive government's ability to dominate them through the manipulation of membership of the functional constituencies in the Legislative Council. In Hong Kong's circumstances the involvement of business groups in government and the bureaucracy and regulatory bodies are important and may also create new sites for corporatist arrangements.<sup>10</sup>

There is nothing new about mediation between government and business interests. Business in most states is involved in some 'close and co-operative decision-making'.<sup>11</sup> But there is something distinctive about it in the past and present in Hong Kong even though these relationships are not static over time and like many others have been affected by multinational corporations and the globalisation. In Hong Kong corporatism has produced less formal direction by the executive government than in other parts of East Asia. It more resembles corporatism in liberal western European states than more authoritarian east Asian forms.<sup>12</sup> In the financial sector it still tends to be an exclusionary corporatism, rather than the inclusionary kind seen elsewhere although that is changing in the SFC and HKEx.<sup>13</sup>

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<sup>6</sup> PC Schmitter, 'Interest intermediation and regime governability in contemporary Western Europe and North America' in Suzanne Berger (ed) *Organizing Interests in Western Europe* (Cambridge: Cambridge University Press, 1981) 295.

<sup>7</sup> Phillip C Schmitter, 'Still the century of corporatism?' [1974] *Review of Politics* 85, 97.

<sup>8</sup> Howard J Wiarda, *Corporatism and Comparative Politics: The Other Great 'Ism'* (Armonk NY: ME Sharpe, 1997), 22

<sup>9</sup> *Ibid* 5-6.

<sup>10</sup> Wiarda, above n 8, 21.

<sup>11</sup> David Johnson, 'The Canadian regulatory system and corporatism; empirical findings and analysis' (1993) 8 *Canadian Journal of Law and Society* 95, at 106.

<sup>12</sup> Anthony BL Cheung, 'New interventionism in the making: interpreting state interventions in Hong Kong after the change of sovereignty' (2000) 9 *Journal of Contemporary China* (24) 291, 294. J Unger and A Chan, 'China, corporatism, and the East Asian model' (1995) *Australian Journal of Chinese Affairs* 29-53.

<sup>13</sup> A Stepan, *The State and Society: Peru in Comparative Perspective* (Princeton: Princeton University Press, 1978) cited in Cheung, above n 12, 298 note 26.

In its colonial form corporatism blended the business elite and local executive government and legislative institutions through an extensive system of committees. Membership was jealously guarded through an appointments committee. This has continued in the SAR. The new government has tended towards greater interventionism, partly in competition with the departed British, partly through the first Chief Executive's enthusiasm for the corporatism found in other parts of Asia, and partly because of adverse economic circumstances. These threatened prosperity and the legitimacy that gave to a government which had become less democratic. The downturn also made the SAR government more dependent on the economic support of the Central Government. The older corporatism was driven by reformism within the colonial bureaucracy. It now tends to be embedded in the exogenous forces in changing institutional, political and economic conditions.<sup>14</sup> It is also now meshing with the state directed corporatism of China. The reduced democratic structures are making Hong Kong more dependent on economic and political support from the Central Government.<sup>15</sup> This can be seen at the macro level but also in the micro corporatist arrangements. For example the increasing numbers of the Hong Kong listed Mainland companies cross listed in Shanghai may make Hong Kong regulatory institutions a de facto regulator of the Shanghai exchange in a very different corporatist system which can already be seen feeding changes back into regulatory relationships in Hong Kong.<sup>16</sup>

Corporatism is distinguishable from other models used to describe one party states which have used organizations representing economic sectors to govern. Chinese and soviet socialist systems fixed the number of organizations recognised by both the party and the state in a form described as monism which could be differentiated from corporatism. Representative roles within the party and the state in these systems were granted in exchange for controls over the selection of members in these groups.<sup>17</sup> The corporatisation and privatisation of the Chinese economy with fewer changes in the political system have seen a new form of state-society relationships emerge in China, a hybrid of socialist corporatism and clientelism, or *guanxi*.<sup>18</sup> Pearson has demonstrated this hybrid pattern in her study of Chinese business. Her claim that it has deep roots in Chinese history implicitly suggests that there has been a continuity in Chinese business culture in spite of socialism.<sup>19</sup> This indicates that government and business in Hong Kong will more easily find similarities and analogies with Mainland business and firms. The government of the SAR is also ultimately controlled by the Central Government. That government's influence may be seen more in the economy than in the state because of sensitivities in Beijing to any perceived deviation from the 'two systems one country' of the Sino-British Agreement and the carefully negotiated *Basic Law*. The Central

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<sup>14</sup> Cheung, above n 12, 291.

<sup>15</sup> Ian Holliday, 'After 1997: the dialectics of Hong Kong independence' (2004) 34 *Journal of Contemporary Asia* (2) 254-270.

<sup>16</sup> Maiden (2), above n 1, 2.

<sup>17</sup> Schmitter, above n 7, 97.

<sup>18</sup> Corporatism derives from the theory of the corporate state which was popular in western Europe in the 1920s and 1930s. Functional interests, represented by corporate bodies, were being permitted to share in the making of political decisions by the state. To some extent they were usurping the role of older state institutions such as parliament. In exchange these functional groups were meant to discipline their members to support to the agreed policies. T Smith, *The Politics of the Corporate Economy* (London, 1979) K Middlemas, *Politics in a Corporate Society* (London, 1979). Clientelism refers to the relationship between an individual and a patron. It gains access to resources for the client, in exchange for support or solidarity with the patron. The influence and power of the patron depends on the clients in their network of relationships. SN Eisenstadt and L Roniger, *Patrons, Clients and Friends* (Cambridge, 1984); Caroline White, *Patrons and Partisans* (Cambridge, 1980). *Guanxi*, whatever it may mean in Chinese, describes strong personal ties based on shared and unbreakable mutual obligations which might arise out of a common experience or background. It overrides other considerations. L Pye, *The Dynamics of Chinese Politics* (Cambridge, Mass, 1981).

<sup>19</sup> Margaret M Pearson, *China's New Business Elite: The Political Consequences of Economic Reform* (Berkeley : University of California Press, 1997). Hill Gates, *China's Motor: A Thousand Years of Petty Capitalism* (Ithaca: Cornell University Press, 1996) 249. Andrew G Walder and Jean C Oi, 'Property Rights in the Chinese Economy: Contours in the Process of Change' in Jean C Oi, and Andrew G Walder (eds) *Property Rights and Economic Reform in China* (Stanford: Stanford University Press, 1999) 1, at 17, also refer to an elite in this context as hollowing out the ownership of state owned assets.

Government has stepped back from some unpopular measures and removed the unpopular first Chief Executive. The Central Government has also directed the listing of private and state-owned corporations to the HKEx which has become a major component of Hong Kong's prosperity. Significant business figures in Hong Kong have seen the opportunities for business advantages on the Mainland through assistance to provincial and central governments both in Hong Kong and the Mainland. Multinational corporations and professional firms are also sensitive to the way in which help and hindrance in the SAR can be significant in obtaining Beijing's permission and support for participation in the Mainland's economy.

The regulatory patterns about the HKEx goes beyond mediating conflicting, competitive and adversarial interests in the network of established bodies and processes. They are marked by the presence of interest groups which are officially recognized in the executive and legislative governments. They are seen as 'co-responsible.' They are negotiated with regularly. Their agreement is required for policies to be adopted. They implement the policies both through their own organisations and also provide the members of the executive government, the legislature, the SFC and the board and listing committee of the HKEx. These bodies do not comprehensively represent all interests. There were no consumer, or retail investors', representatives or representatives of broader community interest groups until recently. Their addition further legitimises the processes. Law and regulatory procedures endorsed by the legislature are also important in this legitimisation.

#### *The disappearance of formal and rational law*

A strength of corporatist analysis is its focus on rules, rule making and enforcement in relationships between the state and business. This emphasis may reflect the influence of legal analysis in its development. Weber recognised that the state and its bureaucracy had difficulties in formulating policies for business. Business had superior information which made the state bureaucracy dependent on it in policy and law making. Poor economic results from unforeseen consequences of poorly informed policy choices were also apparent.<sup>20</sup> Weber had also observed the antiformalist tendencies within law.<sup>21</sup> Neumann drew on both ideas in showing how the older formal rationalist legal order had faded in the face of the capitalist cartels and their close relationship with the state which he observed in late imperial and Weimar Germany.

Neumann accepted, perhaps too uncritically, that in the competitive capitalism of the 1800s legal norms had been exactly determined. They were as formal and as rational as possible. Judges had as little discretion as possible. They did not have recourse to legal standards such as good faith, good morals, reasonableness, or public policy. The state, if it interfered at all, had to make its interferences predictable. It could not interfere retroactively, for this would invalidate expectations. It could not intervene by individual commands as individual intervention violated the principle of equality prevailing between equal competitors.<sup>22</sup> Neumann observed that this changed as competitive forces in the economy changed from competition in efficiency to restrictive competition. In restrictive competition 'the fight is to abolish the freedom of the market or to strengthen or complete the monopoly.'<sup>23</sup> The nature of the Rechtsstaat changes with the change in the concept of law and the function of jurisdiction. Individual law 'obtains decisive importance' as the state confronts a few monopolies. It deals with these as individual facts instead of developing general norms. Legislation transfers jurisdiction to administrative branches of government from the courts:

Skeleton laws lay down only general rules and the decisive shaping of laws is left to the ministerial bureaucracy. ... This development produces an immense strengthening of the power of the executive. Legislative functions are transferred to it, while, at the same time the administrative

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<sup>20</sup> Max Weber, G Roth and C Wittich (ed) *Economy and Society* (Berkeley: University of California Press, 1978) 994.

<sup>21</sup> M Rheinstein, *Max Weber on Law in Economy and Society* (Cambridge Mass: 1954, 303.

<sup>22</sup> Franz Neumann, *The Rule of Law: Political Theory and the Modern Legal System in Modern Society* (original title *The Governance of the Rule of Law: An Investigation into the Practical Legal Theories, the Legal System, and the Social Background in the Competitive Society*) (Leamington Spa: Berg, 1986) 256

<sup>23</sup> *Ibid* 191-192.

sphere continues to expand. ... At the same time, however, bureaucracy emancipated itself from parliamentary control.<sup>24</sup>

Judges now apply individualised instructions from the legislator and laws drafted by the executive government. At the same time the monopoly economy destroys the rational character of law altogether. Legal institutes, for example, 'faith and trust', 'good manners', 'whole economy', 'public welfare', and innumerable other general clauses, become the central feature of the application of law, which is therefore naturally transformed into administrative action.'<sup>25</sup> The process reinforces itself as it is considered desirable to bring capital into even closer association with the state and integrate it. It confirms the usefulness to the state of having capital regulate, license and police their own members and the advantages of using these corporate groups to help implement government social programs.<sup>26</sup>

#### *A brief history of colonial corporatism in Hong Kong*

The corporatism seen in the regulatory system around the HKEx originates in the colonial bureaucracy's involvement with the local commercial elite in policy and law making. One pressure on the bureaucracy was the British government's insistence that the colonial budget balance so that Hong Kong was financially autonomous with a surplus providing significant reserves.<sup>27</sup> There were no local representative political institutions to pressure the colonial bureaucracy into more interventions in the economy.<sup>28</sup> In 1967 the cultural revolution spilt into the territory with protests and riots against British rule. The legitimacy of the colonial government was damaged and exposed. The colonial administration reacted with greater intrusion into the colony below the commercial elite into issues of social stability, economic diversification and capital accumulation.<sup>29</sup> It abandoned its ostensible non-intervention in the economy although the rhetoric was retained.<sup>30</sup> The bureaucracy and London now based their legitimacy on the prosperity of the people.<sup>31</sup> This required the expansion of an already extensive system of consultative committees. By the 1970s it was clear that in financial services these committees often failed to produce satisfactory regulatory policies but they were dominated by the older commercial elite. The exchange members and other participants consulted were often the beneficiaries of poor regulation.<sup>32</sup> The government also included professional elites for expertise in modifying English company and securities law to local conditions. Any significant change was already a lengthy process of reconciling competing interests. The Companies Law Revision

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<sup>24</sup> Franz Neumann, 'Rechtsstaat, the division of powers and socialism' in Otto Kirchheimer and Franz Neumann, Keith Tribe (ed) *Social Democracy and the Rule of Law* (London: Allen & Unwin, 1987) 66 at 71.

<sup>25</sup> Ibid 72.

<sup>26</sup> Schmitter, above n 7, 97.

<sup>27</sup> Cheung, above n 12, 296.

<sup>28</sup> Ibid 298-301.

<sup>29</sup> I Scott, *Political Change and the Crisis of Legitimacy in Hong Kong* (Hong Kong: Oxford University Press, 1989).

<sup>30</sup> J R Schiffer, *Anatomy of a Laissez-faire Government: The Hong Kong Growth Model Reconsidered* (Hong Kong: Centre of Urban Studies and Urban Planning, University of Hong Kong, 1983) 3.

<sup>31</sup> I Scott, *Political Change and the Crisis of Legitimacy in Hong Kong* (Hong Kong: Oxford University Press, 1989).

<sup>32</sup> In 1950 there had been 50 committees. In the 1980s there were over 200. By 1997 there were 375. Anthony BL Cheung and Paul CW Wong 'Who advised the Hong Kong Government? The politics of absorption before and after 1997' (2004) 44 *Asian Survey* (Nov/Dec) 874, 887. They note that the committee system has been little studied. They served a number of purposes tapping expert advice, stimulating business action, smoothing over politically embarrassing decisions, keeping government clients happy, ensuring the cooperation of voluntary organisations and satisfying the public that the government is doing something. They facilitated a symbiotic relationship between colonial officials and unofficials and produced a closer intermingling of 'public policy and private interests' forming a type of coalition government. N Miners, *The Government and Politics of Hong Kong* (HK: Oxford Univ Press, 5<sup>th</sup> ed 1995) 106-107.

Committee, composed of interest group representatives, was appointed in 1962. It presented its first report in 1971 which it felt the need to claim 'fairly representing informed opinion in the Colony ...'.<sup>33</sup>

This first report contained the past rhetoric of non-interventionism but was based on the processes the present corporatist arrangement in which government and the commercial elite and their professional advisors are regularly negotiated with, consent to the adoption of policies and collaborate in their implementation.<sup>34</sup> The Committee rejected the idea of a government controlled regulatory body to regulate the exchanges and their participants. There was a lot to be said in theory, it noted, for a 'formidable agency' like the US SEC but that a 'more flexible though theoretically less perfect system was to be preferred.'<sup>35</sup> It concluded:

We, too, are fully convinced that the Government should not get deeply involved in attempts to regulate and supervise stock exchanges and dealings thereon, and should confine its activities in the main to ensuring that stock exchanges take action through self-regulation to remedy abuses whenever they appear or show signs of developing.<sup>36</sup>

Some oversight was to be provided by a Securities Advisory Board of seven members including the Commissioner for Securities. The chair and other members were to be from outside government.<sup>37</sup> The non-intervention recommended by the Committee ended in 1973 when the exchanges were seen to be threatening social stability. Even monks and nuns were buying shares and amahs would only work for families who would pay them in shares.<sup>38</sup> The *Stock Exchange Ordinance 1973* (HK) was passed in February 1973 to prevent a fifth exchange, the Asia Stock Exchange, from formally opening. As it was already trading without telephones its demise was produced by the stock market crash rather than the Ordinance.<sup>39</sup> The impact of the crash led to the introduction of the first securities legislation in 1974.<sup>40</sup>

The 1988 Securities Review Committee, which investigated the regulation of listed companies in the wake of the 1987 stock market crash, found that the regime established in 1974 was ineffective. The failure of the self-regulatory system was demonstrated when Ronald Li, the retired chair of the HKSE, was charged by the Independent Commission Against Corruption under the *Prevention of Bribery Ordinance* with accepting a beneficial interest in shares in return for approving a new issue.<sup>41</sup> It reported on the consequences of the acting on the advice 17 years before of the Companies Law Revision Committee:

We found that, while the entire system had originally been based on self-regulation by the Exchanges with the support of an authoritative and impartial body to assist them in taking action

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<sup>33</sup> Companies Law Revision Committee, *First Report of the Companies Law Revision Committee: The Protection of Investors* (Hong Kong: The Government Printer, 24 June 1971). It was chaired by a representative of the Attorney-General and its members included a representative of the Deputy Economic Secretary, the Registrar General, the Hong Kong General Chamber of Commerce, the Hong Kong Branch of the Association of Certified and Corporate Accountants, the Association of Chartered Accountants in Hong Kong, the Association of the Chartered Institute of Secretaries in Hong Kong and the Law Society of Hong Kong. Subsequently a representative of the Hong Kong Bar Association was added. *Ibid* ii, v, vii

<sup>34</sup> Schmitter, above n 5, 295.

<sup>35</sup> Companies Law Revision Committee, above n 33, 92

<sup>36</sup> *Ibid* 93.

<sup>37</sup> *Ibid*.

<sup>38</sup> Siu-lun Wong and Elizabeth Sinn, *A Glimpse of the Past: Hong Kong Stock Market History project* (HK: SEHK, 1998) 19-21

<sup>39</sup> Securities Review Committee, *Report of the Securities Review Committee, The Operation and Regulation of the Hong Kong Securities Industry* (27 May 1988) 372-373 The fourth one was the Asia Stock Exchange which was registered in 1970 and opened on 18 February 1973 – although the telephones were not installed. The end of the bull market ended it rather than the Ordinance. Wong and Sinn, above n 38, 18-19

<sup>40</sup> *Ibid* 19-21

<sup>41</sup> The crash in HK and its effects are summarised in Appendix 1, Securities Review Committee, above n 39, 349-354.

themselves to curb questionable practices ... the concept of self-regulation and market discipline had failed to develop in Hong Kong. What is equally unfortunate is that, faced with this, the supervisory bodies charged with overseeing the markets had lost effective control.<sup>42</sup>

The Securities Commission and Commodities Trading Commissions 'had been relegated in recent years to a passive and reactive role.' Governments had not given them sufficient resources to be effective. Its comments on the role of the exchange showed that the government's relationship with the exchange was more important than the credibility of its own Securities Commission:

... faced recently with a determined and forceful Stock Exchange leadership, and lacking sufficient support from Government, it had lost the initiative.<sup>43</sup>

#### *The compact around the stock exchange*

The power of the HKEx is based partly on a compact which had led to the amalgamation of the four exchanges into one in another example of the corporatism which developed after 1967. In 1975 the government had proposed their unification. The exchanges publicly refused to consider it in 1976. A declining stock market removed some opposition. A working party was established in 1978 under the Commissioner of Securities but made little progress. In 1980 the government used the Legislative Council to pass the *Stock Exchange Unification Ordinance 1980* (HK). It provided a legislative incentive for the existing exchanges to combine, the removal of further competition. The new exchange would have a monopoly in the territory. An initial problem was that while all existing brokers would be permitted to apply for membership corporations, including banks, and firms were barred from membership. This ban was removed in 1982 as negotiations continued. Finally, in 1986 ten years after the negotiations had started the unified exchange opened.<sup>44</sup> The Securities Commission now found that it was effectively cut out of a regulatory role in the deals done between the government and interest groups in the creation of the new exchange. The new exchange ignored it:

at the Stock Exchange of Hong Kong, which had opened in April 1986 after the unification of four smaller exchanges, an inside group treated the Exchange as a private club rather than a public utility for the general benefit of members, investors and issuers. Its executive staff were ineffective, lacking adequate knowledge and experience to cope with the evolving and expanding securities industry, and insufficiently independent of the governing Committee. ... There were serious shortcomings in the listing arrangements.<sup>45</sup>

The Securities Commission was left underfunded and ineffective. The Securities Review Committee reported 'the supervisory bodies charged with overseeing the markets had lost effective control.'<sup>46</sup> The commission was never intended to have control.

The Securities Review Committee recommended that the two commissions be amalgamated and headed and staffed by full-time regulators. It made a number of contradictory proposals which may reflect its own involvement in negotiations with interest groups or opinion of what was possible in the corporatist arrangements. It referred back to the earlier observations of the Companies Law Revision Committee that the government should not become too involved in market regulation 'in line with its traditional free market philosophy'. The free market was now used to conceal the uncompetitive arrangements which had limited the Commission: 'Laissez faire has served Hong Kong too well for it to be abandoned altogether just because it has been ineptly used and grossly abused.'<sup>47</sup> And there was a new reason given, self regulation. The Committee claimed it to be more flexible and the only way rapid developments in markets could be

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<sup>42</sup> Ibid 3 quoting Financial Secretary, Sir Phillip Haddon-Cave, 3 January 1973, announcing the establishment of the Securities Advisory Council, the forerunner to the Securities Commission.

<sup>43</sup> Ibid 5.

<sup>44</sup> Ibid 39, 374-375.

<sup>45</sup> Ibid 3-4, 48.

<sup>46</sup> Ibid 3.

<sup>47</sup> Ibid 32.



accommodated as government regulation would stifle growth.<sup>48</sup> These were difficult to reconcile with the Committee's recommendations that the new commission 'should ensure that the exchange properly regulated its markets and should have extensive powers to intervene if they fall down on the job.'<sup>49</sup>

Changes taking place in Hong Kong which were leading to government intervention in other areas were observed by the Committee. The Committee appreciated that there was a strong local retail investment in the share market. Elsewhere this would justify stronger regulation by the state. But not in Hong Kong. In contrast to other markets it believed that small investors in Hong Kong were 'not especially risk adverse'.<sup>50</sup> The Committee saw that there had been a general failure to announce relevant information on an ongoing basis and that 'the demarcation between the public and private interests of controlling shareholders is not scrupulously respected.'<sup>51</sup> This appeared to be in part the result of the absence of requirements to disclose and the failure to disclose relevant information about material shareholdings, directors' dealings and major transactions, which caused the Committee concern. In particular there was no requirement to disclose non-arms length transactions.<sup>52</sup> The Committee thought that there should be a requirement for prior shareholder approval for major transactions although it recognised that many Hong Kong investors bought shares because they respected the business acumen of the controlling shareholder.<sup>53</sup> There should also be a code to cover directors' share trading but that it should not be as strict as the US requirement that all profits made within six months of a trade be disgorged.<sup>54</sup>

The Committee's report can be read as a strengthening of the corporatist principles which had led to the exchanges monopoly in stock markets and effective monopoly in their regulation. The Committee recognised that listing was a major problem requiring urgent attention.<sup>55</sup> Yet the government should not appoint members to the board of the exchange as this would be an unreasonable interference in its affairs. It recommended that the corporate members of the exchange be permitted to nominate members and that fund managers and listed company representatives be appointed to the board.<sup>56</sup> The committee found that the exchange had actively pushed for new listings to be underpriced and with low minimum subscriptions. It also permitted only one new issue at a time which was inflexible and led to the reactivation of shells of listed companies.<sup>57</sup> The listing department should be strengthened. It, rather than the board, should be the source of media statements.<sup>58</sup> There were too many suspensions without reasons being published. In the two years 1986-1988 231 companies had been suspended at their request. Five had been suspended at the request of the commission. This was the same number as the London Stock Exchange which had five times the number of companies listed. These problems, the Committee advised, could be remedied in part by

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<sup>48</sup> Ibid 32-33.

<sup>49</sup> Ibid 7, 231-236. It recommended that it have an advisory committee, consisting of experts and not amateurs or generalists – drawn from the Hong Kong securities industry plus a lawyer, an accountant, a representative from a listed company and perhaps someone from outside, but no one from the SEHK was to be given the commission's watchdog role. Ibid, 8-12, 237-238.

<sup>50</sup> Ibid 36. See SEHK Ltd, Shareownership in Hong Kong 1989 (Hong Kong: SEHK, 1989, 20).

<sup>51</sup> Securities Review Committee, above n 39, 312.

<sup>52</sup> Ibid 313-315. Phillip Lawton 'Directors' Remuneration Benefits and Extractions, an Analysis of the their Uses, abuse and Controls in the Corporate Governance Context of Hong Kong (1995) 4 *Australian Journal of Corporate Law* 430. Phillip Lawton, Expanding Shareholder Control in Hong Kong in *Legal Developments in China: Market Economy and Law* (Hong Kong: Sweet and Maxwell, 1996).

<sup>53</sup> Securities Review Committee, above n 39, 318-320. See Henry MK Kok, Kin Lam, Iris YK Cheung 'The unique structure of stock returns in Hong Kong' (1989) *Securities Bulletin* (March) 5 which showed that the price of shares in companies controlled by a family had similar co-movements irrespective of the industry in which individual companies were engaged. 'A Comprehensive View on Family Control over Listed Companies' [1989] *Securities Bulletin* (March) 19. Mark S Gaylord and Charles A Armitage, 'All in the family: corporate structure, business and culture and insider dealing in Hong Kong' (1993) 2 *Asia Pacific Law Review* 26.

<sup>54</sup> Securities Review Committee, above n 32, 317.

<sup>55</sup> Ibid 85.

<sup>56</sup> Ibid 50-53.

<sup>57</sup> Ibid 86.

<sup>58</sup> Ibid 87-89.

insisting that the sponsoring broker be an active participant and not just a formality.<sup>59</sup> It recommended that there should be a general review of the securities legislation of Hong Kong as a matter of urgency.<sup>60</sup> But the network of business and government around the exchange with its monopoly and right to regulate itself did not share that sense of urgency.

#### *A briefer history of corporatism in the SAR*

The corporatism created by the reformist bureaucracy were deliberately retained by the Central Government and became formally embedded in the political institutions of the SAR.

Under Article 43 of the *Basic Law* executive power is vested in the Chief Executive. While ultimately the Chief Executive is to be elected by a universal vote the initial elections have been 'in the light of the actual situation in the Hong Kong Special Administrative Region and in accordance with the principle of gradual and orderly progress'.<sup>61</sup> This has involved an Election Committee of 800 voters composed from economic and social functional sectors of Hong Kong.<sup>62</sup> The Chinese government in the period leading up to the transfer of Hong Kong pursued a strategy of using the Chinese Hong Kong business elites to counterbalance the British establishment. Often these had previously been pro-British.<sup>63</sup> The process has been described as 'the political absorption of economics' in contrast with colonial approach, 'the administrative absorption of politics'.<sup>64</sup> The most powerful of the transitional committees was the Preparatory Committee which included almost all of the twenty richest residents of Hong Kong. Beijing wanted to avoid a flight of capital. It assisted strategic companies and families with funds, including the shipping companies of the first Chief Executive.<sup>65</sup> A number of people from the business sector were appointed to national institutions including the National People's Congress and the National People's Consultative Congress.<sup>66</sup> The Hong Kong commercial elite were included in the drafting of the *Basic Law* as well as the selection of the first Chief Executive, Tung Che Wah, from their ranks.<sup>67</sup> Many retained their positions on the Election Committee for the Chief Executive.

#### *Legislative Council*

Since 2004 the Legislative Council has consisted of 60 members. Thirty are elected by geographic constituencies. Thirty are elected by functional constituencies including corporations. Legislation must be passed by a majority of both groups, The wide expansion of the franchise in functional constituencies in the final years of colonial rule was reversed in 1997 making them much more controllable by the commercial elite.<sup>68</sup> Functional constituencies originated in colonial corporatism. The constituencies with a general

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<sup>59</sup> Ibid 90-92.

<sup>60</sup> Ibid 321

<sup>61</sup> Article 45.

<sup>62</sup> One quarter are from the industry, commercial and financial sectors, one quarter from the professions, one quarter from trades unions, social services and religious sectors and the final 200 from the Legislative Council, Hong Kong members of the National Committee of the Chinese People's Political Consultative Conference People's National Congress. Annex 1, *Basic Law*.

<sup>63</sup> SK Lau, *Decolonization without Independence: the Unfinished Political Reforms of the Hong Kong Government* (Occasional Papers No 19 (Hong Kong: Centre for Hong Kong Studies, Chinese University of Hong Kong, May 1987) 36. LF Goodstalt, 'China and the selection of the Hong Kong's post-colonial elite (2000) 163 *China Quarterly* (September) 721-41. A study of 1483 committee members showed that 62 per cent were from business and professional communities and only 11 per cent from the general community. Of these 48 per cent had been active with the colonial government and 50 per cent had been involved in political parties, but not the Chinese Communist Party.

<sup>64</sup> Cheung and Wong, above n 32, 874,

<sup>65</sup> Daniel A Bell, 'Hong Kong's transition to capitalism' (1998) 45 *Dissent* (1) page 15, 17-18

<sup>66</sup> Cheung and Wong, above n 32, 883.

<sup>67</sup> AYC King, 'The Hong Kong talks and Hong Kong politics' (1986) 22 *Issues and Studies* (6), (June 1986), 52-75.

<sup>68</sup> *Legislative Council Ordinance* s 26. 'Under the last British governor the franchise for the functional constituencies had been widened to include those working them. In the period after the return to China 2.5

interest in financial regulation include the insurers, lawyers, accountants, commercial (first) (members of the Hong Kong Chamber of Commerce) and commercial (second) (members of the Chinese Chamber of Commerce) and banks and deposit taking institutions.<sup>69</sup> The financial services constituency itself consisted of stock exchange traders and members of the Chinese Gold and Silver Exchange Society.<sup>70</sup> The election of members to the Legislative Council, who had been co-opted in the earliest corporatist arrangements, increased their bargaining powers over policy and appointments by using the threat of withdrawal of support. This occurred in 1998 when a coalition led by the Liberal Party, which mainly represents big business and functional interest groups linked to it, forced the government to buy shares to support the currency and the stock market.<sup>71</sup> Companies and umbrella associations may also be entitled to vote. The smaller the electorate the more likely it is that companies will have voting rights. Larger electorates tend to have more individual voters. The banks and deposit taking institutions seat in 2004 had 219 corporate electors and no individuals. The financial services constituency had 744 corporations and 93 individuals.<sup>72</sup>

It is possible for a single controller to create a number of companies which then exercise a vote.<sup>73</sup> The criteria used to recognise umbrella groups by the Legislative Council are inconsistently applied.<sup>74</sup> There are government corporate bodies entitled to vote, including foreign governments.<sup>75</sup> The government is sensitive to a number of anomalies produced by these inconsistencies in the functional electorates. It refuses to make the electoral registers available for further analysis to determine who may be controlling corporate and umbrella votes. The functional constituency representatives are generally seen as having 'close links with tycoons and/or large business interests.' Their preservation by the Chinese government is intended to preserve a colonial status quo. Not pressing for democratic reform can be financially rewarded by Beijing.<sup>76</sup> As one tycoon observed in 2004:

Even if some local business are currying favour from Beijing, benefits received are private to those individuals and are economic in nature. It is no one's business.<sup>77</sup>

The view of the Chinese and Hong Kong governments in 2004 was that this arrangement was necessary to maintain Hong Kong's stability.<sup>78</sup>

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million voters were removed which again maximised the influence of the business sector. The editors of the *Asian Wall Street Journal*, which is not known for its socialist tendencies, commented that "the arrangement is a means of reducing public participation in the political process while stacking the next legislature with people who depend on favours from the regime in Hong Kong or Beijing and answer to narrow special interests, particularly the business elite." Bell, above n 65, 18-19.

<sup>69</sup> *Legislative Council Ordinance s 20C, 20F, 20G, 20P, and 20T*

<sup>70</sup> *Legislative Council Ordinance s 20U*. These are described in Simon NY Young and Anthony Law, *A Critical Introduction to Hong Kong's Functional Constituencies* (Hong Kong: Civic Exchange. July 2004) Appendix 3, 61-66.

<sup>71</sup> Cheung and Wong, above n 32, 894.

<sup>72</sup> Young and Law, above n 70, Appendix 7, 71.

<sup>73</sup> *Ibid* 44, 55, 57.

<sup>74</sup> *Ibid* 52.

<sup>75</sup> *Ibid* 49. The Queensland Government Office Hong Kong has membership of the Hong Kong General Chamber of Commerce and a vote. Allen & Overy, the multinational law firm votes in Industrial (First) constituency, *ibid* 48.

<sup>76</sup> Christine Loh, *Government and Business Alliance: Hong Kong's Functional Constituencies* (Civic Exchange, Hong Kong, August 2004) 23.

<sup>77</sup> Ronnie Chan, "I stand on the side of law and reason – Ronnie Chan", Letters, *South China Morning Post*, 15 May 2004 quoted in Christine Loh, above n 76, 23.

<sup>78</sup> HKSAR Government's 2004 Constitutional Law Task Force quoted Ji Penfei on submitting the draft Basic Law to the PNC on 28 March 1990: '... Hong Kong's economic development, its economic prosperity is largely attributable to the joint efforts of the trade and industrial sectors, the middle class, professionals, the working class and other sectors of society. Therefore this principle deal with a proper appropriation of political power among all sectors, with the aim of preserving prosperity and stability.' Young and Law, above n 70, 3.

### *Panel on Financial Affairs*

The Legislative Council has a Panel on Financial Affairs. In 2005 it had 17 members. Unsurprisingly its members include representatives of relevant functional electorates. It was chaired by Bernard Chan, the member for the insurance functional constituency. He was also president of the Asia Finance Group and Asia Insurance Group, a member of the Insurance Advisory Committee and also a member of the Executive Council.<sup>79</sup> The deputy chair was Hon Ronny Tong Ka-wah SC a member for a geographical constituency. He was a former chair of the Bar Association of Hong Kong.<sup>80</sup> It included seven other geographical seat holders and the members for the functional constituencies of Finance, Information Technology, Real Estate and Construction, Commercial (First), Industrial (First), Accounting, Import and Export and Financial Services.<sup>81</sup> The members from geographical constituencies in 2005 reflected the interest and knowledge, professional and business relations common in other legislative bodies a number of which relate directly, or indirectly, to the securities industry.<sup>82</sup> These links also occurred with the functional members. The Import and Export member of the committee, Wong Ting-kwong, had served as a non-executive director of the Mandatory Provident Fund Schemes Authority.<sup>83</sup> The Financial Services member is also a listed company director. He is notorious for his involvement in controversial attacks on the SFC. He was involved in one of its longer running cases involving a listed company. It ended in him being ordered to buy out public shareholders. Its shares were finally traded after a record 14 year old suspension.<sup>84</sup>

## **2. Corporate regulation in Hong Kong: the government as the committee of the whole**

### *The Chief Executive*

In mid 2005 the First Chief Executive, Tung Che-wah, resigned and Donald Tsang Yam-kuen was elected unopposed by the Electoral Committee. The Standing Committee of the People's National Congress re-interpreted the Basic Law to give him a probationary two-year rather than full five-year term.<sup>85</sup> Unlike Tung, Tsang was not from the commercial elite but he was well networked into it particularly in the late colonial and early SAR period. He had been a member of the colonial civil service since 1967. He subsequently worked in areas of trade and finance as well as the implementation Sino-British Joint Declaration. He became Financial Secretary in 1995 and was knighted by the departing sovereign. He was

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<sup>79</sup> Hong Kong, LegCo, 'Hon Bernard Chan JP' <http://www.legco.gov.hk/english/index.htm> (11 May 2005).

<sup>80</sup> Hong Kong, LegCo, 'Hon Ronny TONG Ka-wah, SC' <http://www.legco.gov.hk/english/index.htm> (11 May 2005) 11.

<sup>81</sup> Hong Kong, LegCo, 'Panel on Financial Affairs' <http://www.legco.gov.hk/english/index.htm> (11 May 2005).

<sup>82</sup> Two are solicitors, one was a trade union official, one a journalist who had been chair of the journalists' professional association, another whose working background was not revealed had served on a number of government boards and committees, one company director of listed companies and a publisher and investor who had served on the SFC's shareholders advisory group. See the biographies on members, Hong Kong, LegCo, 'Members' at <http://www.legco.gov.hk/english/index.htm> (12 May 2005).

<sup>83</sup> Hong Kong, LegCo, 'Hon WONG Ting-kwong BBS' <http://www.legco.gov.hk/english/index.htm> (12 May 2005).

<sup>84</sup> Hong Kong, LegCo, 'Hon CCHIM Pui-chung' <http://www.legco.gov.hk/english/index.htm> 12 May 2005.

Mr Chim had been a broker. He was convicted in 1998 of conspiring to forge share documents and sentenced to one year imprisonment leading to him forfeiting his legislative Council seat. His campaign was aimed at helping small brokers who are squeezed by large and medium sized broker firms. He is famously out spoken. Enoch Yiu 'From Legco to; prison and back; Chim Pui-chung reclaims seat with a resounding win' *South China Morning Post* (14 September 2004) 5. Jane Moir, 'Chim lashes out at SFC' *South China Morning Post* (9 December 1998). Jane Moir, 'Chim ordered to make \$143m Mandarin offer' *South China Morning Post* (22 July 2000).

<sup>85</sup> Interpretation of Paragraph 2, Article 53 of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China by the Standing Committee of the National People's Congress Adopted at the 15 th Session of the Standing Committee of the Tenth National People's Congress on 27 April 2005

significant in managing the financial crisis of 1997. In 2001 he became Chief Secretary.<sup>86</sup>

Even at this level a ubiquitous committee composed of business representatives exists, the Chief Executive's Council of International Advisers. It links the Chief Executive directly with multinational corporations. Tung established it in 1998. It is the only advisory body which the Chief Executive heads. One of the members' mandates is to advise on the measures which Hong Kong should take to enhance its role as a financial and commercial centre. It meets only once a year. The Chinese premier and vice-premier have sometimes attended, partly to motivate other members to turn up.<sup>87</sup> The members are senior officers of multinational corporations including major banks and financial firms.<sup>88</sup> It lacks transparency and potentially provides an opportunity for members to seek benefits. Its advice is rated as being the same as that of '[l]ate-night noodle sellers at street stalls.'<sup>89</sup>

### *Executive Council*

The Basic Law requires the Chief Executive to consult ExCo on important policy matters including proposed legislation, subordinate legislation and dissolving the LegCo. It has been described as 'not a real cabinet, but an aggrandized advisory body that gives the government a semblance of cross-sector support.'<sup>90</sup> ExCo consisted of the 13 Secretaries who were official members and 15 un-official members. Membership is restricted to Chinese citizens who are permanent residents of the SAR with no right of abode in a foreign state. This excludes many members of the Hong Kong business community. Still many of the unofficial members are drawn from the commercial sector and are directors of large corporations. In the colonial period the Hongkong and Shanghai Bank once had a de facto seat.<sup>91</sup> In 1997 Tung established task forces led by members of the Executive Council, members who had direct financial interests in commercial developments they were overseeing.<sup>92</sup> This challenged the established role and power of the civil service. Under Tsang the Executive Council has reverted to the model used under British rule.<sup>93</sup>

Two members of ExCo have significant interests in securities regulation. Jasper Tsang Yok-sing is a full time Legislative Councillor and non executive director of the SFC. He is also a member of the ICAC Complaints Committee and a member of the Chinese People's Political Consultative Conference, described

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<sup>86</sup> 'Chief Executive, Biography' <http://www.ceo.gov.hk/eng/biography.htm> (15 January 2007).

<sup>87</sup> Tont Latter, 'Money well spent?' *South China Morning Post* (11 November 2004) 17.

<sup>88</sup> The 2004 meeting was a two day meeting in Hong Kong and Guangzhou. In Guangzhou it was hosted by a member of the Political Bureau of the Communist Party of China Central Committee and the Secretary of the Guangdong Provincial Party Committee, Zhang Dejiang. The group has the chair of the supervisory board of Siemens AG, the group of HSBC Holdings plc, the president and co-CEO of Power Corporation of Canada, chair of the supervisory board of DaimlerChrysler AG, the chairman and CEO of Suez, group managing director of the Royal Dutch, chair of BP plc senior adviser to the Bank of Tokyo-Mitsubishi Ltd, and the honorary chair of Toyota Motor Corporation. Chief Executive, 'CE and international advisers meet in Guangzhou' (4 November 2004) <http://www.info.gov.hk/gia/general/200411/04/1104147.htm> (15 January 2007).

<sup>89</sup> Lachlan Colqhoun, 'Why Hong Kong's chief is talking the wrong language' *Evening Standard* (London) (22 January 1999) 41.

<sup>90</sup> Christine Loh, 'Hong Kong's Relations with China: The Future of "One Country, Two Systems' *Social Research* (2006) 73 *Social Research* (April) 293.

<sup>91</sup> Bell, above n 65, 19-21. Before elected geographical constituencies were introduced in 1991 non-official members had been appointed to both Legco and Exco to augment rather than limit government power. Members from both councils worked on joint committees related to the main activities of government. They were assisted by the Office of Members of the Executive and Legislative Councils. The system broke down as the LegCo started its own panels and barred ExCo members from them as their appointment was 'undemocratic'. The Governor ended the overlapping appointments to LegCo and ExCo in 1992. Cheung and Wong, above n 32, 890-892.

<sup>92</sup> John Ridding, 'Tung attacked on task force appointment' *Financial Times* (25 March 1997)

8. Leung Chun-ying, 43, a property developer headed a new task force on housing. Bruce Gilley, 'The men who matter' *Far Eastern Economic Review* (3 April 1997) 20.

<sup>93</sup> Loh, above n 90, 293.

as a 'community activity' rather than 'public service'.<sup>94</sup> A recent appointee is Laura Cha, a former deputy chair of the SFC and the CSRC. A lawyer, she was in 2006 an independent director of the HKEx as well of the Hongkong and Shanghai Banking Corporation Ltd and Bank of Communications and other companies which were also listed on the HKEx. She was also Vice Chairman, International Advisory Council of the CSRC.<sup>95</sup> Other non-official members included two bankers, a land developer, an accountant and two lawyers. Their representativeness was broadened with a performing arts teacher, a political science professor and a trade unionist who is also a member of the People's National Congress. A number were directors of listed companies.<sup>96</sup>

#### *Financial Secretary and Secretary for Financial Services and the Treasury*

A system of secretaries, who head departments and devise policy, was created in the early 1970s by the British government in the early 1970s on the advice of McKinsey, the consulting firm,<sup>97</sup> At present below the Chief Executive are two Secretaries, the Chief Secretary and the Financial Secretary, who co-ordinate policy activities and the other 11 secretaries of bureaux. The role of the Financial Secretary is to have a broad policy and governance oversight of the financial, economic and employment sectors. The Secretary for Financial Services and Treasury, the director of the bureau with the same name, has to formulate, initiate, formulate, implement and monitor policies in respect of the financial markets. The Secretary is assisted by two Permanent Secretaries. One has particular responsibility for financial services and the other for the treasury.<sup>98</sup> They all share responsibility for Article 109 of the Basic Law in providing an appropriate economic and legal environment to maintain Hong Kong as an international financial centre.

In 2005 the new Chief Secretary, the Financial Secretary and the Secretary for Financial Services and Treasury all had backgrounds which networked them into Hong Kong industry and finance as well as government.<sup>99</sup> The Financial Secretary, Henry Tang Ying-yen, was a member of the Executive Council. He was appointed as a member of LegCo on joining the government as Secretary for Commerce Industry and Technology and was a member from 1991 to 1998. Prior to this he was 'a leading industrialist' and also Chairman of the Federation of Hong Kong Industries from 1995 to 2001 as well as a Steward of the Hong Kong Jockey Club.<sup>100</sup> He has emphasised the reform and support for the capital market as one of the keystones of Hong Kong's economy.<sup>101</sup>

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<sup>94</sup> Hong Kong, Exco, 'The Honourable Jasper TSANG Yok-sing GBS JP' <http://www.ceo.gov.hk/exco/eng/members.htm#lcha> (12 January 2007).

<sup>95</sup> The other companies were Johnson Electric Holdings Ltd and Baoshan Iron & Steel Co Ltd. She was also an advisor to the Investor AB, a Swedish conglomerate with a financial services arm. Hong Kong, ExCo, 'The Honourable Laura M Cha SBS JP' <http://www.ceo.gov.hk/exco/eng/members.htm#yystsang> (12 January 2007). Hong Kong, Exco, Register of Interests of Members of the Executive Council Laura M Cha' (20 June 2006). Available at <http://www.ceo.gov.hk/exco/eng/interests.htm> (12 January 2007).

<sup>96</sup> Hong Kong, ExCo, 'Executive Council' <http://www.ceo.gov.hk/exco/eng/members.htm> (12 January 2007)

<sup>97</sup> Bell, above n 65, 19.

<sup>98</sup> Robert G Kotewall & Gordon C K Kwong, *Report of the Panel of Inquiry on the Penny Stocks Incident* (September 2002) 24.

<sup>99</sup> The Chief Secretary had been Secretary for Financial Services from 1995-2000. In that year he resigned to become the managing director of the Mandatory Provident Funds Scheme Authority. He became a director of a number of local listed companies and a steward of the Jockey Club. Hong Kong, Chief Secretary for Administration's Office, 'Mr Rafael Hui Si-yan GBS JP Chief Secretary for Administration, Hong Kong Special Administrative Region' <http://www.info.gov.hk/info/cs.htm> (15 January 2007).

<sup>100</sup> Hong Kong, Financial Secretary's Office, 'Mr Henry Tang GBS JP Financial Secretary Hong Kong Special Administrative Region' <http://www.info.gov.hk/info/fs.htm> (13 May 2005). Hong Kong, Register of Interests of Members of the Executive Council Mr Henry Tang' (26 June 2006). Available at <http://www.ceo.gov.hk/exco/eng/interests.htm> (12 January 2007)

<sup>101</sup> Hong Kong, Financial Secretaries Office, 'Press Release: Speech delivered by the Financial Secretary at a luncheon Hong Kong Capital Markets Association, the Hong Kong Association of Corporate Treasurers

Frederick Ma Si-hang, the Secretary for Financial Service and the Treasury, before appointment in 2002 had been Group Chief Financial Officer of PCCW Ltd, the local telephone utility controlled by Richard Li Tzar-kai. He was also at the time an executive director and member of the Executive Committee of the Group, a Li Ka Shing family controlled company. He had previously worked in international financial centres for multinational firms including JP Morgan Private Bank, Chase Manhattan Bank, Kumagai Gumi (Hong Kong) Ltd and RBC Dominion Securities Limited. He had been a director of both the SFC and the HKEx and counted both as public service.<sup>102</sup> The Secretary was assisted by two permanent secretaries, one for treasury and one for financial services. The permanent secretary for financial services was assisted by a deputy secretary, a principal assistant secretary and two assistant secretaries with significant responsibilities for securities.<sup>103</sup> They had had regular meetings with market participants since 1995 and monthly lunches with the Hong Kong Stock Brokers Association.<sup>104</sup> In July 2001 the Secretary moved to the Central Government Offices in Central leaving the Bureau staff at Admiralty. This ended considerable informal contact between the Secretary and these civil servants producing some misunderstandings and miscommunications between the Bureau and the Secretary over stock exchange regulation.<sup>105</sup>

### *Central Policy Unit*

The Central Policy Unit, established in 1989, is one of the key bureaux in the government. It assists the Chief Executive draft the annual Policy Address. It also assists key secretaries including the Financial Secretary in 'cross bureaux' activities. It 'has a broad network of contacts and consults different experts, scholars, and in particular its part-time Members before tendering policy advice.' It funds particular consultancies and 'assesses public opinion for the Government's reference in decision making, though public opinion polls, focus group discussion, social networking and dialogue.'<sup>106</sup> A number of the part time members are from the securities industries and the professions which service it.<sup>107</sup> It was involved in the listing of Chinese private firms in Hong Kong.<sup>108</sup> It is also active in facilitating other economic planning with the Mainland including the effects on Hong Kong of central state planning and Hong Kong's position in national and provincial Five-Year Plans.<sup>109</sup> With the Commission on Strategic Development it has proposed that more 'experts and talented people' were needed to maintain Hong Kong's international status. Some of its members have suggested the liberalisation of the listing rules 'to encourage growth of the equity market.'<sup>110</sup>

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and the Hong Kong Society of Financial Analysts today (April 13)' <http://www.info.gov.hk/gia/general/200504/13/04130168.htm> (13 May 2005).

<sup>102</sup> Frederick Ma Si-hang, Secretary for Financial Service and the Treasury, *The Development and Future Challenges of HK's Securities Market* <http://www.fstb.gov.hk/eng/sfst/fstb15.html> 2 May 2005)

<sup>103</sup> Kotewall and Kwong, above n 98, Annex 4.1.

<sup>104</sup> Ibid 30.

<sup>105</sup> Ibid 28.

<sup>106</sup> Hong Kong, Central Policy Unit, 'About CPU' <http://www.info.gov.hk/cpu/english/about.htm> (13 May 2005).

<sup>107</sup> Hong Kong, Central Policy Unit, 'Central Policy Unit Organisation Chart Part-time Members of the Central Policy Unit' <http://www.info.gov.hk/cpu/english/parttime.htm> (13 May 2005).

<sup>108</sup> Hong Kong, Central Policy Unit, *Study of Mainland Policies and Practices to Facilitate Private Enterprises in Setting Up Business in Hong Kong* (8 October 2004) (in Chinese). Available at [http://www.cpu.gov.hk/english/research\\_reports.htm](http://www.cpu.gov.hk/english/research_reports.htm) (12 January 2007)

<sup>109</sup> Hong Kong, Central Policy Unit, 'Economic Summit on "China's 11th Five-Year Plan and the Development of Hong Kong"' (press release 23 August 2006), Available at [http://www.cpu.gov.hk/english/new\\_press.htm](http://www.cpu.gov.hk/english/new_press.htm) (12 January 2007)

<sup>110</sup> Denise Hung, 'Hong Kong urged to attract more experts' *South China Morning Post* (6 October 2006) 2; Tony Chan, 'CSD committee expounds HK's roles in country' *China Daily* (Hong Kong Ed) (10 February 2006) 2; Albert Au Yeung, 'Ask what you can do for your country' *China Daily* (Hong Kong Ed) (3 November 2006) 2

### 3. Securities and Futures Commission

The SFC has an established and well-oiled consultation network – the Commission itself, the Shareholders Group and the Advisory Committee. Robert G Kotewall and Gordon C K Kwong, *Report of the Panel of Inquiry on the Penny Stocks Incident* (September 2002) 85.

The Securities and Futures Commission (SFC), an independent statutory body, was established in 1989 by the Securities and Futures Commission Ordinance (SFCO). It followed the report of the 1988 Securities Review Committee, which had investigated the regulation of listed companies after the stock market crash of 1987. It found that the exchange had abused its self-regulatory powers and that the former Securities Commission was powerless and ineffective in dealing with the exchange.<sup>111</sup> In 2005 the SFC, in spite of claims to be the principal statutory regulator,<sup>112</sup> the SFC still appeared to be weak in face of the power of the HKEx.

#### *The board of SFC*

The board of the SFC in 2005 consisted of five executives and seven non-executive directors as indicated in Table 3.<sup>113</sup> The two executive chairs who succeeded each other in 2005 had had limited connections with Hong Kong before their appointment. One chair retired after seven years service. He had been recruited from the Hong Kong Monetary Authority where he had managed the reserves for five years. He had previously been a senior manager of the World Bank and had held various positions with the Central Bank of Malaysia. Since retiring he has been appointed as Convenor of the International Council of Advisors to the CBRC, to the Board of of the Qatar Financial Regulatory Authority as well as academic positions in universities in Malaysia and China.<sup>114</sup> He was replaced by the recently appointed executive director responsible for the supervision of markets. He had been deputy chief executive LSE and had served on its board for six years and been with it for 18 years.<sup>115</sup> His may have been a short term appointment while legislation was passed to turn the chair into a part-time non-executive and make the chief operating officer the chief executive officer, following the practices of business corporations.<sup>116</sup> The executive director and chief operating officer had had lengthy appointment with investment banking with the HSBC.

The executive directors at the beginning of 2005 were all lawyers. One had been a legal academic after working for corporate commercial firms in HK and New York. She had had a large part in drafting the SFO. Another had been a lawyer with an international law firm and was involved in activities of the Law Society and the final one had been an employee of the Australian National Companies and Securities Commission. When he left he was replaced by the director who became the new chair.

The board has a majority of independent directors, appointed by the government, which the SFC states 'ensures independent supervision of the Commission's executive functions.'<sup>117</sup> They have access to senior staff and can seek independent professional advice at the expense of the SFC.<sup>118</sup> They not only represent interests associated with the HKEx but also of core economic activities in Hong Kong. Two represented property companies although the listed companies had other interests in finance and technology. One was a

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<sup>111</sup> The crash in HK and its effects are summarised in Appendix 1, Securities Review Committee, *Report of the Securities Review Committee, The Operation and Regulation of the Hong Kong Securities Industry* (27 May 1988) 349-354

<sup>112</sup> Kotewall and Kwong, above n 98, 19.

<sup>113</sup> Unless otherwise indicated the source of the information here comes from Table 3.

<sup>114</sup> <http://www.andrewsheng.net/biodata.html> (17 January 2007)

<sup>115</sup> SFC, *SFCAlert* (19 October 2005) [www.sfc.hk/sfc/doc/EN/speeches/public/newsletter/05/sep\\_oct05.pdf](http://www.sfc.hk/sfc/doc/EN/speeches/public/newsletter/05/sep_oct05.pdf) – (17 January 2007)

<sup>116</sup> SFC, above n 1, 14. In 2005 the *Securities and Futures (Amendment) Bill* to break up the role of chair and CEO was passed. In future the chair will be a non-executive leads on direction and policies and a CEO will be responsible for the day to day operations of the Commission

<sup>117</sup> SFC(2), above n1, 14. 'NEDS play an important role in ensuring that the Commission is accountable and transparent by chairing and participating in various Commission committees ...' Ibid 15, 25.

<sup>118</sup> Ibid.



director of an unlisted corporate planning and development company specialising in equity investment and divestment. Four were directors of listed companies although this was not disclosed by the SFC.<sup>119</sup> Of the others one represented a major international accounting firm another the senior commercial bar. One was a professor of economics. The final member was also a government party member of LegCO, ExCO and the Chinese People's Political Consultative Council. This group also represented other interest groups with which they were affiliated including the Hong Kong General Chamber of Commerce, the General Committee of Hong Kong Industries and the Real Estate Developers Association. This will be seen in many regulatory systems.

What is distinctive to Hong Kong is the illustration of how the advisory committee structure created to legitimise the colonial government continues to be interlock business and government along a lengthy boundary. Between them they were members of 19 committees.<sup>120</sup> There was, surprisingly, only one steward of the Hong Kong Jockey Club revealed which is an unofficial position held by many senior people in government and business. Only one revealed an involvement with the HKEx, membership of the Listing Committee. This indicates a clear demarcation between the SFC and the HKEx.

#### *The SFC's committees and advisory groups*

The SFC has two committees which are significant in forming part of the network of committees linking Hong Kong Government and business have large majority of external members on them.

One is the Advisory Committee which must meet four times each year which is created by s 7 of the SFO.<sup>121</sup> It advises the SFC on any matter of policy regarding the performance of its functions. It includes the Chair and two other executive directors, the chief operating officer and in 2005 one executive director.<sup>122</sup> It was here the SFC and HKEx met with the chief executive and one independent non executive director of the HKEx serving on it. In 2005 the members appointed by the Financial Secretary consisted of the chair of a listed publishing company, one listed property company, one local and one Mainland sharebroking company, two multinational commercial banks and one listed local commercial bank. Two members represented the asset management arm of the HSBC which is also listed on the HKEx. The final two members were the CEO of Civic Exchange, a Hong Kong public interest group and research centre and a representative of the Hong Kong General Chamber of Commerce.<sup>123</sup>

The other is the Public Shareholder Group 'with a largely external membership drawn from the market.'<sup>124</sup> It is an indicator of the inclusive nature of more recent corporatism.<sup>125</sup> It is designed to represent the views of retail and institutional investors, market commentators, advocates of investors' rights, academics and a representative from the Consumer Council. It meets about five to eight times a year. In particular it advised

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<sup>119</sup> Hang Lung Group, 'Profile of directors' [http://www.hanglung.com/hlg\\_contents.asp?articleid=1579](http://www.hanglung.com/hlg_contents.asp?articleid=1579) one member did not list his directorship of a listed company

<sup>120</sup> They were the: Exchange Fund Advisory Committee, Judicial Salaries and Conditions of Service, Mandatory Provident Fund; Board of Review (Inland Revenue Ordinance): Advisory Committee on Legal Education: Hong Kong Port Development Council: Hong Kong Council for Academic Accreditation; Council of Advisors on Innovation and Technology; Barristers Disciplinary Tribunal Panel; Commission on Strategic Development; Member, Steering Committee on Innovation and Technology. Hong Kong Committee on Pacific Economic Co-operation; Independent Commission on Remuneration for Members of the Executive Council and the Legislature of the HKSAR; Skills Upgrading Scheme Steering Committee; Manpower Development Committee; Land and Building Advisory Committee; Hong Kong Institute for Monetary Research of Hong Kong Monetary Authority; ICAC Complaints Committee; and the Disaster Relief Fund Advisory Committee.

<sup>121</sup> SFC, above n 1. 110. SFC(2), above n1, 144. *Securities and Futures Ordinance* s 7.

<sup>122</sup> See Table 2.

<sup>123</sup> SFC, above n 1, 144. Kotewall and Kwong, above n 98 Annex 4.14 A20.

<sup>124</sup> SFC, Above n1, 14.

<sup>125</sup> Stepan, above n 13, 298 note 26.

on the regulation of sponsors and independent financial advisors, the Financial Reporting Council Bill and proposals on changes to the prospectus regime.<sup>126</sup>

There were other committees which were involved in exercising powers of the SFC. The non-executive directors 'play an important role in ensuring that the Commission is accountable and transparent by chairing and participating in various Commission committees.' Almost all committees had external representatives on them.<sup>127</sup> The committees with their external members can lead to similar inconsistencies seen in the listing decisions of the HKEx.

Takeovers and Mergers Panel which administers the Code on Takeovers and Mergers<sup>128</sup> In 2004 it was involved by the SFC in proposed amendments to the Code.<sup>129</sup>

Takeovers Appeal Committee which reviews penalties of the Takeovers and Mergers Panel to determine if they are unfair.<sup>130</sup>

Committee on Unit Trusts which authorises collective investment schemes.<sup>131</sup>

Committee on Investment-Linked Assurance and Pooled Retirement Funds which authorises such schemes.<sup>132</sup>

Committee on Real Estate Investment Trusts which advises on relevant policies and regulatory issues.<sup>133</sup>

Investors Compensation Fund Committee which administers the Investor Compensation Fund under Part XII of the Securities and Futures Ordinance.<sup>134</sup>

Investor Education Advisory Committee.<sup>135</sup>

Academic and Accreditation Advisory Committee which approves courses and examinations for licencing requirements.<sup>136</sup>

SFC Dual Filing Advisory Group.<sup>137</sup>

SFC (HKEC Listing) Committee which exercises the powers of the Main Board and GEM Listing Committees where there are real or potential conflicts of interests.<sup>138</sup>

#### *External review bodies*

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<sup>126</sup> SFC, above n1, 44. SFC(2), above n1,37, 148.

<sup>127</sup> SFC, above n1, 15.

<sup>128</sup> It met four times in 2004-2005 and only twice in 2005-2006. SFC, above n1, 44 and SFC(2), above n1,144.

<sup>129</sup> Ibid 35.

<sup>130</sup> It did not meet in 2004-2005 or 2005-2006. SFC, above n1, 145. SFC(2), above n1,145.

<sup>131</sup> It met three times in 2004-2005 and twice in 2005-2006. SFC, above n1, 145. SFC(2), above n1,145.

<sup>132</sup> It did not meet in 2004-2005 or 2005-2006. SFC, above n1, 146. SFC(2), above n1,146.

<sup>133</sup> It met twice in both 2004-2005 and 2005-2006. SFC, above n1, 146. SFC(2), above n1,146.

<sup>134</sup> It is the successor to the Securities Compensation Fund Committee and Futures Fund Compensation Fund Committee which relate to compensation claims before 2003. SFC, above n1, 147.

<sup>135</sup> It met three times in both 2004-2005 and 2005-2006. SFC, above n1, 148. SFC(2), above n1,147.

<sup>136</sup> It met twice in both 2004-2005 and 2005-2006, SFC, SFC, above n1, 148. SFC(2), above n1,148.

<sup>137</sup> SFC, SFC, above n1, 149. SFC, SFC(2), above n1,148

<sup>138</sup> It did not meet in 2003-2004, 2004-2005 or 2005-2006. SFC, *Annual Report 2003-2004* (Hong Kong: SFC, 2004). SFC(2), above n1. SFC, above n1, 149.

The SFC is subject to a number of external review and control processes some of which are more formal than others. These review bodies provide an opportunity for interest group members to participate in the regulation of the regulator and so represent a closer integration of industry and government. There are also a large number of checks rather than balances on the SFC which are a major issue in new policy developments. These seem better adapted to defend the interests of industry participants than consumers.<sup>139</sup>

The Chief Executive can give the SFC a written direction on the performance of its regulatory functions if this is in the public interest.<sup>140</sup> The SFC must consult with the Secretary for Financial Services and Treasury in exercising particular powers.<sup>141</sup> The ICAC has also conducted reviews of the SFC's practices and procedures. The last of these was in 2004 into corruption prevention in the performance of its listing related functions.<sup>142</sup> Officers from ICAC have also been seconded to the SFC. There were also two complaints to the Ombudsman in 2005-2006.<sup>143</sup>

In 2000 the Chief Executive established the Process Review Panel to review the SFC's internal market regulation processes. It consists of 12 members. Nine are from the financial sector, accountancy law and academia. Three ex-officio members include the Secretary for Justice (or nominee), the SFC chair and a non-executive director of the SFC. It investigated a number of issues in 2005-2006 including the settlement of disciplinary cases, issuing of warning letters and dual filing cases.<sup>144</sup> In the previous year it had investigated investigations and disciplinary action.<sup>145</sup> There is concern that it has not examined cases where the SFC failed to take action following public complaints.<sup>146</sup>

A number of regulatory decisions mainly affecting intermediaries can be subject to merits review by the Securities and Futures Appeals Tribunal. It is chaired by a judge of the Court of First Instance of the High Court appointed by the Chief Executive on the recommendation of the Chief Justice. The chair recommends two other 'market representative' members of a panel of 21 people appointed by the Chief Executive to the Secretary for Financial Services and the Treasury for appointment to particular panels.<sup>147</sup> There were 17 applications lodged in 2005-2006 and six were carried forward from 2004-2005. Three were determined, three were withdrawn and eleven were still pending in mid 2006. The Tribunal replaced the Securities and Futures Appeals Panel which had heard complaints against intermediaries. It was disbanded after hearing its last cases.<sup>148</sup> In 2004-2005 the Tribunal was criticised for not being able to review on the merits and the need for greater industry participation in it. The SFC rejected these criticisms. It claims that the Tribunal does review on the merits and the only times when there are no market representatives is when the appellant asks for a judge to sit alone.<sup>149</sup> The existence of the Tribunal has led to the High Court refusing judicial review of SFC decisions for the discretionary reason that there is an alternative statutory form of review.<sup>150</sup>

#### *Internal divisions within the SFC*

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<sup>139</sup> Financial Services and Treasury Bureau, *Consultation Conclusions on Proposals to Enhance the Regulation of Listing* (26 March 2004) <http://www.fstb.gov.hk/fsb/ppr/consult/index.htm> (18 January 2007). Appendix D A12.

<sup>140</sup> SFC, above n 1, 21. Kotewall and Kwong, above n 98, 17-18.

<sup>141</sup> SFC, above n 1, 21.

<sup>142</sup> SFC, Above n 1, 21. SFC(2), above n1, 20.

<sup>143</sup> SFC, above n1, 21.

<sup>144</sup> Ibid 20.

<sup>145</sup> SFC(2), above n1,19.

<sup>146</sup> SFC, *Follow up actions to LegCo Panel of Financial Affairs Meeting on 3 April 2006 Regulation of market misconduct* (LC Paper No. CB(1)1376/05-06(01)).

<sup>147</sup> SFC(2), above n1 The Tribunal also hears appeals from Investor Compensation Company and the Hong Kong Monetary Authority.

<sup>148</sup> SFC, above n1, 20, 68. In the previous year there were 20 appeals lodged, five were determined, eight withdrawn and seven were in progress in at the end of the year. SFC(2), above n1,19, 62.

<sup>149</sup> SFC(2), above n1, 64.

<sup>150</sup> SFC(2), above n1, 75. Hartmann *J Berich Brokerage Ltd v Securities and Futures Commission* [2005] HKCFI 30 (21 January 2005)

The key divisions within the SFC dealing with corporate governance issues are:

Corporate Finance. This listed as its four highest priorities the administration of the takeovers and share repurchase codes, investor protection and corporate governance, oversight of the SEHK's listing functions and reviewing and recommending changes to the listing rules.<sup>151</sup> In 2004-2005 it worked with the HKEx on its Code of Corporate Governance Practices and on its own Corporate Governance Report.<sup>152</sup>

Enforcement. It described its role as monitoring irregularities, inspecting books and records of listed companies where impropriety is suspected and enforcing law relating to the securities industry.<sup>153</sup> In 2005-2006 it reported 24 matters to the Police Commercial Crime Bureau and assisted ICAC in one prosecution. This led to the imprisonment of a former general manager of a listed public company. It reported three other cases to ICAC.<sup>154</sup> In 2004-2005 it had reported 31 cases to the police.<sup>155</sup> It successfully prosecuted one company and one of its directors for providing false or misleading information to the public which led to both being fined HK\$50 000.<sup>156</sup> In that year it also had ICEA Capital Limited, which had sponsored the listing of Euro Asia Agricultural (Holdings) Company Limited, pay penalties of HK\$30 million without admission of liability.<sup>157</sup>

In respect of corporate governance issues in listed companies the Corporate Finance Division is largely responsible for overseeing the HKSE's listing related functions. The Enforcement Division is responsible for instituting proceedings for misconduct. Overall there appears to be more emphasis on consultation and discussion than enforcement although like other securities regulators it indicates periodically that it will crack down on poor practices.

This is partly historic because of the distrust of a strong regulator by the commercial community and the hostility of the HKEx to the erosion of the primary role which the colonial government had guaranteed for it. Consequently it was wrapped in several layers of advisory groups and committees in a system of corporatist checks and balances. It is partly because it was only with the dual listing provisions apart from the possible triggering of the Takeovers Code that the SFC had jurisdiction to intervene in corporate irregularities of listed issuers.<sup>158</sup> The SFC is now required by the Financial Secretary to conduct an annual review of the HKEx's handling of listing matters.<sup>159</sup>

#### *Dual listing*

A dual filing system in respect of material information commenced in April 2003. Listing applications and company announcements are filed with the SEHK and through it with the SFC.<sup>160</sup> The SFC is advised by a Dual Filing Advisory Group which has recommended that it address issues of quality. In 2004 the SFC indicated to the SEHK that it would exercise its power to object to a listing and application for listing subsequently lapsed. It also identified a number of significant disclosure issues:

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<sup>151</sup> It employed 41 executives and 15 non-executives. SFC, above n1,26. SFC(2), above n1, 35.

<sup>152</sup> Ibid,

<sup>153</sup> It employed 73 executives and 20 other staff. SFC(2), above n1,28, 40.

<sup>154</sup> SFC, above n1, 29, 37. This was a high profile case relating to Shanghai Land Holdings Ltd which linked back into scandals involving a senior officer of the Bank of China in both Hong Kong and Shanghai which connected into political events relating to President Hu's succession to President Jing. SFC, above n1. SFC(2), above n1,58.

<sup>155</sup> SFC(2), above n1, 52.

<sup>156</sup> Ibid, 74.

<sup>157</sup> Ibid 60.

<sup>158</sup> Kotewall and Kwong, above n 98, 21.

<sup>159</sup> SFC, *Report on the Securities and Futures Commission's 2005 annual review of the Exchange's performance in its regulation of listing matters* (SFC: Hong Kong, 13 July 2005)

<sup>160</sup> SFC(2), above n1,37.

unusual or undisclosed relationships between a listing applicant and its suppliers or customers, ... and acquisition or disposal of significant business shortly before the listing application.<sup>161</sup>

The first prosecution for providing false or misleading information under the listing rules was concluded in September 2004.<sup>162</sup>

The system is very different from the proposals that subsequently followed from the expert panel which reviewed the regulation of the listing rules after the penny stock incident. It recommended that the listing functions be given to a new division of the SFC, the Hong Kong Listing Authority.<sup>163</sup> The report observed:

No issue has been subject to such heated debate as the one of the appropriateness of the HKEx as a listed company retaining its role as the primary regulator of companies seeking entry to the stock market and of their conduct after listing.<sup>164</sup>

The Financial Secretary immediately endorsed the recommendations in an unusual display of decisiveness in Hong Kong corporate regulation:

We believe that the direction recommended is appropriate and will enhance the quality of our market. ... We are fully aware of the implications of the Expert Group's recommendations on the future roles of SFC and HKEx.<sup>165</sup>

He reversed his decision within a short time when it was announced that the government would hold further consultations. One of the three members of the group, a former chair of Merrill Lynch Asia Pacific, wrote to the Financial Affairs Panel of the Legislative Council describing it as 'the government's swift capitulation to pressure from certain vested interests' had raised serious questions 'about governance at the most senior levels in Hong Kong.' He also indicated that the experts had noted that the regulatory fees charged by the HKEx contributed significantly to its profitability. This was one reason why over 90 per cent of the people spoken to had stated that it should be stripped of its regulatory functions. He observed that many critics of the HKEx were forced to be silent:

Other market participants, intermediaries, listed companies and other respondents who supported reform to us privately are in many cases unable or unwilling to express their views publicly, certainly not as publicly as HKEx has done. This is regrettable but understandable given concerns about business relationships, fear of offending vested interests ... .<sup>166</sup>

He continued:

These events have brought into question the very nature of the relationship between the Government and a commercial entity to which it has granted monopoly powers.<sup>167</sup>

The government came under indirect attack from the HKEx. Its chair moved from qualified support to criticising the members of the group for not having properly considered its submission. It, and the government now said that it would accept the report's findings if a public consultation indicated support for

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<sup>161</sup> Ibid .

<sup>162</sup> Ibid, 28, 37.

<sup>163</sup> [53] 14

<sup>164</sup> [22] 714

<sup>165</sup> Hong Kong, Financial Secretary, 'FS' response to Report by Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure' (21 March 2003)  
<http://www.info.gov.hk/gia/general/200303/21/0321286.htm>

<sup>166</sup> Hong Kong, Legislative Council, Peter Clarke, Letter to Hon Ambrose Lau Hon-chuen, 1 June 2003.  
CB(1)1861/02-03(01)

<sup>167</sup> Ibid.

them. At a level outside of the structured committees and advisory bodies the vested interests in the HKEx had approached the Chief Executive who had ordered a delay to its implementation.<sup>168</sup>

A consultation paper was released by the FSTB on the removal of the HKEx's regulatory function which focussed on another proposal of the experts, that the listing rules have statutory backing.<sup>169</sup> That focus was maintained on statutory backing for the listing rules and not on who would regulate them. Statutory backing, rather than their removal from the control of the HKEx, was now overwhelmingly endorsed. Regulation would continue to be shared by the SFC and the HKEx but the powers of the SFC to impose penalties would be increased.<sup>170</sup> The HKEx itself was also consulting about changes to its listing decision making processes.<sup>171</sup>

#### *Statutory backing for the listing rules*

The exclusion of the HKEx from a regulatory role in listing, as indicated, has become a debate on the statutory enforcement of the listing rules. This itself has led to prolonged and extensive consultations which again have drifted towards policies which tend to protect the interests of participants in floats on the HKEx. In January 2005 the FSTB issued a consultation paper on specific legislative proposals to amend the SFO to give statutory backing to the listing rules.<sup>172</sup> The SFC also published a consultation paper on its proposals to amend the Securities and Futures (Stock Market) Listing Rules if the SFO were to be amended. The amendments would codify in the SFO important listing requirements, including financial reporting and other periodic disclosure, disclosure of price-sensitive information and shareholders' approval for notifiable transactions. The consultations ended in March with the government reporting in April that there was support for the proposal. There was also support for the SFC have power to impose civil sanctions such as reprimands, disqualifications and disgorgement orders for breaches of the rules. Only the Market Misconduct Tribunal would be vested with the power to impose civil fines. The SFC argued for it to also have this power.<sup>173</sup>

The government proposes that

the SFC be able to impose civil fines up to HK\$5 million on issuers and directors.

the Market Misconduct Tribunal be empowered to impose civil fines up to HK\$8 million on issuers and directors.

criminal penalties in particular cases.<sup>174</sup>

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<sup>168</sup> Simon Pritchard and Enoch Yiu, 'Market reform under fire' *South China Morning Post* ( 5 June 2003) 1.

<sup>169</sup> Expert Group, above n 3, [3.37] 65 [3.44]- [3.50] 67-68. FSTB, *Consultation Paper on Proposals to Enhance the Regulation of Listing* (3 October 2003) <http://www.fstb.gov.hk/fsb/ppr/consult/index.htm> (18 January 2007). SFC, above n 138, 63. SFC(2), above n1, 29, 38.

<sup>170</sup> FSTB, *Consultation Conclusions on Proposals to Enhance the Regulation of Listing* (26 March 2004) <http://www.fstb.gov.hk/fsb/ppr/consult/index.htm> (18 January 2007). FSTB, *Government Announces Measures to Enhance the Regulation of Listing* (26 March 2004)

<sup>171</sup> HKEx, *Legislative Council Panel on Financial Affairs Meeting: 6 March 2006 New Structure For Listing Decision-Making* LC Paper No. CB(1)997/05-06(04) Appendix 1. SFC(2), above n1, 73.

<sup>172</sup> FSTB, *Consultation Paper On Proposed Amendments To The Securities And Futures Ordinance To Give Statutory Backing To Major Listing Requirements* (January 2005) <http://www.fstb.gov.hk/fsb/ppr/consult/statutorybacking.htm> (18 January 2007) SFC, *A Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules* (January 2005) <http://www.sfc.hk/sfc/html/EN/speeches/consult/consult.html>

<sup>173</sup> Financial Services Branch, *Legislative Council Panel on Financial Affairs Securities and Futures (Amendment) (No.2) Bill 2005 Proposals to Give Statutory Backing to Major Listing Requirements* (March 2005) LC Paper No. CB(1)1160/04-05(04) SFC, *Note to the Panel on Financial Affairs, RE; Agenda V – Proposed amendments to the Securities and Futures Ordinance – Proposals to give statutory backing to major listing requirements'* (31 March 2005) LC Paper No. CB(1)12000/04-05(01).

<sup>174</sup> *Ibid* 38.

The SFC thought the SFC should be able to impose fines up to \$10 million and the Market Misconduct Tribunal should have unlimited powers to make the regime credible and to ensure that 'listed sector' will take it seriously.<sup>175</sup> The SFC has continued to argue that it is essential that it had these powers and not be forced to rely on taking cases to the Market Misconduct Tribunal.<sup>176</sup>

The SFC identified three important principles which needed to be recognised by statute:

disclosure of price sensitive information

disclosure and publication of annual and periodic reports.

disclosure of and shareholders approval for notifiable transactions and connected transactions.<sup>177</sup>

These have also been affected by consultation on the disclosure of interest under Part XV of the SFO<sup>178</sup> and the development of a Financial Reporting Council to oversee an Audit Investigation Board and a Financial Reporting Review Committee. This represents one of the latest corporatist creations, a hybrid of public and private power and funding. The AIB will investigate suspected irregularities by auditors and the FRRRC will investigate suspected non-compliance of listed company accounts and financial statements with legal and accounting requirements. It is funded by the government, the HKEx, the Hong Kong Institute of Certified Public Accountants and the SFC each providing HK\$2.5 million over three years and a one off payment of HK\$2.5 million as a reserve.<sup>179</sup>

In May 2006 there were indications that a Bill to amend the SFO to give statutory backing to the listing rules would soon be introduced. Sheng, the retiring chair of the SFC, congratulated himself in the 2004-2005 annual report:

With the statutory backing of the listing requirements, the Commission has finally emerged as the statutory regulator of listed company disclosure, clarifying its roles in the capital markets and placing the Commission on par with the roles and functions of the securities regulators in the major markets.<sup>180</sup>

Continuing distrust and uncertainty about the SFC appears to again have delayed these changes. That distrust has made the SFC more cautious and successful in its negotiations with interest groups in the endless discussions over regulatory reform in not provoking too many outbursts against it. It itself stated that it precedes changes to regulatory procedures with 'informal soft consultations with market practitioners.'<sup>181</sup> Observers confirm:

Before embarking on public consultation ... conducts informal soundings through its consultation networks. The aim is to test the key concepts with knowledgeable individuals of repute, especially those who can be counted on to maintain confidentiality.<sup>182</sup>

In seeking to minimise its conflicts with other players around the HKEx and the regulation of listed companies the SFC appears to make slow progress in expanding its power and role in spite of the scandals periodically produced by the exchange's practices. How this conflict is mediated is discussed below.

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<sup>175</sup> Ibid.

<sup>176</sup> Ibid 38.

<sup>177</sup> Ibid 38.

<sup>178</sup> SFC, *Consultation Paper on the Review of the Disclosure of Interests Regime under Part XV of the SFO* was circulated by the SFC (January 2005). SFC(2), above n1, 68.

<sup>179</sup> SFC(2), above n1, 39.

<sup>180</sup> SFC(2), above n1, 5.

<sup>181</sup> SFC(2), above n1, 7.

<sup>182</sup> Kotewall and Kwong, above n 98, 32.

#### 4. The Hong Kong Stock Exchange

While the Disciplinary Committee is not itself a statutory creation, its purpose and existence derive from the duty imposed by the SFO on SEHK to regulate the securities market, acting in the interests of the investing public. It is part of the machinery for protecting those interests. *The Stock Exchange of Hong Kong Ltd v New World Development Co Ltd* [2006] HKCFA 47 Ribeiro PJ [33]

You cannot have the rabbits in charge of the lettuce. Justice Anthony Rogers, Court of Appeal and Chair of the Standing Company Law Review Committee on learning that the HKEx would still have responsibility for the listing rules. 'Rabbits in charge of the lettuce ...' *Asianmoney* (1 May 2003)

##### *The creation of the demutualised exchange*

The HKEx is a subsidiary of Hong Kong Exchanges and Clearing Ltd. Comprehensive reform of the share and future markets was announced in the Budget speech of the then Financial Secretary, Donald Tsang in 1999. The stock exchange and futures exchange demutualised and merged with the related clearing company to form a single company, SEHK. The merger was completed in March 2000 and the company was listed in June 2000. There are restrictions on holding more than five per cent of its issued shares. As a listed company it is regulated in respect to any main board or GEM listings by the SFC which granted an authority to operate an exchange under s 19 of the *Securities and Futures Ordinance*. Its fees must also be approved by the SFC.<sup>183</sup> The SFC may direct the HKEx to cease to operate specified facilities and must approve any new or amended listing rules.<sup>184</sup> As a result of recent reforms the board has been separated from the listing function because of conflicts between profit making and regulation.

##### *The Board of the HKEx*

In 2005 the board was composed of a chair and the chief executive and 11 other members. Unusually for a listed company the government has the power to appoint five members of the Board. The board itself becomes another part of the corporatist committee system. This is demonstrated by only one of the directors not holding another government committee position. The government appointed directors can be seen to have representative roles which also doubled with professional and business skills. Their corporate and committee appointments tended to outrank those of the members of the SFC.<sup>185</sup>

The chair was appointed by the government. He was the founding partner of a local firm of corporate and commercial lawyers as well as a chartered accountant. He had served on the more significant committees, the Executive Council from 1997 to 2002, the Selection Committee of Hong Kong, which chose the first Chief Executive and the Governor's Business Council from 1992 to 1997. He was in 2005 also Chair of the Mandatory Provident Fund Scheme. The chief executive had a background in technology. He had previously held senior positions with the HSBC in Asia. He was also connected into the committee system serving on the Advisory Committee of the SFC, the Standing Committee on Company Law Reform. He also was associated with other industry and professional organizations. He had been chair of the Hong Kong Investment Fund Association in 2000-2001 during his period with HSBC. In 2005 he was a government appointed member of the Hong Kong Institute of Certified Public Accountant's Council. He was also was a director of Hong Kong Cyberport Management Company Ltd, a Li Ka Shing family company.

One government appointed director chaired the Listing Committee and had been the former chief executive of an international accounting firm and a former president of the HKICPA. He also was a director of a listed commercial bank and a number of other listed companies. Previously an appointed member of the Legislative Council and the Urban Council his connections into the committee system involved the Exchange Fund Advisory Committee, the Tracker Fund of Hong Kong and the Airport Authority as well as

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<sup>183</sup> Chapter 38 of the Main Board Listing Rules and Chap 36 of the GEM Listing Rules and a Memorandum of Understanding of 22 August 2001. <http://www.hkex.com.hk/rulereg/introreg/introreg.htm> 29 April 2005

<sup>184</sup> Kotewall and Kwong, above n 98, 32.

<sup>185</sup> Unless otherwise indicated the source of the information is Table 2.



the Greater Pearl Delta Business Council. A lawyer turned business executive represented listed infrastructure companies and airlines. He had been a member of the SFC and was presently a member of the Standing Committee on Judicial Salaries and Conditions of Service and the Zhejiang Province Committee of the Chinese People's Political Consultative Conference and Hong Kong Science and Technology Parks Corporation. Another lawyer represented a global investment bank as well as the listed companies in insurance and the Li family group. He had previously been a lawyer with an international legal firm and a President of the Council of the Law Society. He had also served on the Takeovers Panel and the former Securities and Futures Appeals Panel. Another accountant also represented international accounting firms. He had served on the Listing Committee in the past. He was in 2005 appointed by the government to two bodies which oversaw the SFC, the Process Review Panel and the Securities and Futures Review Panel. He also served on the Supervisory Committee of the Tracker Fund.

The elected members were dominated by four representatives from the securities and financial services industries. Of these three represented local broking and securities firms and one an international asset management company. Of these two also were active in the Hong Kong Securities Institute of which one had been chair. He was the director of a former listed company which had been privatised in a manner subsequently banned under the Takeovers Code. The other director active in the Securities Institute had also been chair of the Hong Kong Stockbrokers Association. Two of the elected members were also accountants. These had external government appointments largely limited to membership of the Securities and Futures Appeals Tribunal or membership of the Advisory Committee of the SFC although two were also members of the Airport Authority and one was on the Review Committee of ICAC. One was a member of the government's Advisory Committee on Human Resources Development in the Financial Services Sector. There was a representative of a listed land and investment company who was a vice president of the Real Estate Developers Association. Of the six only two were not also directors of listed companies. Including the government appointed directors three were also directors of companies in the Li Ka-shing's family group and another three had close relationships with the HSBC.

The most distinctive elected director was David Webb, elected in 2003. An investor and shareholder activist he edits Webb-site.com which promotes better corporate and economic governance in Hong Kong by exposing questionable transactions by listed companies and government. In spite of this he has passed the test of the appointments committee and has been appointed to the SFC's Takeovers and Mergers Panel, Takeover Appeals Committee and Public Shareholders Group. This indicates that the corporatism is now more inclusive and trying to mediate more conflicting interests within the committee system. It may also indicate that better corporate governance is recognized by corporatist interests as good for Hong Kong.

### *The Listing Committee*

[W]e note that a significant number of the Listing Division staff of the HKEx are holders of pre-listing share options and that all full-time staff in the Division are eligible for consideration for a discretionary performance-linked bonus. Hong Kong, The Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure, *Report by the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure* (March 2003) [25] 8 <http://www.info.gov.hk/info/expert/expertreport-e.htm> (18 January 2007)

The Listing Rules are administered by the Listing Committee which also acts as the review body in respect of its decisions and provides advice to the Listing Division of the HKEx.<sup>186</sup> In 2005 it was continuing experimental reforms to deal with previous criticism. It was publishing decisions to communicate the rationale behind them. It was assisting the Listing Division to establish standards to give greater certainty to the decision making process. It continued to publish detailed biographical information on its members to assist parties appearing before it in identifying conflicts of interests. Some lack of transparency was still justified as required by confidentiality, natural justice and statutory obligations for secrecy.<sup>187</sup>

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<sup>186</sup> HKEx, The Listing Committee Annual Report 2006 Available at <http://www.hkex.com.hk/listing/listing.htm> (16 January 2006) 2.

<sup>187</sup> Ibid 3.

The supervision of the Division by the Committee broke down in the early 2000s:

members of the Listing Committee have not felt authorised or empowered to oversee the activities of the listing division. It is notable, but not widely appreciated that the new Memorandum of Understanding Governing Listing Matters between the SFC and the Stock Exchange of Hong Kong, dated 28 th January 2003 includes no reference to this responsibility, in contrast to the previous MOU dated 6 th March 2000 where the responsibility was quite specific. The Listing Committee has understandably refused to be accountable for something it cannot control and there is no longer any pretence of supervision.<sup>188</sup>

In 2005 the Committees composition and powers were reviewed by the HKEx in a consultative process which the Listing Committee considered in October. The Committee, when requested by the Listing Division to provide advice, declined to do so stating that it was inappropriate for it to be closely involved in determining its composition. Its statement that appointees must have the right knowledge and experience conveyed some of the resentment of the SFC interfering in its affairs and the criticism of it by a number of inquiries.<sup>189</sup> Its composition had been unrepresentative. In 2003 it had had only one fund manager on it and the HKEx rules would permit only four investors' representatives. One critic, who later joined it, said 'It's not a listing committee, it's an issuers committee.'<sup>190</sup> Its composition changed in early 2006. The size of the Main Board committee was increased from 25 to 28 to include at least eight investor representatives, the HKEx Chief Executive and 'a suitable balance of representatives of listed issuers and market practitioners including lawyers, accountants, corporate finance advisers and Exchange Participants.'<sup>191</sup> The maximum term of members was increased from three to six years. The Listing Nomination Committee (LNC) was made more independent of the HKEx by replacing the the Chief executive of the SEHK and two non-executive directors to three non-executive directors.<sup>192</sup>

Members of the Committee themselves pay in other ways as the unpaid representatives of business. They were confronted by voluminous papers which they received on Tuesday morning for a Thursday afternoon meeting. In the first two months of 2005 they had 23 meetings: six regular; one policy; eight review; and eight disciplinary. They also found that the composition of the meeting varied making it difficult to maintain consistency, particularly as those who attended the initial meeting cannot attend a review meeting.<sup>193</sup>

#### *The membership of the Listing Committee*

The Committee's membership is corporatist, conflicting interest groups are brought together. A biography of members is displayed on the HKEx web site so that parties appearing before it can identify conflicts of interest. In early 2006 it had 29 members, including the chief executive of the HKEx ex officio. The chair in early 2006 was the KPMG partner in charge of audits as well as a vice president of the HKICPA. He was a member of the Takeovers and Mergers Panel and Dual Filing Advisory Group of the SFC. He was also a member of the Standing Committee on Company Law Reform.<sup>194</sup> The other members showed similar overlaps into government and business. Eight served on committees and advisory groups of the SFC and one was a member of the Securities and Futures Appeals Tribunal. Three were members of the Standing Committee on Company Law Reform. Only one was a member of the prestigious Election Committee for the Chief Executive. Two had served as members of bodies associated with the running of the Mandatory Provident Funds Scheme. Nine had a direct interest in the Committee's activities as directors of companies

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<sup>188</sup> Clarke, above n 155.

<sup>189</sup> HKEx, The Listing Committee Annual Report 2005 Available at <http://www.hkex.com.hk/listing/listing.htm> (16 January 2006) 3-4..

<sup>190</sup> Jasper Moiseiwitsch, 'The twilight regulator' <http://www.cfoasia.com/archives/200303-04.htm> (18 January 2007)

<sup>191</sup> HKEx., above n 186.

<sup>192</sup> Ibid 4.

<sup>193</sup> HKEx, above n 189. 4-5.

<sup>194</sup> HKEx, *Listing Matters and Listed Companies, Listing Committee Members' Biographies* [http://www.hkex.com.hk/listing/listcomrpt/tong\\_ka\\_shing\\_carlson.htm](http://www.hkex.com.hk/listing/listcomrpt/tong_ka_shing_carlson.htm) (16 January 2007).

listed on it but surprisingly only one came from a land development company. A number of others also worked in areas relating to the Committee's activities: four represented multinational investment banks; two represented investment funds; two represented asset managers; and there were single representatives of broking firms and market research companies. There were four lawyers of whom all but one were from international commercial firms. Only one had been on the Council of the Law Society. There were three accountants representing multinational accounting firms but three other members also had connections with the Council of the HKICPA. The appointments made in 2005 and early 2006 added very different sectors to the Committees making it more representative of Hong Kong but included some from groups who had been critical of the HKEx. Single individuals represented specific issues of corporate governance, sustainable development and consumer rights. Three members were senior figures in political think tanks and public advocacy groups which are often critical of the opaque relationship between government and business.<sup>195</sup>

The Listing Committee operates to normalise the abnormalities of Chinese enterprises by finding analogies within standards devised for private controlled capital. Waivers are useful in this regard. It dealt not only with the problems of control with Hong Kong but spent time considering related party financial reporting standards in respect of H share companies and whether all state-owned entities are related parties. It recognised that the conflicting interpretations revolved around the problem of being able to identify all state-owned entities and the fact that some state-owned entities had no significant relationship with others. It accepted that there need not be one single and comprehensive related party note in the accounts provided all the relevant information was disclosed.<sup>196</sup>

### *Enforcement*

There were few rejections of applications for listing. Some are deferred. In 2005 there were 61 applications to list on the Main Board and 58 were approved. One was rejected and two were deferred.<sup>197</sup> It did, however, in 2005 approve placing 12 companies in the third and final stage before delisting as opposed to four in 2004.<sup>198</sup>

The HKEx has had to largely rely on its contractual powers to regulate listed entities.<sup>199</sup> The Committee's policy is to pursue only 'the most egregious breaches of the Listing Rules.' The reasons for this is the demand made on the unpaid services of those members attending. The papers are particularly voluminous, the meetings are longer as the issues are contentious and there is an increasing tendency for the proceedings to be interrupted by procedural challenges.<sup>200</sup> There were eight matters for the failure to publish accounts in the required time. There were six cases of failures to obtain approvals for connected transactions. Of the 28 cases taken 20 ended in a published sanction, four in a private sanction and two with no sanction.<sup>201</sup> In 2006 confronted by serious breaches of the rules by H share companies one company received a public censure in respect of unapproved connected transaction including a statement that the retention of office by named 'individuals was prejudicial to the interests of investors.'<sup>202</sup> In another case directors were required to undertake remedial action.<sup>203</sup>

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<sup>195</sup> HKEx, Listing Matters and Listed Companies, Listing Committee Members' Biographies [http://www.hkex.com.hk/listing/listcomrpt/lc\\_member\\_bio.htm](http://www.hkex.com.hk/listing/listcomrpt/lc_member_bio.htm) (16 January 2006). According to the HKEx own categories in 2004-2005 there were five representatives of exchange participants, 11 representatives of market practitioners and users and five listed companies. HKEx, above n 189, Appendix II – Listing Committee Members. In 2005-2006 there were five representatives of listed companies, 12 representatives of market practitioner and user, and four representatives of exchange participants. HKEx, above n 185, Appendix II – Listing Committee Members.

<sup>196</sup> Ibid 10-12. In 2005 it met 101 times and in 2004 85 times. Above n 185, 8.

<sup>197</sup> Above n 185, 9

<sup>198</sup> Above n 189, 10.

<sup>199</sup> Kotewall and Kwong, above n 98, 21.

<sup>200</sup> HKEx, above n 189, 16. In 2006 it was expressed as 'the most blatant and serious cases.' HKEx, n 185, 22.

<sup>201</sup> HKEx, n 189, 17. The figures are similar for 2006. HKEx, above n 185, 24.

<sup>202</sup> HKEx, n 189, 22.

<sup>203</sup> HKEx, n 189, 23.

In one of the paradoxes of corporatism the HKEx has had to become more official in its approach to hearings to determine reaches. A serious failure to disclose a fall in earnings forecasts lead to allegations of insider trading and a hearing for breaching the disclosure rules. In 2005 the Court of Appeal ruled that the Listing Committee in a disciplinary hearing was a 'court' for the purposes of Article 35 of the *Basic Law*. This was overturned by the Court of Final Appeal.<sup>204</sup> The judgment noted that the HKEx accepted that it was bound by principles of fairness. The Committee clearly is opposed to further procedures which affect its informal and expedited approach. It intends to use the power the court indicated that it had to limit the role of counsel. Lawyers, it considers, destroys the value of direct dialogue between the Committee and the parties.<sup>205</sup>

### **After company law and after its enforcement: company law as a conversation**

Hong Kong's historic corporatist legacy meant that it already contained the blending of public and private interests by merging business and government activities in the same institutions a tendency which became clearer in western states in the 1990s as new regulatory practices were required to match the down-sizing of government. Law as something which is used in a coercive way tends to disappear in this arrangement but not entirely. There are examples of it use as compulsion backed up by state power in Hong Kong but often against less well connected companies and people.

The very measures taken to resolve conflict have become so complex that they create further but different conflicts. Co-ordinating the large numbers of people, firms, associations, companies and government institutions has led to the creation of further bodies, presently called meetings, composed of the inner core of those involved in the regulation of the HKEx from which new committees may emerge. The Financial Secretary meets about nine times a year with the Secretary for Financial Services and Treasury to discuss financial market issues.<sup>206</sup> The Securities and Futures Liaison Meeting occurs monthly between the FSTB and the SFC which brings together the chair of the SFC and executive directors with the Secretary for Financial Services and Treasury, the permanent head for financial services and the five principal officers dealing with securities.<sup>207</sup> The Tripartite Meeting brings the HKEx chief executive together with the SFC chair and the deputy secretary for financial services and treasury and the permanent secretary for financial services once every two months. It is chaired by the Secretary.<sup>208</sup> The Co-ordination Committee meets every two to three months and brings the Secretary for Financial Services and Treasury together with the chair and executive director (corporate finance) of the SFC and the chair, chief executive and senior staff of the HKEx to serve as an advisory group for the HKEx and to facilitate its liaison with government and regulatory bodies in Hong Kong and on the Mainland. It is chaired by the HKEx chair.<sup>209</sup> The Corporate Finance Division of the SFC and the Listing, Regulation and Risk Management Unit of the HKEx also conduct monthly liaison meetings.<sup>210</sup>

Company law in Hong Kong has recently been most visible in the endless discussions of changes to better regulate the companies listed on the HKEx. A large amount of activity goes into making policy and rules. The different interests and interest groups embedded in the SFC and HKEx produce tension in law and policy making as well as in regulation. This is generated in part by basic properties of knowledge and the power and influence it carries as well as the right to control process.

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<sup>204</sup> *The Stock Exchange of Hong Kong Ltd v New World Development Co Ltd* [2006] HKCFA 47 and *New World Development Co Ltd v The Stock Exchange Of Hong Kong Ltd* [2005] HKCA 146; [2005] 2 HKLRD 612.

<sup>205</sup> HKEx, n 185 20-22.

<sup>206</sup> Kotewall and Kwong, above n 98, I, 1-2.29.

<sup>207</sup> *Ibid* I, 1-2, Annex 4.10, A16.

<sup>208</sup> *Ibid* I, 1-2, Annex 4.11, A17.

<sup>209</sup> *Ibid* I, 1-2, Annex 4.12 A18. In addition the Secretary for Financial Services and Treasury also chairs the Financial Markets Development Task Force and the Financial Stability Committee which discuss general financial markets rather than regulatory issues. *Ibid*, 29-30 A19

<sup>210</sup> *Ibid* 30, Annex 4.13.

Law has come to be enforced in a different sense. The present debate about the listing rules and their enforcement was touched off in 2002 in the penny stocks affair. The market crashed after a consultation paper published by the HKEx indicated that shares under HK.50 would be delisted.<sup>211</sup> The principle accusation made against the HKEx by the government, members of the LegCo and the SFC and industry groups was that the HKEx had failed to consult sufficiently.<sup>212</sup> It had broken the corporatist compact. Not all the parties were uninformed as they tried to appear to be. The SFST had to ultimately apologise for his role in the affair and the SFC also admitted it also had some responsibility. The industry groups which gathered to condemn the HKEx at the meeting of the Financial Services Panel early in the affair were also aware given the representation of members on exchange bodies. They moved to maximise the leverage the exchange's apparent stumble had given them and it has resulted in the power of the HKEx and particularly its board being reduced.

How much consultation is not enough? The HKEx gave eight draft consultation papers to the Corporate Finance Division of the SFC. The SFC gave written detailed responses and discussed them at four regular monthly liaison meetings and two special meetings.<sup>213</sup> The SFC chair discussed the proposals for delisting and quality in 'very general terms' with the Financial Secretary. They were raised at two Co-ordination Committee meetings, three Tripartite meetings, one meeting of the Securities and Futures Liaison Meeting and two special meetings called by the Bureau.<sup>214</sup> This was just a consultation paper for public discussion. Part of the role of company law in this appears to be as a thing which is discussed rather than enforced. It creates the reason for regularly bringing the interest groups together.

Company law, as predicted by corporatist theory can also be seen in Hong Kong as being absorbed by administrative practice. As the rules and policies do not seem to be significant in the sense that they are not important in calculating consequences this indicates that the consultation is about something else. It may be legitimacy. It is recognised in contemporary regulatory theory that there is a need to connect the practices of regulation into concepts of justice which is particularly significant in Hong Kong where the legislature lacks the legitimacy of democratic election. It also responds to the significance of risk and its management.<sup>215</sup> It may also be the way in 'individual facts' which cannot be handled in administrative processes are dealt with using even broader versions of legal institutes such as 'whole economy' and 'public welfare'. Or to put it simply, scandals which expose the legitimacy of the corporatist system are dealt with by government and business appearing to do something.

Table 1: The regulatory framework of the Hong Kong Stock Exchange

| PUBLIC   | ⇒   | ⇒                        | ⇒                                       | ⇒                        | PRIVATE                             |
|--|---|--------------------------|---|--------------------------|-------------------------------------|
| Legislative Council and its panels                                       | Securities and Futures Commission                         | SFC Process Review Panel | Tripartite Meeting (SFC BFST HKEx)      | Hong Kong Stock Exchange | Securities Institute                |
| Chief Executive, Executive Council<br>Financial Secretary, Secretary for | Takeovers and Mergers Panel<br><br>Takeovers Appeal Panel | SFC Advisory Group       | Co-ordination Committee (SFC BFST HKEx) | Listing Committee        | Hong Kong Stock Brokers Association |

<sup>211</sup> Kotewall and Kwong, above n 98, I, 1-2.

<sup>212</sup> Legislative Council, Legislative Council Panel on Financial Affairs, Minutes of special meeting held on Wednesday, 31 July 2002 at 2:30 pm in the Chamber of the Legislative Council Building (LC Paper No. CB(1)230/02-03) 13-14.

<sup>213</sup> Kotewall and Kwong, above n 98, 52-53.

<sup>214</sup> Kotewall and Kwong, above n 98, 54.

<sup>215</sup> D Garland, 'The rise of risk' in R Ericson (ed) *Risk and Morality* (Toronto: University of Toronto Press, 2002).

|   |                            |                                |  |   |   |
|---|----------------------------|--------------------------------|--|---|---|
| Financial Services and Treasury               |                            |                                |  |   |   |
| Court of First Instance High Court of Justice |                            | SFC Public Shareholders Group  |  |   | Hong Kong Investment Funds Association  |
| Police Commercial Crime Bureau                | Market Misconduct Tribunal | SFC Dual Filing Advisory Group |  | Asian Corporate Governance Association              | The Hong Kong Institute of Directors    |
| Ombudsman                                     |                            |                                | Financial Reporting Council and Audit Investigation Boards and Financial Review Reporting Committees | Hong Kong Institute of Certified Public Accountants | Hong Kong Society of Financial Analysts |
| Independent Commission Against Corruption     |                            |                                |  | The Hong Kong Institute of Chartered Secretaries    |   |

Table 2: Board of Hong Kong Stock Exchange

Table 3: Directors of the Securities and Futures Commission Hong Kong