
SFC's Powers to Seek Compensation for Investors

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Introduction

One of the first cases in which Hong Kong's Securities and Futures Commission (the **SFC**) obtained compensation for public investors was the Lehman Brothers Minibond case, in which the SFC and the HKMA reached agreements with 16 distributing banks that they should repurchase from investors the Lehman equity-linked notes (the so-called "minibonds") which had become worthless when Lehman Brothers filed for bankruptcy in 2008. In the Lehman Minibond case, however, the SFC did not bring any regulatory action against the banks distributing the minibonds in spite of allegations of misrepresentation of the risks involved and failure by banks' employees to ensure the suitability of the product for customers to whom it was recommended, as required under the SFC's code of conduct. No disciplinary proceedings were involved in the Lehman minibonds case. In view of the banks' willingness to repurchase the Lehman minibonds, both the SFC and HKMA decided not to take any disciplinary action. Following the Lehman minibond case, both the SFC and HKMA conducted in depth reviews of the circumstances surrounding the sale of approximately HK\$12.7 billion Lehman minibonds, many of which were sold to retail investors. The review resulted in a change to Hong Kong's laws to provide stricter regulation of offers of "structured products" (such as the Lehman minibonds and other equity linked instruments). Essentially, "structured products" can no longer be offered under the wider exemptions that are available under what is now the Companies (Winding Up and Miscellaneous Provisions) Ordinance. Offers of such products are governed by the Securities and Futures Ordinance which requires that offering documents are authorised for offer to the public by the SFC unless an exemption is available. The exemptions for offers of structured products are fairly limited – the main one being for offers to "professional investors".

More recently however, there have been a number of successful actions by the SFC to obtain remedies for investors who have suffered loss as a result of misconduct of one type or another, such as misleading financial disclosure by listed companies and insider dealing and other types of market misconduct offences.

As noted by the Financial Services Development Council in 2014, the SFC has "repeatedly broken new ground by conducting 'surrogate' actions" on behalf of investors using its powers under sections 212 to 214 of the Securities and Futures Ordinance (**SFO**).¹

The Court of Final Appeal's landmark ruling in the case of New York-based asset manager, Tiger Asia, in April 2013 affirmed that the Court of First Instance may make orders under section 213 SFO based on its finding of misconduct without a prior finding of misconduct by a criminal court or the Market Misconduct Tribunal (**MMT**).² The CFA thus affirmed that the Court of First Instance may order remedies for investors under sections 212 to 214 separately from, and where appropriate, in addition to, proceedings in the criminal court or before the MMT.

The use of these sections has faced some criticism as creating a "third way" which allows the bringing of criminal and civil proceedings against a party in respect of the same conduct (this was one of the arguments made by the appellants in the Tiger Asia case discussed below). The criticism stems from the fact that it is not possible for both civil and criminal market misconduct proceedings under Parts

¹ FSDC. "*Positioning Hong Kong as an International IPO Centre of Choice*". 18 June 2014, paragraph 4.4.3, page 44.

² SFC. "[*Court of Final Appeal dismisses Tiger Asia appeal*](#)". 30 April 2013

XIII and XIV SFO to be brought in respect of the same conduct. On the other hand, the SFC's ability to obtain remedies for investors cures some of the problems created by Hong Kong's lack of a class action regime and contingency fees which makes it prohibitively expensive for minority shareholders to seek redress for corporate misconduct. Surrogate actions brought by the SFC also enable Hong Kong to avoid some of the disadvantages of a class action regime, such as higher incidences of speculative litigation.

The SFC's Statutory Powers

Section 213 SFO

Section 213 of the SFO allows the SFC to apply to the court of first instance (**CFI**) for a broad range of orders and injunctions where a person has contravened any provision of the Securities and Futures Ordinance or any provision of the prospectus regime now set out in the Companies (Winding Up and Miscellaneous Provisions) Ordinance.

Recent years have thus seen the SFC successfully obtain orders to provide remedies for investors. The types of orders commonly granted by the courts are:

- ***Restoration orders***

These require the wrongdoer to restore the counterparty(ies) to the transaction to the position they would have been in if they hadn't entered into the transaction. Restoration orders have been sought by the SFC to:

- require a listed company to make an offer to buy back its shares from subscribers in its IPO and secondary market purchasers to obtain redress for shareholders who suffered loss due to misleading disclosure in the company's IPO prospectus (in the case of Hontex);
- require insider dealers and others committing market misconduct to pay to the counterparties to the relevant transactions the difference between the value of the shares on the day of the transaction and the actual transaction price.

- ***Freezing orders***

These are typically sought to prevent the disposal of assets pending the outcome of the section 213 proceedings.

Section 212 – Winding Up Orders

In order to protect the interests of company shareholders, clients, creditors and the investing public, the SFC can apply to the Court of First Instance under section 212 SFO for an order to wind-up a company under the Companies (Winding Up and Miscellaneous Provisions) Ordinance. The SFC must consider that the making of a winding-up order would be in the public interest and be just and equitable. The SFC may also seek the appointment of provisional liquidators to manage the company's affairs pending the winding-up.

Proceedings brought by the SFC under sections 212 to 214 are aimed at providing remedies for investors. The "wrongdoers" sometimes face separate proceedings for market misconduct offences in either the criminal courts or before the MMT.

1. Obtaining Remedies for Investors

1.1 Court of Final Appeal Ruling in Tiger Asia Management LLC

The Court of Final Appeal's landmark ruling on the appeal of Tiger Asia Management LLC (**Tiger Asia**) and three of its officers in April 2013 opened the way for the SFC to obtain redress for investors who suffer loss as a result of various types of misconduct. Tiger Asia and its two senior officers were ordered to pay HK\$45.3 million to around 1,800 investors who had traded with Tiger Asia in insider dealing transactions in shares of China Construction Bank Corporation (**CCB**) and Bank of China (**BOC**). The amount to be repaid was calculated by reference to the difference between the actual price of CCB and BOC shares sold by Tiger Asia and the value of those shares taking into account the inside information known to Tiger Asia, as assessed by an expert.³

Facts

Tiger Asia is a New York-based asset management company that was alleged to have contravened the SFO's insider dealing and market manipulation provisions in dealing in the shares of CCB and BOC. The SFC applied to the court under section 213 SFO seeking orders for violations of the market misconduct provisions of the SFO.

Tiger Asia's appeal argued that the court had no jurisdiction under section 213 to find that there had been a contravention of the SFO's market misconduct provisions without a pre-existing criminal conviction or a finding of civil market misconduct by the Market Misconduct Tribunal (MMT). In dismissing the appeal, the CFA affirmed that the Court of First Instance is entitled to make a civil finding of market misconduct and to make an order under section 213 in respect of any misconduct without there having been any prior finding of market misconduct by a criminal court or the MMT.

In his judgement, the Right Honourable Lord Hoffmann NPJ stated that the MMT and the criminal court are not intended to be the only avenues for dealing with market misconduct, stating that:

- the remedies under section 213 serve a different purpose to the penalties that can be imposed in criminal or civil market misconduct proceedings under Parts XIII and XIV of the SFO, respectively;
- in proceedings under section 213, the SFC acts as a "protector of the collective interests of the persons dealing in the market who have been injured by market misconduct" rather than as a prosecutor; and
- the question of whether a person has committed a criminal offence is entirely a matter for the criminal court and is not a matter that is determined in proceedings under section 213 which are clearly civil proceedings.⁴

1.2 Other Proceedings under s213 SFO obtaining redress for investors

1.2.1 Proceedings against CITIC

³ SFC. "[Tiger Asia admits insider dealing and ordered to pay investors \\$45 million](#)". 20 December 2013.

⁴ SFC. "[Court of Final Appeal gives reasons for dismissal of Tiger Asia appeal](#)". 10 May 2013

The SFC commenced proceedings in both the CFI and the MMT against CITIC Limited (CITIC) and five of its former executive directors in September 2014 based on market misconduct involving disclosure of false or misleading information on CITIC's financial position following huge losses incurred as a result of its investment in leveraged foreign exchange contracts in 2008.⁵

The SFC is seeking restoration or compensation orders in the CFI to restore or compensate up to 4,500 investors who purchased CITIC shares between the date on which the false or misleading information was allegedly announced and the date the true financial position was disclosed. The allegations relate to a 12 September 2008 circular issued by the company stating that the directors were not aware of any adverse material change in the group's financial or trading position since the end of 2007. Just over a month later, on 20 October 2008, the company issued a profit warning which disclosed huge realised and mark to market losses arising from leveraged foreign exchange contracts of which it became aware on 7 September 2007, just prior to the circular containing the statement of no material adverse change. CITIC incurred a loss of US\$2 billion from the forex derivatives, also known as "accumulators". The MMT proceedings are due to commence on 16 November 2015.

The day after the profit warning, the share price dropped 55% from HK\$14.52 to HK\$6.52 on 21 October 2008. According to press reports, about 100 million shares were purchased during the relevant period which means that the compensation could be as high as HK\$2 billion given the highest purchase price paid was HK\$24.50 and the lowest was HK\$3.66.

1.2.2 Order for former Morgan Stanley MD to pay HK\$23.9 million to Investors affected by his Insider Dealing

The Hong Kong courts made their first restoration order in an insider dealing case when the CFI ordered former Morgan Stanley Asia Limited Managing Director, Mr. Du Jun, to pay HK\$23.9 million to 297 investors affected by his insider dealing in the shares of CITIC Resources Holdings Limited in 2007.⁶ The order was made under section 213 SFO on 12 December 2013 and was intended to restore counterparties to the CITIC Resources share transactions to their pre-transaction positions through payment of the difference between the value of the shares on the day of the transaction (taking into account the inside information possessed by Du) and the actual transaction price.

Du had already been convicted in criminal proceedings on ten counts of insider dealing in relation to the same transactions in 2009. He was sentenced to seven years' imprisonment, which was reduced on appeal to six years.⁷

1.2.3 HK\$13.7 million Restoration Order against Futures Trader for Price Rigging Offence

The SFC obtained a restoration order in January 2014 against futures trader, Mr. Tsoi Bun, which ordered him to pay HK\$13.7 million to around 500 investors affected by his

⁵ SFC. "[SFC commences proceedings against CITIC, its former chairman and executive directors](#)". 11 September 2014

⁶ SFC. "[Court orders inside dealer Du Jun to pay \\$23.9 million to investors](#)". 12 December 2013

⁷ SFC. "[Ex-Morgan Stanley banker jailed for seven years for inside dealing](#)". 18 September 2009

manipulation of the calculated opening prices of index futures contracts in the futures market between 2007 and 2009.⁸

Mr. Tsoi had been convicted on five charges of market manipulation in January 2012 in respect of which he was sentenced to six months' imprisonment suspended for two years, fined HK\$500,000 and ordered to pay the SFC's costs of investigation.⁹ This was the first criminal prosecution for market manipulation in Hong Kong's futures market.

1.2.4 Hontex Ordered to make HK\$1.03 billion Buy-back Offer for Untrue IPO Prospectus

In June 2012, the CFI granted an order sought by the SFC under section 213 SFO for Hontex International Holdings Company Limited (**Hontex**) to make a repurchase offer to around 7,700 public shareholders who had subscribed for Hontex shares in its IPO or purchased Hontex shares in the secondary market.¹⁰ The order was made based on Hontex's admission that it had contravened Section 298 SFO (the offence of disclosure of false or misleading information inducing transactions) which it made for the purposes of the section 213 proceedings only.

Hontex was additionally ordered to pay the SFC's costs of HK\$7 million.

In separate disciplinary proceedings, the SFC revoked the licence of Hontex's IPO sponsor, Mega Capital (Asia) Company Limited, for inadequate and sub-standard due diligence work on the Hontex IPO and fined it HK\$42 million.¹¹

1.2.5 SFC Proceedings against Qunxing Paper Holdings for Misleading Prospectus Disclosure

The SFC commenced proceedings under section 213 against Qunxing Paper Holdings Company Limited (**Qunxing**) alleging that materially false or misleading information was included in Qunxing's IPO prospectus for its 2007 listing and the announcements of its annual results for the years 2007 to 2011. The court granted an interim order on 12 December 2013 freezing the total amount of assets raised by Qunxing from the investing public. The SFC is also seeking orders for Qunxing's public shareholders and warrant holders to be restored to their positions before entering the transactions. The SFC has obtained an order from the CFI for the appointment of interim receivers and managers over Qunxing.¹²

The SFC alleges that Qunxing contravened the following provisions:

- sections 277 and 298 SFO (the offence of disclosure of false or misleading information inducing transactions);
- section 384 of the SFO which prohibits the giving of false or misleading information to the Stock Exchange or the SFC in any filing made under the SFO or Parts II and XII of the Companies (Winding Up and Miscellaneous Provisions) Ordinance; and/or

⁸ SFC. "[Court orders futures trader to compensate investors over \\$13 million](#)". 14 Jan 2014.

⁹ SFC. "[Futures trader Tsoi Bun convicted of price rigging after retrial](#)". 30 Jan 2012.

¹⁰ SFC. "[Hontex ordered to make \\$1.03 billion buy-back over untrue IPO prospectus](#)". 20 June 2012

¹¹ SFC. "[SFC fines and revokes the licence of Mega Capital \(Asia\) Company Limited](#)". 22 April 2012

¹² SFC. "[Court continues interim injunction to freeze assets of Qunxing](#)". 20 Dec 2013.

- section 342F of the Companies (Winding Up and Miscellaneous Provisions) Ordinance which imposes criminal liability on a person who "authorises the issue" of a prospectus containing an untrue statement.

The case is on-going.

2. Winding-up Orders Obtained by SFC under Section 212 SFO

The SFC has filed two winding-up petitions under section 212 SFO to protect the interests of company shareholders, clients, creditors and the investing public.

2.1 China Metal Recycling (Holdings) Limited

In July 2013, the SFC presented a petition to the CFI to wind up China Metal Recycling (Holdings) Limited (**China Metal**) on the basis that the company had overstated its financial position in its 2009 IPO prospectus and annual report.¹³ The court also granted an order for the appointment of provisional liquidators.¹⁴ The effect of the presentation of the winding-up petition and the appointment of provisional liquidators was to:

- place administrative control of the company in the hands of the provisional liquidators;
- suspend the power of the company's board of directors over management of the company's affairs; and
- make void any disposal of the company's property, and any transfer of shares or change to the status of the company's shareholders (unless ordered by the court).

2.2 Salisbury Securities Limited (Salisbury)

In August 2013, the CFI order the winding-up of Salisbury Securities Limited following a petition by the SFC under section 212 based on concerns as to the whereabouts of nearly HK\$9 million of securities and sale proceeds belonging to clients.¹⁵ In June 2013, the CFI made an order for the appointment of provisional liquidators again on the application of the SFC.¹⁶

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¹³ SFC. "[SFC seeks to wind up China Metal Recycling Limited](#)". 29 July 2013

¹⁴ SFC. "[Court continues appointment of provisional liquidators for China Metal Recycling \(Holdings\) Limited](#)". 2 August 2013

¹⁵ SFC. "[Court orders winding up of Salisbury Securities](#)". 28 August 2012

¹⁶ SFC. "[Court appoints provisional liquidators for Salisbury Securities Limited](#)". 28 June 2013