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A Comparative Study of Continuing Disclosure in Hong Kong and the PRC

*Implications for
Cross Border Listings on
H-share and A-share markets*

September 2008

The Hong Kong Institute of Chartered Secretaries

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The Institute is part of the Institute of Chartered Secretaries and Administrators (ICSA) of London. It was first established in 1949 as an association of Hong Kong members of ICSA. It became a branch of ICSA in 1990 before gaining local status in 1994.

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FOREWORD

This report examines the challenges faced by companies with dual listings on the Hong Kong and Mainland bourses in terms of compliance and disclosure requirements as well as the different approaches taken by the regulators in these jurisdictions.

There is little doubt (at least for those of us who work with both Hong Kong and Mainland listed issuers) that there has been some convergence on area such the general principles of disclosure of price-sensitive information for A and H share companies; and certainly since December 2007 the accounting standards of Hong Kong and the Mainland have been marked by, if not yet a union, then at least a substantial movement towards each other. While these moves are to be applauded, those professionals involved in advising listed issuers and with the responsibility of informing the market about price sensitive issues should continue to encourage the regulators in both Hong Kong and the Mainland to agree, as much as it is possible, on a common and best practice platform. I add the last phrase deliberately to highlight that a common platform should not mean a lowering of standards or surrender by Hong Kong regulators and government of the very items that make our stock market so attractive to Mainland issuers. The lowest common denominator in terms of reporting is not an option that should be considered, let alone discussed. Quality is the key to success, not ease of entrance.

This said there are areas that need agreement. Past incidents of non-simultaneous suspension of trading in A and H shares of the same company has revealed the risk of arbitrage by sharp eyed investors. Enforcement by regulators as well as clear lines of reporting and responsibility of disclosure needs to be agreed upon if further confusion is to be avoided.

I hope that this report will go some way to helping all the parties involved – be they regulators, governments, investors or companies – understand the questions a little better, even if it does not provide all the answers.

This report is one of the most ambitious and challenging research projects undertaken by The Hong Kong Institute of Chartered Secretaries. While many people contributed to this report I would like to especially thank lead author Dr Leng Jing, Assistant Professor, Law Faculty, University of Hong Kong and other major contributors including Dr Brian Lo, Vice President & Company Secretary of APT Satellite Holdings Limited, our Council member and who is also serving as Chairman, Education Committee of the Institute; Mildred Chan, Senior Manager, Technical Services, Tricor Services Limited; Virginia Leung, Supervisor – Technical Services, also of Tricor Services Limited and last but certainly not least Loretta Chan, Director, Technical & Research at the Institute. Without their dedication and hard work in the past year, this project would not have been possible.

My sincere thanks to those involved in the production of this research report not only to those mentioned above but also the vast number of people not named either above or in the acknowledgement list at the end of this paper who were involved in copy proofing, advising, editing and general polishing of this research paper. It truly is a team effort and its publication is a credit to you, the Institute and the profession of Chartered Secretary.

Natalia Seng, FCIS FCS (PE)

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PREFACE

At the end of August 2008 there were 55 companies that have issued both A and H-shares on the Mainland and in Hong Kong respectively, these collectively account for approximately 26% of the total market capitalisation of the Stock Exchange of Hong Kong. This is a significant number and the differences in the regulatory regimes present unique challenges for investors, management and the board of directors and of course, regulators. It is important that we all understand the differences between the jurisdictions of the Mainland and Hong Kong.

I greatly welcome this research report published by The Hong Kong Institute of Chartered Secretaries as it pinpoints potential areas of differences that may give rise to confusion. Although it does not give solutions to every potential point of conflict between the respective jurisdictions, and nor should it, it does provide guidance as to those tricky areas that require more attention.

As the promotion of understanding of the securities and futures industry is a key aim of the SFC, we actively encourage research into our industry. The regulatory differences between Hong Kong and the Mainland is an area in need of more research and I am delighted to see independent third parties such as The Hong Kong Institute of Chartered Secretaries and other professional bodies, as well as academic institutions, carry out thorough and engaging research. As ever information and communication are the keys to clarity.

Once again, I would like to offer my sincere thanks and congratulations to The Hong Kong Institute of Chartered Secretaries for publishing this excellent and much needed research report.

Eddy Fong GBS, JP

Chairman

Securities and Futures Commission

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Executive Summary

The last few years have seen a substantial increase in the number of A&H dual listings in Hong Kong and the PRC. As of 12 August 2008, 55 companies were listed on both markets. These cross-border dual listings bring challenges to issuers and regulators in both Hong Kong and the PRC. One of the biggest concerns that issuers face is to ensure simultaneous and consistent compliance with the continuing disclosure regimes in the two jurisdictions. These regimes differ in several ways, including in terms of their structures, enforcement patterns and regulatory intensity. The most pressing challenges for the regulators are growing investor concerns about possible unequal treatment of shareholders and regulatory arbitrage resulting from regime differences in Hong Kong and the mainland; both of these concerns are commonly caused by compliance inconsistencies and the differences in enforcement between the two markets.

Comparison of regulations in the A-and H-share markets

This study presents an in-depth comparison of the continuing disclosure regimes in Hong Kong and the PRC. We analyse critical general differences between the two markets, such as the general frameworks and structures of the two disclosure regimes, overall frequency and intensity of disclosure required by two sets of laws and regulations, as well as common methods of disclosure. We also study material differences in four specific areas of continuing disclosure: disclosure of price-sensitive information, periodic financial reporting, disclosure of notifiable transactions and disclosure of connected transactions.

Our findings on material differences in the four specific areas are as follows.

Disclosure of price-sensitive information

While there are signs of convergence in general disclosure principles, the scope of discloseable information, and the timing and method of disclosure, other material differences still exist. These include the parties responsible for making disclosure, monitoring unusual price movements, suspension of trading and mechanisms for combating insider dealing. It seems that gaps between policies on suspension of trading have created most problems. This was brought to light through the non-simultaneous suspension of trading in the A-shares and H-shares of a dual-listed company, and this event highlighted the risk of regulatory arbitrage and the losses it could cause investors. There is therefore an urgent need for synchronisation in cross-border suspension.

Periodic financial reporting

This area is where much of the recent convergence between the two regimes has taken place. Since December 2007, there has been encouraging progress in substantial convergence between accounting standards in Hong Kong and the PRC. This marked the beginning of a welcome process of mutual acceptance of accounting standards for listing by regulators in the other jurisdiction. The recent proposal for mandatory quarterly reporting by the main board issuers in Hong Kong is also regarded by market participants as an important effort to bring Hong Kong's financial reporting practices in line with developments in advanced capital markets and with the mainland, where quarterly reporting is already mandatory. Despite the convergence in accounting standards, however, there are still several material differences in financial reporting standards and practices regarding, for example, industry-specific financial reporting requirements, the announcement of preliminary results, the audit of accounts, the form and content of periodic financial reports and post-vetting of periodic financial reports.

Disclosure of notifiable transactions

Discloseable transactions in the PRC are essentially what the Hong Kong market regards as notifiable transactions. However, the categorisation methods and percentage ratios which apply to notifiable transactions in Hong Kong differ from those applied to discloseable transactions in the PRC. The grant of guarantees by listed issuers on behalf of related entities is one type of transaction that has received more intensive attention from regulators in the PRC, where it is subject to stringent disclosure and shareholder approval rules, than in Hong Kong. This may be because many A-share companies have a worrying record of pledging guarantees to creditors in order to secure loans to their parent companies, and these loans have often turned bad. The benchmarks for triggering disclosure requirements, shareholder approval or both, and the implementation of shareholder approval procedures, are two other areas where material differences exist.

Disclosure of connected transactions

The definition of a connected person in Hong Kong and the definition of a related party in the PRC are rather different. Other notable differences lie in the disclosure and shareholder approval requirements for connected transactions in Hong Kong and for related party transactions in the PRC, as well as the respective exemptions. In the PRC, related party transactions involving the granting of corporate guarantees are all subject to stringent disclosure requirements and shareholder approval; none of these transactions are exempt from these requirements, regardless of the amount involved. In Hong Kong, by comparison, the granting of guarantees is only subject to the relatively less demanding benchmarks that trigger disclosure and approval procedures.

Enforcement in the two markets

This study also examines differences in the general patterns of enforcement against listing rules breaches in Hong Kong and the PRC. Areas of material difference include the parties subject to regulatory sanctions or disciplinary actions, overall frequency of enforcement and categories of breaches. One of the main differences here is that in the PRC, both the stock exchanges and the China Securities Regulatory Commission have enforcement powers over breaches of disclosure rules, although interestingly there does not seem to be any significant overlap with this parallel enforcement pattern. In Hong Kong, the primary enforcement body for disclosure matters is the Stock Exchange of Hong Kong. In both Hong Kong and the PRC, most of the breaches of listing rules are disclosure-related, suggesting stronger future efforts should be made by regulators and listed issuers in both markets in this area to further improve market transparency and investor protection.

Our conclusions and suggestions are as follows:

1. Although there are material differences in certain substantive and procedural features of the four specific areas examined – disclosure of price-sensitive information, periodic financial reporting, disclosure of notifiable transactions and disclosure of connected transactions – we have not identified any major conflicts between two sets of laws and regulations. To a large extent, the material differences found in these specific areas of disclosure seem primarily to be discrepancies. In recent years there has been a great deal of regulatory convergence, especially with respect to periodic financial reporting and the disclosure of price-sensitive information. The differences in laws and regulations governing continuing disclosure in the two markets are generally grounded on the fundamental differences in the regulatory frameworks, enforcement philosophy, levels of market liberalisation and market structures.
2. Dual-listed issuers do not seem to face any serious difficulties in complying with these two sets of different regulatory requirements. In practice, issuers tend to comply with the higher reporting and disclosure standards, although doing this usually results in higher compliance costs. Generally, the dual-listed issuers have had a good compliance record.
3. Both the Hong Kong and PRC capital markets are retail-driven with a relatively high level of participation by individual investors. The trends in both markets of moving toward tighter disclosure – as reflected in a series of regulatory reforms implemented or proposed by regulators on both sides – can be seen as a direct response to calls for better protection of public investors and higher market transparency, given the high proportion of retail investors.

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- 4 As most large state-owned enterprises have now completed their H-share listings, the next wave of PRC issuers likely to come to Hong Kong to list will be primarily smaller state-owned enterprises and private enterprises (minying qiye). This might pose new monitoring challenges for Hong Kong regulators due to the generally weaker corporate governance associated with these smaller firms.

We believe that this research study is timely. The ongoing trend for A&H dual listings requires a close examination of material regulatory differences between the Hong Kong and PRC markets to help make cross-border capital flows smooth and sustainable and to maintain Hong Kong's strength in attracting mainland listings. We hope that this study can make a significant contribution to the future development of capital markets in both Hong Kong and the PRC, particularly in regulatory co-ordination and convergence.

List of abbreviations

| | |
|--------|---|
| CSRC | China Securities Regulatory Commission |
| EDP | Electronic Disclosure Project |
| HKEx | Hong Kong Exchanges and Clearing Limited |
| HKFRSs | Hong Kong Financial Reporting Standards |
| HKICPA | Hong Kong Institute of Certified Public Accountants |
| HKICS | The Hong Kong Institute of Chartered Secretaries |
| IAS | International Accounting Standards |
| IASB | International Accounting Standards Board |
| IFRSs | International Financial Reporting Standards |
| IPO | Initial Public Offering |
| MMT | Market Misconduct Tribunal |
| PSI | Price-sensitive information |
| SEHK | The Stock Exchange of Hong Kong Limited |
| SFC | Securities and Futures Commission |
| SFO | Securities and Futures Ordinance |
| SGX | Singapore Stock Exchange |
| SHSE | Shanghai Stock Exchange |
| SOE | State-owned enterprise |
| SZSE | Shenzhen Stock Exchange |

PART 1: INTRODUCTION

Background

Increase in A&H dual listings

This project is undertaken at a time of strong increase in the number of dual listings of PRC companies on both Hong Kong and mainland stock markets. There were 55 dual-listed companies as of 12 August 2008 (see Appendix A).

So far, there have been three kinds of dual listing:

Simultaneous A and H listings: A listed company issues A-shares to the PRC market and H-shares to the Hong Kong market at the same time. An example is the Industrial and Commercial Bank of China initial public offerings (IPOs), which took place in Hong Kong and Shanghai in October 2006.

Non-simultaneous H first, A second listings: An H-share listing is followed by a subsequent A-share listing. This has been the case of most of the current dual-listed PRC companies with outstanding A-shares and H-shares.

Non-simultaneous A first, H second listings: An A-share listing is followed by a subsequent H-share listing. This type of dual listing only started quite recently but is gaining increasing currency among PRC companies, especially large state-owned companies, and driven by the PRC government's encouragement as part of its measures to develop domestic capital markets. The first such listing took place with the launch of dual IPOs by China Railway Group in Shanghai and Hong Kong on 3 December 2007 and 7 December 2007 respectively.

Driving forces behind A&H dual listings

The phenomenon of cross-border dual listings by PRC companies has largely been driven by three main factors.

The first factor is the Chinese government's effort to prepare large state-owned enterprises (SOEs) operating in strategic industries for global competition after China joined the World Trade Organization in 2001. These enterprises represent the commanding heights of the Chinese economy and have been undergoing structural and corporate governance reforms, centring on ownership diversification. As well as helping these companies access a much wider investor base and inviting greater participation of international capital in ownership structures, listing in Hong Kong can subject these enterprises to higher standards of securities regulation and markets discipline. In particular, overseas listing is widely believed in China to have the effect of propelling domestic enterprises to strive for international best corporate governance practices.

The second factor is the strengthened co-operation between the mainland and Hong Kong governments in building Hong Kong as an international financial centre and a primary gateway for channelling global capital to finance PRC companies. Specifically, one of the aims of the arrangements under the Closer Economic Partnership Arrangement reached by the mainland and Hong Kong governments is mutual economic co-operation through the encouragement and support for the listing of PRC companies in Hong Kong. In its recent report on "China's 11th Five-Year Plan and the Development of Hong Kong," released in January 2007, the Hong Kong government for the first time officially positioned Hong Kong's development in the overall context of the mainland's economic development strategy. With increasing regional and global competition for overseas listings, this report sets the promotion of further fund-raising activities by PRC companies through Hong Kong as a key component of the Hong Kong government's agenda for enhancing the city's financial services sector.

The third factor is the ongoing reform and liberalisation of China's domestic capital markets. The progress made in enhancing the quality of the A-share market explains to a significant extent the recent trend of H-share companies returning to the Shanghai Stock Exchange through a new A-share listing. The reform and liberalisation process aims at improving regulatory quality and market structure. A recent reform focus has been to remove a long-standing split-share structure under which A-shares had been divided into tradable and non-tradable categories. The reform's purpose was to make non-tradable shares tradable and diversify the investor base. The initiation of the share structure reform (gu gai) marked a decisive turn in the government's policy on continuing maintenance of state dominance in the ownership of listed companies. It is anticipated that gu gai, currently near its completion, will essentially remove from the domestic capital markets a historically entrenched structural deficiency, therefore rationalising the overall market structure and easing market conditions for new IPOs. This market condition is especially important to the launch of A-share IPOs of the returning H-share companies, which are generally large-cap blue chips and in particular need of positive investor sentiment supported by sound market basics.

Another factor to exert a potential impact on the trend of cross-border listing, although not directly concerning PRC-incorporated companies, is the ongoing effort of Chinese securities regulators to assess the prospects of opening up domestic capital markets to foreign issuers by allowing them to launch IPOs in the A-share market.¹ According to the China Securities Regulatory Commission (CSRC), the possible liberalisation of the A-share IPO market would firstly impact so-called red chip companies that are currently listed in Hong Kong.² PRC regulators have been consulting market participants on entry qualifications for admission to A-share listings of red-chip companies.³ In addition, the

¹ See, for example, "NYSE set to list on Shanghai exchange", South China Morning Post, 15 April 2008; Sundeep Tucker and Justine Lau, "Beijing set to encourage foreign listings", Financial Times, 17 January 2008.

² See, for example, "Whole bank, not just HSBC China, for Shanghai listing", The Standard, 12 December 2007, online: http://finance.thestandard.com.hk/chi/comp_news_view.asp?code=0005&aid=58674. Red-chip companies are incorporated in Hong Kong or certain foreign jurisdictions recognised by the Stock Exchange of Hong Kong (SEHK) and have substantial business or personnel connections to the Mainland. According to the Joint Policy Statement Regarding the Listing of Overseas Companies issued by SFC and the SEHK on 7 March 2007, the recognised non-PRC jurisdictions are Bermuda and the Cayman Islands.

³ Nevin Nie, "Size limit for returning red chips seen to stabilise A shares", South China Morning Post, 9 June 2007.

likelihood of allowing multinational companies, such as HSBC, Coca-Cola and Siemens, to issue A-shares is also under review by PRC regulators.⁴

Calls to reduce regulatory gaps

Issuers' compliance challenges

While the factors given above indicate the major causes for the intensified movement of cross-border dual listings, they also point to an underlying challenge: since there are certain material differences between Hong Kong and PRC laws and regulations governing post-IPO requirements on corporate governance practices and disclosure obligations, companies with an A&H dual listing face higher compliance costs than companies with a single listing.

Growing investor concerns about regulatory gaps

While most dual-listed issuers have managed to struggle through the regulatory gaps without recording any unusual frequency or extent of compliance failures or deviations that would alarm the regulators⁵, there have nevertheless been concerns about inconsistency and imbalance in compliance under some circumstances, particularly with regard to post-IPO continuing disclosure. Hong Kong regulators have expressed their worries about the practical risk of unequal treatment of shareholders of dual-listed companies, pointing to the potential disadvantage that Hong Kong investors have in promptly receiving price-sensitive information, which might be circulated in the mainland news media in advance of a formal announcement by issuers on both exchanges.⁶

Regulators' appeals for closer co-ordination and synchronised enforcement

The existence of regulatory gaps and the resulting compliance challenge have drawn close attention from the regulators in both markets. For example, Eddy Fong, Securities and Futures Commission (SFC) non-executive chairman, has recently remarked that due to differences in the regulatory requirements and business cultures in the Hong Kong and mainland capital markets, investors in Hong Kong have suffered from sub-standard disclosure by some dual-listed PRC companies, usually in the form of insider information leaking to mainland investors through earlier or selective disclosure. This unequal treatment of shareholders, in his view, could be mitigated through improved, closer regulatory dialogue and collaboration between Hong Kong and the mainland in achieving synchronised enforcement.⁷

⁴ See "NYSE set to list on Shanghai exchange", South China Morning Post, 15 April 2008; Enoch Yiu, "Shanghai bourse studies listing of multinationals", South China Morning Post, 19 November 2007.

⁵ Empirical data provided in Part III show that for the period from 2005-2007, only two A&H companies, Nanjing Panda Electronics and Luoyang Glass, were sanctioned by the SEHK through public censure, both for failing to meet continuing disclosure obligations.

⁶ Justine Lau and Geoff Dyer, "Spotlight falls on co-ordination of stock exchanges", Financial Times, 7 June 2006.

⁷ "SFC Chairman Eddy Fong: Regulatory Gaps between A-share and H-share Markets Need to be Addressed Urgently", Hong Kong Commercial Daily, 12 October 2007 ("香港證監會主席方正：AH股條例差異須急處", 2007年10月12日, 香港商報, online: <http://stock.jrj.com.cn/news/2007-10-12/000002777303.html>).

Laura Cha, a member of the Executive Council of the Hong Kong government and an independent non-executive director of the Hong Kong Exchanges and Clearing Limited (HKEx), has also made strong comments on the urgent need to make the two sets of listing regulations in Hong Kong and the PRC more in line, and less in conflict, with each other.⁸ In particular, she pointed out the worrying fact that the major enactment on H-share listings of PRC companies, the Mandatory Articles of Association for Companies Listing Abroad (the Mandatory Articles), was drafted in 1994 and has increasingly proven to be outdated and has hindered the operational efficiency and prompt corporate decision-making of H-share companies. One revealing example is the notice period for annual general meetings (AGMs). While at least 20 days' notice is required for an A-share company's AGM and at least 21 days' for a company listed on the Stock Exchange of Hong Kong (SEHK) (other than PRC issuers), H-share companies have to give shareholders 45 days' notice – a considerably heavier burden.⁹ Similar discrepancies also exist in continuing disclosure requirements.

In light of the growing trend in A&H dual listings, the inconsistencies between laws and regulations in the two markets have posed technical problems with IPOs. To address market concerns, the CSRC has expressed its intention of studying the strategy of amending relevant regulations to help H-share company operations, although without specifying a detailed task schedule.¹⁰

Value and potential impact of this report

This project is conducted against the background detailed above and combines market, regulatory and policy perspectives and concerns. We seek to address some of the most critical issues arising from the dual listing phenomenon: specifically, how to improve cross-border regulatory collaboration and how to achieve better rule alignment on continuing disclosure. This report is primarily concerned with helping further improvements in market transparency and regulatory quality through better synchronised enforcement of disclosure regimes on both Hong Kong and mainland exchanges to afford equal protection to investors in both markets. We believe that the release of this report is timely and of significant practical importance to the future development of capital markets in both Hong Kong and the PRC.

⁸ Laura Cha was appointed to the CSRC by the State Council and became the first person outside the Mainland to join the Chinese government at the vice-ministerial rank. She served at the CSRC from 2001 to 2004 as its vice-chairwoman in charge of reforming IPO mechanisms and improving the corporate governance of listed companies. As part of her contribution to the development of China's capital markets, Laura Cha helped with the establishment and strengthening of the regulatory infrastructure at the CSRC during its early years of operation.

⁹ See HKEx Combined Consultation Paper on Proposed Changes to the Listing Rules (January 2008).

¹⁰ "Laura Cha: Review Needed for Regulations on H-share Listing", Mingpao, 5 March 2008 ("史美倫：H股上市條款應檢討", 明報, 5 March 2008).

Timeliness

The Hong Kong government has made it its strategic priority to maintain (if not further increase) Hong Kong's competitive edge in attracting listings of overseas issuers and in serving as an international financial centre, especially as a global IPO hub. This policy priority calls for continuous review of the regulatory framework for, inter alia, listing standards and disclosure requirements, to make capital market regulation in Hong Kong further aligned with prevailing international practice.

In this context, the release of this report is timely in the sense that the ongoing trend of A&H dual listings requires a close examination of material regulatory differences between Hong Kong and the PRC to help make cross-border capital flows smooth and sustainable and to maintain Hong Kong's strength in attracting mainland listings.

Regulatory and policy significance

We hope that the findings of this report will prove useful to both regulators and listed companies in their dealings with disclosure-related matters. In particular, we expect this report to provide important, updated information that can help regulators in their efforts to build closer collaboration across borders in both rule-making and enforcement. We believe that this would benefit the future development and possible convergence of capital markets in Hong Kong and the PRC.

Practical and forthcoming issues

In addition to analysing material differences between the two continuing disclosure regimes, this report also discusses proposed reforms to the disclosure regime in Hong Kong initiated by the SFC and HKEx. In particular, we address certain important issues arising from the following reform proposals: the SFC Consultation Paper on giving statutory backing to certain Listing Rules on disclosure and the consultation's conclusions; the HKEx's Consultation Paper on periodic financial reporting; and the HKEx Combined Consultation Paper on introducing amendments to the Listing Rules. In July 2008, the HKEx published the conclusion of its consultation on shortening the deadlines for half-year and annual reporting by main board issuers¹¹.

¹¹ See "Consultation Conclusion on Shortening the Deadlines for Half-Year and Annual Reporting by Main Board Issuers" published by the HKEx on 18 July 2008.

Coverage

This report closely examines the following five features of the two disclosure regimes:

- (1) General differences in regulatory framework and structure
- (2) Disclosure of price-sensitive information
- (3) Periodic financial reporting
- (4) Disclosure of notifiable transactions
- (5) Disclosure of connected transactions

Methodology

Three methods are employed in this report:

- (1) Formative review of material differences in laws and regulations
- (2) Empirical study of enforcement against breaches of disclosure rules and corporate governance performance of listed companies
- (3) Qualitative analysis of two existing disclosure regimes and their reforms, including ongoing reforms and trends of future reforms

Qualifications and disclaimer

This report focuses on material differences between disclosure regimes in Hong Kong and the PRC which have a significant impact on the level of consistent compliance. Five major aspects of disclosure (identified above) are reviewed where material differences may exist. Accordingly, this report does not address the numerous textual and technical differences in the various issuer disclosure obligations required on both the Hong Kong and PRC markets, which do not seem to have posed serious problems. After all, many of the minor, non-essential differences are justified on a number of legitimate grounds, including, *inter alia*, fundamental differences in market structure, regulatory philosophy and level of sophistication in financial rule-making in Hong Kong and the PRC. Accordingly, this report is not meant to serve as guidance for issuer compliance; nor is it intended to substitute for legal and professional advice in particular circumstances.

Instead, this report is aimed at indicating material regulatory gaps and possible compliance challenges, and making recommendations to regulators, primarily for their reference, on possible ways of addressing those concerns. In addition, this report also discusses possible future trends for convergence between the Hong Kong and PRC capital markets, especially regarding the strategies for improving future regulatory collaboration.

PART II: REVIEW AND COMPARISON OF HONG KONG AND PRC LAWS AND REGULATIONS

Main laws and regulations

PRC companies seeking an H-share listing need to comply with relevant provisions in the Securities and Futures Ordinance (SFO) and the SEHK Listing Rules. Other sources of regulation also apply, including guidance notes and practice notes issued by the SFC and the SEHK. A list of the main pertinent laws and regulations, as well as proposed new regulations specified in the regulators' consultation papers, is provided in Appendix B.

PRC companies seeking an A-share listing need to comply with relevant provisions in the Company Law, Securities Law, CSRC regulations and stock exchange regulations. A list of the main pertinent laws and regulations can be found in Appendix C.

From our review of these laws and regulations, there are two types of material differences between continuing disclosure regimes in Hong Kong and the PRC: general differences and specific differences.

General differences

General framework and structure of the disclosure regimes

Streamlined rule-making and enforcement by the SEHK (subject to change upon the implementation of the statutory backing to the listing rules) compares with parallel rule-making and enforcement by the CSRC and mainland stock exchanges

Hong Kong

The SEHK is the primary rule-maker for H-share companies on disclosure matters and is the frontline enforcement body of the disclosure regime. The Listing Rules and relevant Appendices set out comprehensive disclosure requirements, including not only general principles and provisions, but also detailed, specific guidance and practice notes. Meanwhile, under the dual filing system, which came into force in 2003, the SFC also has jurisdiction over enforcement of disclosure by listed companies, which must be accurate and complete, failing which the SFC may exercise its statutory powers to investigate the matter.

The main sources of laws and regulations on disclosure that issuers must comply with are the SFO and the Listing Rules. Since substantial portions of disclosure requirements are written into the non-statutory Listing Rules, a good understanding of the Listing Rules can keep issuers reasonably informed of what they and their executives are required to do in discharging continuing disclosure obligations, although awareness of other sources is also necessary. In general, non-compliance may lead to exchange sanction or disciplinary action, usually in the form of public censure or criticism, in addition to the exchange's power to suspend or cancel a listing.

However, Hong Kong's disclosure regime will likely be significantly reformed in the near future. In early 2007, the SFC concluded its market consultations on proposals to give statutory backing to major disclosure requirements of the Listing Rules.¹² The proposed statutory backing to the Listing Rules covers three areas:

- (1) Periodic financial reporting
- (2) Disclosure of price sensitive information
- (3) Certain notifiable transactions and connected transactions which require disclosure and/or shareholder approval

The highlight of the SFC's current stance on giving statutory backing to the Listing Rules is a proposed revised approach, under which:

- a set of general principles will be incorporated in the SFO;
- the general principles will be supplemented and elaborated on by ancillary provisions in a new Schedule to the SFO; and
- the more detailed and technical provisions will be set out in a non-statutory Listing Code to be issued by the SFC.

Since the SFC indicated in its Consultation Conclusions that it will introduce a Securities and Futures (Amendment) Bill to the Legislative Council "as soon as practicable", issuers are advised to note four likely changes upon the implementation of the proposed statutory backing to the listing rules¹³.

First, the three areas of disclosure requirements to be covered by the SFO and the non-statutory Listing Code will be deleted from the Listing Rules upon commencement of the new statutory disclosure regime.¹⁴

Second, while disclosure is currently based on pre-vetting of announcements and documents by the SEHK, under the new statutory disclosure regime this practice will be gradually moved to reduce pre-vetting. This is likely to result in more specific liability for individuals in the case of non-compliance. To align with this direction, the SEHK has proposed in its Combined Consultation Paper to shift progressively from extensive pre-vetting of issuers' announcements and documents toward post-vetting.¹⁵

¹² SFC Consultation Paper on the Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules (SMLR) (January 2005) and Consultation Conclusions (February 2007).

¹³ See Submission made by The Hong Kong Institute of Chartered Secretaries (HKICS) on 22 March 2007 in response to the SFC's Consultation Conclusions for its views on some of the points raised in the Consultation Conclusions www.hkics.org.hk/News/1976_Submission-SFC.pdf

¹⁴ These include relevant requirements in Chapters 4, 13, 14 and 14A and Appendices 15 and 16.

¹⁵ HKEx Combined Consultation Paper on Proposed Changes to the Listing Rules (January 2008).

Third, upon the new statutory disclosure regime coming into force, the regulator of disclosure in the specified three areas will change from the SEHK to the SFC. In response to market concerns that this change may give rise to inconsistent enforcement (such as different interpretations of the same rules by different regulators), the SFC has stressed in its Consultation Conclusions that this situation will not arise.

Fourth, non-compliance will result in different types of enforcement actions according to the types of rules breached, including civil fines of up to HK\$10 million imposed by the SFC and criminal prosecution. These will be severer than the current SEHK sanctions which take the form of public censure or criticism.¹⁶

It should be noted that since the release of the Consultation Conclusions in February 2007, the plan to introduce the proposed Securities and Futures (Amendment) Bill by the SFC to the Legislative Council has been put on hold, pending further government deliberation.

PRC

For A-share companies, by comparison, the disclosure regime is built on three levels of rules and is characterised by parallel enforcement by both the CSRC and the stock exchanges.

The first level of rules consists of the Company Law and the Securities Law, which set out broad principles and provisions on continuing disclosure.¹⁷ These provisions are relatively brief and principle-oriented, and are meant to be supplemented by detailed regulations issued by the CSRC and the stock exchanges. Enforcement of the Securities Law is vested chiefly with the CSRC, but the courts may intervene (as far as criminal liability is concerned, police authorities and prosecution authorities may also intervene) where insider trading, market manipulation and false statement have caused investor losses or have resulted in criminal liability.

The second level of rules is composed of CSRC regulations which take a variety of forms, including regulations, measures, notices and guidelines. These regulations are subject to constant revisions due to the ongoing reform and development of the A-share market. Most of the CSRC enactments (not including notices and guidelines) are commonly known as departmental regulations (部門規章) which rank lower than laws (法律) (such as the Securities Law) in China's legislative framework. Violations of CSRC regulations are subject to CSRC sanctions, which are known as administrative sanctions (行政處罰). The forms of CSRC sanction for non-compliance with disclosure requirements include charging corrections, warnings, imposing a fine and banning entry into the securities market etc.

¹⁶ Non-compliance with general principles in the SFO will be regarded as market misconduct. Non-compliance with the provisions of the Schedule to SFO or the Listing Code may constitute a contravention of the general principles in the SFO. In such cases the SFC may take action in accordance with the "proportionality principle". Serious cases would potentially be subject to one of the three types of sanction: SFC disciplinary action, Market Misconduct Tribunal (MMT) proceedings or criminal prosecution. In addition, a mens rea test for directors and officers is required in deciding on liability – directors and officers would only be subject to SFC or MMT sanctions if they are knowingly, intentionally or negligently concerned in the breach. See SFC Consultation Conclusions (February 2008).

¹⁷ Securities Law, Chapter 3, Section III and Section IV.

The third level of rules is supported by numerous exchange enactments on disclosure matters, which further substantiate and supplement corresponding CSRC regulations with operational and implementing details. Of these, the Listing Rules are the primary source of exchange regulation on disclosure, although these still need to be coupled with various separately issued exchange enactments to form a comprehensive framework for disclosure regulation. These enactments are self-regulatory in nature. The most common form of exchange disciplinary action for non-compliance with disclosure requirements is public criticism. Keeping pace with their corresponding CSRC regulations, exchange regulations are also subject to constant revisions. Violations of these rules are subject to exchange sanction or disciplinary action. The exchanges may refer serious violations to the CSRC.

In general, there is not much overlap between CSRC enforcement and stock exchange enforcement on disclosure matters. There have been instances where both the CSRC and the exchanges took enforcement action against same companies and/or individuals for the same violations, sometimes with the CSRC listing more items of breach in the same case, but the overall percentage of such cases to the total number of cases handled is statistically insignificant. More analysis is provided in Part III.

This leads us to the observation that there exists a material difference in enforcement between the two markets: while in Hong Kong the SEHK is the primary enforcer, in the PRC both the CSRC and the stock exchanges enforce disclosure regulations and impose sanctions or disciplinary actions for breaches.

Frequency and intensity of disclosure

Although it is difficult to gauge the overall frequency and intensity of disclosure required of listed companies in Hong Kong and the PRC at a comparable level, it has been suggested that in some circumstances A-share companies are under certain disclosure obligations which are not, or not yet, assumed by H-share companies.

For example, A-share companies have to disclose to the public their internal operational rules and administration records, where H-share companies are generally not subject to this obligation. In addition, A-share companies must also produce quarterly financial reports and to file with the exchanges every board resolution as well as the voting records (both for and against) of independent directors on particular resolutions.¹⁸

It should be noted however that Hong Kong regulators have proposed making quarterly financial reporting mandatory for Main Board issuers (GEM issuers have long been subject to this requirement), as proposed by the HKEx in its consultation paper.¹⁹ If implemented, this should close the current gap in the frequency of periodic financial reporting between the Hong Kong and PRC markets.

¹⁸ SHSE/SZSE Listing Rules, 6.6, 8.1.1.

¹⁹ HKEx, Consultation Paper on Periodic Financial Reporting (August 2007).

Methods of disclosure

These are either electronic disclosure or the parallel use of paper-based and electronic disclosure.

Hong Kong

Under the relatively new HKEx Electronic Disclosure Project (EDP), the primary method of disclosure is straight-through publication of issuer documents on the HKEx website. The EDP has brought Hong Kong's securities market to a new era of electronic disclosure and has been in operation since 25 June 2007. The EDP has made publishing full-paid announcements in local newspapers optional for issuers. All issuers are now required to submit their announcements to the HKEx for publication on its website. During a transition period, Main Board issuers that did not have their own websites after 25 December 2007 were still required to publish full-paid announcements in local newspapers when their announcements are published on the HKEx website. From 25 June 2008 onwards, every issuer must have its own website where the public is able to access its Listing Rules-related documents free of charge.²⁰

PRC

To disclose any information according to law, a listed company or any other person obliged to disclose information shall submit the draft announcements and other reference documents to the stock exchange for registration and shall publish them on the newspapers and websites designated by the CSRC.²¹

Remarks

Hong Kong has started to move to a paperless electronic disclosure regime, which is more environmentally friendly and less costly for issuers. By comparison, the mediums through which A-share companies make their information disclosure include both newspapers and websites.²²

Listed companies have enthusiastically welcomed the new changes in Hong Kong. In particular, the abolition of paid announcements is widely believed to significantly reduce compliance costs, given the fact that it is much more expensive to publish announcements in Hong Kong newspapers than it is in the PRC. Although paid announcements are still required in the PRC, these do not seem to add significantly to listed companies' costs because PRC newspapers usually charge much less than their Hong Kong counterparts do for the same service and routinely offer flat discount rates to long-term customers.

²⁰ "Electronic Disclosure Project's First Week of Operation", HKEx News Release, 3 July 2007, online: www.hkgem.com/news/hkexnews/0707032news.htm

²¹ CSRC Measures for Regulating Information Disclosure of Listed Companies (上市公司信息披露管理辦法) (2007), Art. 6 and Art. 71(4).

²² "Designated newspapers" include the China Securities Journal (中國證券報), Shanghai Securities News (上海證券報), Securities Daily (證券日報) and Securities Times (證券時報). "Designated websites" primarily refer to exchange websites.

One of the complaints that A&H companies have often voiced about the claimed higher costs of compliance in Hong Kong is the requirement to mail copies of annual reports and circulars to shareholders (for example, when shareholder approval is needed for certain transactions), which is not a regular practice in the PRC. There seems to be a genuine concern among A&H companies that the additional costs arising from meeting these requirements can be high and are not necessarily justified on cost-effectiveness grounds: shareholders may ignore the material they receive, especially when they can access the same information through a website. It is therefore understandable that the call for changing this requirement has been growing. Lately, the SEHK has expressed an interest in considering possible reform of such requirement to further reduce compliance costs. An idea that is emerging in industry circles is to make delivery of annual reports and circulars by post optional upon shareholders' request: only if shareholders demand that they receive the reports and circulars in writing should listed companies have to comply with their request.²³

Language of disclosure

Hong Kong

H-share companies must generally make disclosure in both the English and Chinese languages. An exception to this is overseas regulatory announcements which have been prepared in one single language and in which the information concerned is not discloseable under the Listing Rules. The SEHK usually only conducts pre-vetting of English text submitted by listed companies.

PRC

All information disclosure shall be in the Chinese language. If it is simultaneously accompanied by a text in a foreign language, the person or entity obliged to disclose the information shall ensure that both texts contain the same content. Where there is any discrepancy between two texts, the Chinese text shall prevail.²⁴

Remarks

H-share companies generally assume a higher cost in providing bilingual documents than their A-share counterparts do.

Pre-vetting and post-vetting of announcements and documents

Hong Kong

Certain types of disclosure, such as disclosure of notifiable and/or connected transactions, are currently based on pre-vetting of announcements and documents by the SEHK. The SEHK usually only pre-vets English text submitted by listed companies. On the grounds that pre-vetting might result in misallocation of responsibility for corporate disclosures and delay in dissemination of information by listed issuers to the market, the SEHK has proposed moving

²³ See HKEx Combined Consultation Paper on Proposed Changes to the Listing Rules (January 2008).

²⁴ CSRC Measures, Art 8.

from extensive pre-vetting towards minimal pre-vetting of announcements as supplemented by post-publication scrutiny and enforcement. It is proposed that announcements relating to certain transactions – such as share option schemes, the issue of new securities, takeovers, mergers or offers and discloseable transactions – shall no longer be pre-vetted. However, according to the proposals, disclosure of major transactions, very substantial acquisitions and disposals, reverse takeovers and connected transactions would continue to be pre-vetted during a transitional period.²⁵ The reduction of pre-vetting is likely to result in more specific liability for individuals in the case of non-compliance.

PRC

Pre-vetting is a regular practice in the PRC. The exchanges routinely conduct a formative review of draft announcements and reference documents before listed companies make their disclosure to the public; as in Hong Kong, the exchanges are not responsible for the accuracy of the contents of the disclosed information.²⁶ The main types of documents subject to pre-vetting include periodic reports and ad hoc reports (pre-vetting, or pre-registering plus post-vetting, depending on the circumstances), particularly those concerned with price-sensitive information, and notifiable and connected transactions.

The more important and more substantive review is post-vetting by the exchanges. This also applies to both periodic reports and ad hoc reports (depending on the circumstances).²⁷ If any errors or mistakes are discovered, listed companies usually receive notices from the exchanges asking them to make necessary corrections, make supplementary disclosure, or both.

Remarks

Both the Hong Kong and PRC exchanges pre-vet certain types of draft documents for disclosure, especially in the case of disclosure of notifiable and connected transactions.

While substantive post-vetting has regularly been used in the A-share market for periodic reports and certain types of ad hoc reports which, as mentioned above, can result in follow-up requests for remedial and/or supplementary disclosure if defects are found, Hong Kong has yet to move to post-vetting on a progressive basis. According to the reform proposals put forward in two recent consultation papers by the SFC and HKEx, these changes would follow a two-step approach: from extensive pre-vetting first to reduced pre-vetting and finally to post-vetting.²⁸

²⁵ HKEx, Combined Consultation Paper on Proposed Changes to the Listing Rules (January 2008).

²⁶ SHSE/SZSE Listing Rules, 2.11.

²⁷ SHSE/SZSE Listing Rules, 2.11.

²⁸ The two consultation papers refer to the SFC Consultation Paper on giving statutory backing to the Listing Rules and the HKEx Combined Consultation Paper on proposed changes to the Listing Rules.

Disclosure management system

Hong Kong

The overall responsibility for discharging disclosure obligations under the Listing Rules rests with the board of directors.

However, with regard to disclosing price-sensitive information, the HKEx Guide makes it clear that issuers are advised to have a communications policy and procedures in place to assist their systematic dissemination of price-sensitive information.²⁹

The HKEx Guide also suggests that issuers' communications policies and procedures be made known to the investing public, although this is not a mandatory requirement. Still, there is no particular corporate office that is specified as being responsible for the centralised management and implementation of disclosure within a listed company. Issuers seem to have considerable room for flexibility in designing their own disclosure implementation mechanisms.

PRC

By comparison, A-share companies must have a systematic management system in place for information disclosure.³⁰ A listed company's rules on the management of its information disclosure are formed by a specific information disclosure department. Once the board of directors has decided to adopt the rules, these rules are submitted to the local bureau of the CSRC where the company is incorporated and to the relevant exchange for archiving. These rules must also be disclosed on the exchange's website.³¹

The board of directors conducts an annual self-assessment of the implementation of the company's rules on information disclosure management, and, when releasing the annual report, must include a report on the self-assessment in the annual report. Similarly, the board of supervisors prepares an annual assessment report on the implementation of the rules on information disclosure management, and must include this in the annual report as well.³²

²⁹ See HKEx Guide on Disclosure of Price-Sensitive Information (HKEx Guide), which does not form part of the Listing Rules.

³⁰ See CSRC Measures for Regulating Information Disclosure of Listed Companies (2007), Art. 37.

³¹ See CSRC Measures for Regulating Information Disclosure of Listed Companies (2007), Art. 37; SHSE Guidelines on Establishing Bylaws of Listed Companies on Information Disclosure (2007), Art. 4, Art. 5.

³² SHSE Guidelines on Establishing Bylaws of Listed Companies on Information Disclosure (2007), Art. 11, Art. 12.

In particular, the secretary to the board of directors is put in charge of organising and co-ordinating matters relating to information disclosure. The board secretary should gather and report to the board discloseable information, pay constant attention to media coverage of the company and verify whether what is reported by the media is true.³³ In other words, the board secretary is the specified corporate officer who co-ordinates the implementation of an issuer's policies and procedures for the systematic disclosure of information. This responsibility is genuinely demanding in practice, especially given that the board secretary is also required to join the chairman of the board of directors as well as managers in assuming the major liability for failure in ensuring the truthfulness, accuracy, completeness, timeliness and fairness of the issuer's *ad hoc* reports.³⁴

Remarks

H-share companies do not have to have designated corporate officer(s), an internal department, or both specifically responsible for implementing the systematic disclosure of company information. In particular, the company/board secretaries of H-share companies are not formally required by the Listing Rules to assume the responsibility for organising and co-ordinating the company's disclosure affairs, as their counterparts in the A-share market do.

In addition, unlike A-share companies, H-share companies are not subject to mandatory filing with regulators, and disclosure to the public, of their internal rules on disclosure management; nor do their board of directors and board of supervisors have to include their self-assessments on the implementation of those rules in the company's annual report.

Role of board/company secretaries in disclosure and management

As discussed above, an important issue that warrants further examination is the role of board/company secretaries of both A-share and H-share companies in the daily running of company business as reflected by their responsibilities in the disclosure of company information.

In A-share companies, board secretaries are regarded as being senior management/officers.³⁵ Although in practice it may not be the case that all A-share companies unanimously accord the formal title of senior officer to their board secretaries and provide them with comparable salary, ranking, executive perks and entitlements as normally enjoyed by vice presidents, directors and senior managers, it is nevertheless common practice for board secretaries to be guaranteed the right to access internal company information and to participate in decision making on important company affairs. The same can be said of board/company secretaries in H-share companies.

³³ CSRC Measures for Regulating Information Disclosure of Listed Companies (2007) (CSRC Measures), Art. 45.

³⁴ CSRC Measures, Art. 58.

³⁵ SHSE LR/SZSE LR, 18.1.

Board secretaries in both A-share and H-share companies are also expected to command a wide range of skills and capacities that make them competent in performing their job. The required qualifications usually include a good knowledge of the industries and businesses that their companies (as well as the companies' subsidiaries and related entities) engage in, a decent level of financial expertise and outstanding communication skills. In practice, loyalty to and trust of the chairman of the board (i.e. being the right hand person to the boss) is also essential to a smooth functioning of the post.

From the various observations above, it can be seen that placing the serious responsibility of managing and co-ordinating information disclosure affairs on the board secretaries of A-share companies seems to be compatible with their general job prescription and profile. Although board/company secretaries of H-share companies do not carry the same responsibility under the Listing Rules, in practice they routinely play a critical role in implementing companies' information disclosure in a similar manner observed of their counterparts in A-share companies.

The most salient difference seems to lie in liability for compliance failures: while board secretaries of A-share companies face the risk of assuming joint liability with other senior officers for defective disclosure in ad hoc reports and therefore may be subject to CSRC or exchange sanctions or disciplinary actions, their counterparts in H-share companies never find themselves becoming the target of SEHK enforcement (it is always the directors who bear liability).

Specific differences

The following summarises material differences in four specific areas between the two disclosure regimes:

- (1) Disclosure of price-sensitive information
- (2) Periodic financial reporting
- (3) Disclosure of notifiable transactions
- (4) Disclosure of connected transactions

Disclosure of price-sensitive information (PSI)

Hong Kong and the PRC have substantially similar regulations on the disclosure of PSI. The obligation to disclose PSI is the same in both markets because both the SEHK and the CSRC require A&H companies to simultaneously disclose the same information to investors in the different markets.³⁶

³⁶ See SEHK LR 13.09(2) and CSRC Measures, Art 2.

There do not appear to be any material differences between the Hong Kong and PRC markets in the following four features of PSI disclosure: general principles for disclosure, scope of discloseable information, timing of disclosure, and method of disclosure.

(i) General principles for disclosure of PSI

With minor textual differences, regulations in both markets stress the principles of truthfulness, accuracy, completeness, timeliness and fairness in the disclosure of PSI.

(ii) Scope of information to be disclosed

Regulations in both Hong Kong and the PRC regard the question of what constitutes PSI to be a matter of judgment on the part of listed companies; they do not give exhaustive lists of discloseable events. Instead, regulations in both markets draw on some general criteria to define price sensitivity and specify certain common examples of discloseable events for the reference of issuers' directors.

For example, under the SEHK Listing Rules, if any of the three criteria given below are met, information relating to a listed company (usually a group company), including information on any major new developments in the company's sphere of activity which is not public knowledge, would be regarded as PSI: The criteria are that the information:

- (1) is necessary to enable investors and the public to appraise the position of the company; or
- (2) is necessary to avoid the establishment of a false market in the company's securities; or
- (3) might be reasonably expected materially to affect market activity in and the price of the company's securities.³⁷

Similarly, under the CSRC Measures for Regulating Information Disclosure of Listed Companies (CSRC Measures),³⁸ a significant event (重大事件) that may materially affect the trading price of a listed company's shares and is not yet known to the investors is regarded as PSI and is subject to disclosure.³⁹

As already pointed out, both the SEHK Listing Rules in the H-share market and the CSRC Measures and exchange listing rules in the A-share market list common examples of events considered to be price sensitive. These examples are non-exhaustive and directors should make independent judgment as to whether to make announcements in situations not covered by the common examples given.

³⁷ SEHK LR 13.09 (1).

³⁸ CSRC Measures for Regulating Information Disclosure of Listed Companies (CSRC Measures) (上市公司信息披露管理辦法) (2007).

³⁹ CSRC Measures, Art 30.

Overall, it can be said that the scope of PSI (股價敏感資料) in the H-share market does not diverge in significant ways from the scope of significant events (重大事件) in the A-share market. Due to different contents of rights and entitlements usually attached to the H-shares and A-shares of a dual-listed company (for example, the lock-up periods for formerly non-tradable A-shares after *gu gai* do not apply to H-shares), information considered price-sensitive in one market may not be viewed as price-sensitive in the other. It is assumed that under such circumstance issuers still need to make simultaneous and the same disclosure to investors in both markets.

(iii) When to disclose

Hong Kong

The guiding principle is that information which is considered price-sensitive (and potentially price-sensitive) and non-public should be announced promptly after it becomes known to a director or senior management of the issuer, is the subject of a decision by the directors or senior management of the issuer, or both.⁴⁰ Until such an announcement is made, the directors must ensure that such information is kept strictly confidential. Where it is felt that the necessary degree of security cannot be maintained or that security may have been breached, an announcement must be made.⁴¹

PRC

A listed company shall, in a timely manner,⁴² disclose the information about a significant event when any of the following circumstances firstly occurs:

- the board of directors or board of supervisors makes a resolution about the significant event;
- the parties concerned enter into a letter of intent or agreement on the significant event; or
- the directors, supervisors or senior managers know the significant event and report it to the company.

Before the disclosure is made, no insiders may publicise or leak the PSI or engage in insider dealings.⁴³

⁴⁰ According to the HKEx Guide, para 10, "promptly" means as soon as reasonably practicable after the senior management of the issuer learns (or when any reasonable issuer should have been aware) that the information is both material and non-public.

⁴¹ HKEx Guide, para 10.

⁴² The phrase "in a timely manner" means within two trading days from the date of start of calculation or at the time of occurrence of the circumstances where information disclosure is required. See CSRC Measures, Art. 71(2).

⁴³ CSRC Measures, Art 4.

However, if any of the following circumstances arise prior to the disclosure of the information on a significant event listed companies shall disclose in a timely manner the present status of relevant matters and risk factors that may have an impact on the development of the significant event:

- where it is difficult to ensure confidentiality of that significant event;
- where the significant event has already been leaked or rumours have already surfaced on the market; and
- where there are unusual movements in the trading of the company's securities and derivatives.⁴⁴

The timing of PSI disclosure is identical for both markets – timely or prompt disclosure is a common requirement. Before the disclosure is made, strict confidentiality must be maintained and insider dealing is prohibited on both markets.

(iv) How to disclose

Hong Kong

Since the launch of the EDP, the HKEx and issuers' websites have become the official channels for dissemination of company information. All issuers must now submit their announcements to the HKEx for publication on its website in both the Chinese and English languages. Before 25 June 2008, if issuers did not have their own websites, they still had to publish paid announcements in newspapers on the next business day after submission of their announcements to the HKEx. From 25 June 2008 onwards, every issuer must have its own website on which the public is able to access its Listing Rules-related documents free of charge.⁴⁵

PRC

Disclosure should be made by submitting the draft announcements and other reference documents to the stock exchange for registration and publishing them on the medium designated by the CSRC (this includes newspapers and websites). An issuer may not publish any information on its website or on any other medium earlier than it does on the designated medium, or replace its obligation to issue announcements by making a news release or answering questions from journalists, or replace its ad hoc reporting obligations with periodic reporting.⁴⁶

Except for the adoption of the HKEx EDP and the abolition of paid announcements in newspapers for H-share companies, there seems to be no other material differences in the means of disclosure.

⁴⁴ CSRC Measures, Art 31.

⁴⁵ "Electronic Disclosure Project's First Week of Operation", HKEx News Release, Updated: 3 July 2007, online: www.hkgem.com/news/hkexnews/0707032news.htm

⁴⁶ CSRC Measures, Art 6 and Art 71(4).

As mentioned above, there are notable signs of convergence between regulations covering the disclosure of PSI in Hong Kong and the PRC. For example, truthful, accurate, timely, complete, non-misleading and fair disclosure is required on both the H-share and A-share markets; both markets have also in recent years tightened regulations on the prohibition of insider dealing. However, some material differences still exist: whether there is a practice guide to compliance; who is obliged to make the disclosure; monitoring unusual price movements; suspension of trading; and mechanisms for combating insider dealing.

(i) Practical guidance for the disclosure of PSI

It is worth noting that mandatory regulations on disclosure of PSI (such as those contained in listing rules) in both Hong Kong and the PRC do not differ much in their principle-based orientation; the issue of whether or not practical guidance exists with more specified instructions does seem to matter significantly to listed companies.

In Hong Kong, the HKEx issued its Guide on Disclosure of Price-Sensitive Information (the HKEx Guide) which further interprets and supplements relevant provisions in the Listing Rules. In the PRC, the CSRC and the exchanges have not issued a streamlined text of practice guidance similar to the HKEx Guide, but the regulators have nevertheless given their specific instructions on how to implement disclosure of PSI in various practical settings and circumstances: this has been done by including provisions on information disclosure in individual enactments on specific types of significant events.

In other words, some form of practice guidance on disclosure of PSI also exists in the A-share market, but it is presented in a rather more diffuse manner when compared with the streamlined text that Hong Kong adopts.

(ii) Parties obliged to make the disclosure

While in Hong Kong it is the issuer and its directors and senior management that are subject to disclosure obligation in relation to PSI, the scope of parties with an obligation to implement and assist with disclosure is broader in the PRC. Apart from issuers and their directors, supervisors and senior management, the CSRC has also made an issuer's shareholders, actual controllers and parties acting in concert with them subject to the obligation of disclosure: these parties shall inform the issuer in a timely and accurate manner on whether any significant event, such as transfer of equity stakes or restructuring of assets, will occur, and assist the issuer in properly implementing disclosure.⁴⁷

⁴⁷ CSRC Measures, Art 35.

(iii) Monitoring unusual price movements

Hong Kong

In the case of unusual movements in the price or trading volume of an issuer's securities, H-share companies are first subject to the SEHK enquiries and are obliged to respond promptly by giving relevant information available to them, or by issuing an announcement containing a statement that they are not aware of any matter or development that is or may be relevant to the unusual movement (commonly known as a negative announcement). The SEHK mandates a standard format for negative statements. There seems to be no specific requirement for the timing of when such announcement is made promptly – for example, listed companies are not obliged to make this kind of announcement on the next trading day (which is required in the PRC).

PRC

By comparison, when the price movement of a listed company's securities is considered unusual by the CSRC (usually through its local bureaus' monitoring) and the exchanges, an announcement of unusual price movement shall be made by the listed company on the next trading day.⁴⁸ Similar to the practice in Hong Kong, if after self-investigation an issuer has come to the conclusion that there is no material information that is discloseable and non-public, it shall also make a negative announcement to convey this message.⁴⁹ The regulators do not appear to have mandated a standard format for this type of announcement, as is the case in Hong Kong.

Also while in Hong Kong the exchange oversees unusual price movements, in the A-share market the exchanges and local bureaus of the CSRC join forces in monitoring unusual price movements.

(iv) Suspension of trading

In both Hong Kong and the PRC, the suspension of trading system is an essential component of the regulations on continuing disclosure, especially in relation to PSI. As the number of A&H dual-listed companies grows, an urgent need for synchronised suspension across borders has become evident. The well-publicised controversy surrounding the staggered, non-simultaneous suspensions of trading in the A-shares and H-shares of Sinopec Shanghai Petrochemical in 2006 acutely revealed the risk of regulatory arbitrage due to existing regulatory gaps, which could harm investors.

Hong Kong

There are two categories of suspension: suspension requested by a listed issuer and suspension by the SEHK without a request from a listed issuer.⁵⁰

⁴⁸ SHSE LR / SZSE LR – R11.5.1 and R12.7.

⁴⁹ SZSE Guidelines for Equal Information Disclosure by Listed Companies, Art. 16.

⁵⁰ SEHK Listing Rules, Practice Note 11, "Suspension and Restoration of Dealings".

Major grounds for suspension requested by issuers include the following: reasonable withholding of PSI agreed by the SEHK; ongoing takeover scenario; need for maintenance of an orderly market; certain levels of notifiable transaction such as substantial changes in the nature, control or structure of an issuer; the issuer is no longer suitable for listing or is becoming a cash company; the issuer is going into receivership or liquidation; and the issuer's inability to meet periodic financial reporting obligations.⁵¹

The grounds for suspension by the SEHK without a request from the issuer generally include unusual movements in the price or trading volume of shares caused by uneven dissemination of PSI and unexplained unusual price and trading volume movements where the issuer's authorised representative cannot be contacted immediately.⁵²

As the SEHK is under an obligation to maintain an orderly and fair market on which listed securities should be continuously traded save in exceptional circumstances, it is generally reluctant to impose suspension unless the reasons given by issuers in support of a suspension warrant such an action.⁵³ In order to guarantee the normal functioning of the securities market and to avoid inappropriate and unwarranted suspension, on most occasions, as long as listed issuers publish a clarifying announcement within the required time period, they are likely to be exempted from a suspension.⁵⁴ Recent revisions to the suspension policy further make certain exemptions mandatory.

In its effort to introduce the mandatory exemptions mentioned above, the SEHK has recently started to implement a revised policy on suspensions of trading following listed issuers' publication of announcements related to PSI. Under this revised policy, which took effect on 10 March 2008, shares of Hong Kong-listed issuers announcing PSI between 6:00 am and 9:00 am are no longer suspended from trading during the morning session. Listed issuers can also publish all types of announcements between 12:30 pm and 2:00 pm without suffering a suspension of trading in the afternoon session.⁵⁵

The suspension period should be kept as short as reasonably possible and the SEHK will lift the suspension as soon as possible following the publication of an appropriate announcement or after specific requirements have been met.⁵⁶ Specific timing for a restoration of trading is not given in the Listing Rules.

⁵¹ SEHK Listing Rules, Practice Note 11, "Suspension and Restoration of Dealings", para 3.

⁵² SEHK Listing Rules, Practice Note 11, "Suspension and Restoration of Dealings", para 3.

⁵³ SEHK Listing Rules, 6.02-6.03.

⁵⁴ SEHK Listing Rules, 6.02.

⁵⁵ "Revised Policy on Suspensions Following Issuers' Publication of Announcements with Price Sensitive Information to Take Effect Next Monday", HKEx News Release, Updated: 6 March 2008, online: www.hkex.com.hk/news/hkexnews/080306news.htm

⁵⁶ SEHK Listing Rules, 6.04-6.05; Practice Note 11, "Suspension and Restoration of Dealings", para 4.

PRC

Generally speaking, apart from suspension at the issuers' request and suspension at the exchange's own initiative (the latter takes place usually when there have been unusual movements in the price or trading volume of listed issuers' securities), suspension of trading in the PRC can be further divided into another two categories: regular suspension and cautionary suspension.

Regular suspension applies to listed issuers that still function in a normal way but which are experiencing some important events specified in the listing rules or other trading rules, such as convening shareholders' meetings or the release of the annual report on a trading day.⁵⁷ This is in notable contrast to the practice in Hong Kong where suspension would not be imposed in those circumstances for the benefit of an orderly and fair market on which continuous trading of all listed securities is guaranteed save in exceptional circumstances.

Cautionary suspension is imposed when listed issuers or the trading in their securities encounter certain abnormal events, such as a takeover or significant asset restructuring, which have caused unusual movements in the price or trading volume of securities and derivatives.⁵⁸ The purpose of cautionary suspension is to make investors aware of the abnormal condition or force the listed issuers to address the problems in question. This type of suspension seems to largely align with the current practice in Hong Kong.

Suspension of trading will be removed at 10:30 am on the day of the announcement. If the day of the announcement is not a trading day, the suspension will be removed on the opening hour of the next trading day (note that there are no equivalent requirements in Hong Kong on specific timing for restoration of trading). According to the SHSE Notice on Strengthening Information Disclosure of Listed Companies During Long Suspension Period, if suspension in relation to a significant event lasts continually for more than five trading days, issuers must make weekly updates during the suspension period on the development of the significant event in question from the first Monday in the period.⁵⁹

Regulatory arbitrage

Inadequate co-ordination between the regulators in Hong Kong and the PRC on the suspension of trading in shares of dual-listed companies has raised investor concerns, as was reflected in the 2006 controversy surrounding Sinopec Shanghai Petrochemical, an A&H company.

⁵⁷ SHSE/SZSE Listing Rules, 12.2-12.3.

⁵⁸ SHSE/SZSE Listing Rules, Chapter 12; SHSE, "Notice about Exerting a Stronger Supervision on the Abnormal Fluctuation of Securities Transaction as well as the Disclosure of Information (《進一步加強股票交易異常波動及信息披露的監管通知》)", September 2007.

⁵⁹ SHSE Notice On Strengthening Information Disclosure of Listed Companies During Long Suspension Period.

In that incident, the suspension of trading in the H-shares of Sinopec Shanghai Petrochemical in Hong Kong took place almost an hour after trading in its A-shares was halted in Shanghai. Before the Shanghai market opened at 9:30am, the SHSE requested the suspension after it spotted a mainland newspaper report saying that the company was about to be privatised by its parent company Sinopec. The company's shares in Hong Kong, however, continued to trade for nearly an hour after the market there opened at 10:00am. During that time, investors in Hong Kong bought shares frantically on hopes that Sinopec would pay a premium to buy the shares they held, driving the share price up as much as 23 per cent. Sinopec eventually dismissed the rumours after the SEHK requested a clarification. As a result, Shanghai Petrochemical's H-share price fell 9 per cent on the following day after trading was resumed and many investors suffered losses.⁶⁰

Remarks

It seems that because the SEHK is more concerned with maintaining and safeguarding the normal functioning of the stock market and avoiding inappropriate and unwarranted suspension, it is more reluctant to suspend trading in certain companies than its PRC counterparts are. In general, suspensions are more frequently imposed in the PRC than in Hong Kong; the suspension period in the PRC also tends to be longer than that in Hong Kong, often at the regulators' insistence that trading will not be restored before a thorough explanation of the matter in question has been provided.

H-share companies do not have to make weekly updates on the development of the significant event in question during the suspension period (updates are still required when necessary, but not on a mandatory weekly basis), unlike A-share companies. No suspension is imposed on H-share companies if announcements are made within the specified ranges of time under the SEHK revised policy; the A-share market does not adopt this policy at present.

Given the higher (indeed much higher) frequency of suspensions in the PRC, in order to improve the efficiency and function of the securities market, PRC stock exchanges should try to work out some new measures to deal with listed issuers' failure in performing their disclosure obligations instead of imposing suspensions.

Material differences in regulation on suspension of trading between the A-share and H-share markets have inevitably caused practical difficulties in cross-border co-ordination. The Sinopec Shanghai Petrochemical incident highlighted this problem. Investors are concerned that similar events could happen in the future as more companies start to issue both A-shares and H-shares.⁶¹ The growing trend for dual listings strongly calls for synchronised suspensions when these relate to the disclosure of corporate-specific PSI.

⁶⁰ Justine Lau and Geoff Dyer, "Spotlight falls on co-ordination of stock exchanges", *Financial Times*, 7 June 2006.

⁶¹ Justine Lau and Geoff Dyer, "Spotlight falls on co-ordination of stock exchanges", *Financial Times*, 7 June 2006.

(v) Prohibition of insider dealing

Hong Kong

In Hong Kong, the prohibition of insider dealing was enhanced after the SFC started to be equipped with greater flexibility and stronger powers in pursuing and combating market misconduct. Since April 2003, insider dealing has been treated as one of the six forms of market misconduct under the SFO.

Under the SFO, market misconduct activity is subject to initial SFC investigation and may thereafter be either referred to the Market Misconduct Tribunal (MMT) or prosecuted in the criminal courts. The first referral to the MMT was instituted in June 2007 and the first criminal prosecution took place in February 2008.⁶² However, no person can be tried under both proceedings. In other words, there can be no double jeopardy. Once either civil or criminal proceedings are under way, they cannot be withdrawn to commence proceedings through the alternative route.⁶³

It is worth emphasising that penalties under the criminal route are particularly harsh: summary convictions carry penalties of up to three years' imprisonment and fines of up to HK\$1 million; convictions on indictment carry up to ten years' imprisonment and fines of up to HK\$10 million.⁶⁴

Insider dealing takes place when a person connected with a listed company, having information that he knows is relevant information in relation to that company, deals in its or its related listed company's securities or derivatives or counsels or procures another person to do so.⁶⁵

The definition of connected person in the context of insider dealing is broad. Under the SFO, the following people are considered to be connected to a listed company⁶⁶:

- its directors;
- its employees (regardless of their level or seniority); or
- its substantial shareholders (meaning one who owns 5% or more nominal value of its voting shares).

⁶² HKICS, "Guidance Note on Insider Dealing", Part 1, March 2008, p. 1; SFC enforcement news, "SFC Starts First Criminal Prosecution for Insider Dealing", 28 February 2008, online: www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=08PR25

⁶³ HKICS, "Guidance Note on Insider Dealing", Part 1, March 2008, p. 2.

⁶⁴ HKICS, "Guidance Note on Insider Dealing", Part 1, March 2008, p. 2.

⁶⁵ HKICS, "Guidance Note on Insider Dealing", Part 1, March 2008, p. 2.

⁶⁶ SFO, s.247.

While the above groups of people are easily identified as connected persons for the purpose of insider dealing, the following people, who may also be covered by the wide definition, are more difficult to identify⁶⁷:

- a person, who by virtue of a professional or business relationship between himself (or his employer or a corporation of which he is a director or a firm of which he is a partner) and the listed company, may reasonably be expected to give him access to the relevant information;
- a person who is a director, employee or substantial shareholder of another corporation, and by virtue of this position, has obtained access to relevant information in relation to the listed company which relates to a transaction (actual or contemplated) involving both corporations.⁶⁸

It is also worth noting that any person who contemplates making a take-over offer for the listed company is also deemed under the SFO to be an insider if he knows that the information that the offer is contemplated or is no longer contemplated is relevant information in relation to the listed company.⁶⁹

As one can see, the definition of connected person covers a wide range of people and particular attention should be given to this area, which can be rather tricky.

As regards the definition of relevant information, the SFO also provides detailed notes and explanations. Under the SFO, relevant information is defined to mean "specific information about the corporation, a shareholder or officer of the corporation or the listed securities of the corporation or their derivatives, which is not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the corporation but which would if it were generally known to them be likely to materially affect the price of the listed securities".⁷⁰

"Specific" means the content of the information must be precisely and unequivocally identified, defined and expressed. Mere rumours, vague hopes or worries and unsubstantiated conjecture are not sufficient. In other words, there must be sufficient particulars in the information.⁷¹

"... not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the corporation" means the information is not generally known to the ordinary reasonable investors in the securities of the corporation.⁷²

⁶⁷ HKICS, "Guidance Note on Insider Dealing", Part 1, March 2008, p. 3.

⁶⁸ HKICS, "Guidance Note on Insider Dealing", Part 1, March 2008, p. 3.

⁶⁹ HKICS, "Guidance Note on Insider Dealing", Part 1, March 2008, p. 3.

⁷⁰ HKICS, "Guidance Note on Insider Dealing", Part 1, March 2008, p. 4.

⁷¹ HKICS, "Guidance Note on Insider Dealing", Part 1, March 2008, p. 4.

⁷² HKICS, "Guidance Note on Insider Dealing", Part 1, March 2008, p. 4.

"... likely to materially affect the price of the listed securities" means that if the information is known, this will have a significant impact on the price of the securities in question.⁷³

It can be concluded that under the SFO, insider dealing is tightly regulated and the penalties are serious and have a powerful deterring effect in the market. Note that even though a listed company and its directors are not liable for insider dealing simply because PSI has been leaked from the company, they may however find themselves in breach of the Listing Rules, leaving them subject to SEHK sanctions.⁷⁴

PRC

The PRC has made equally impressive strides with its anti-insider dealing regulation. The Criminal Law has made insider dealing a criminal offence since 1997. The CSRC has recently tightened regulations to prevent and punish insider dealing in the wake of the completion of *gu gai*, which is anticipated to result in large volumes of sales of formerly non-tradable shares after their lock-up periods lapse. In particular, the CSRC has recently clarified the concept of insider dealing and issued guidelines that, among other things, prohibit investment funds from engaging in speculative transactions, especially so-called rat trading.⁷⁵

The scope of insiders is also broadly defined. Under the Securities Law, insider dealing refers to trading activities (including sales and purchases) involving a listed company's securities by a person who has access to inside information or who has unlawfully obtained inside information before the information is disclosed to the public. The definition also covers anyone who divulges this information or advises others to trade in securities.⁷⁶ This definition does not deviate from what applies in Hong Kong.

Under the Securities Law, insiders (or "informed persons with access to insider information of an issuer") include the following:⁷⁷

- the directors, supervisors and senior managers of issuers;
- shareholders who hold at least 5 per cent of the shares of a company and their directors, supervisors and senior managers, and the actual controller of a company and its directors, supervisors and senior managers;
- the companies in which an issuer has a controlling interest and their directors, supervisors and senior managers;

⁷³ HKICS, "Guidance Note on Insider Dealing", Part 1, March 2008, p. 4.

⁷⁴ HKICS, "Guidance Note on Insider Dealing", Part 2, June 2008, p. 2. Please also refer to the press release of SEHK dated 24 July 2008 in relation to the censure of New World Development Company Limited <http://www.hkex.com.hk/news/hkexnews/080724news.htm>

⁷⁵ Ling Huawei, Qiao Xiaohui, Fu Tao and Hu Runfeng, "Rat-Hunting Regulators Battle Insider Trading", *Caijing*, 31 May 2007, online: www.caijing.com.cn/templates/inc/content.jsp?infolid=42999&type=0&ptime=20071225

⁷⁶ Securities Law, Art 202.

⁷⁷ Securities Law, Art 74.

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- persons who have access to insider information in a company by virtue of their positions in the company;
 - the staff of the CSRC, and other persons who have an involvement in the administration of the offering and trading of securities by virtue of their statutory duties;
 - the relevant staff of sponsors, securities companies acting as underwriters, stock exchanges, securities depository and clearing institutions and securities service institutions; and
 - other persons specified by the CSRC.

The Criminal Law sets a broad coverage for insider information, which is closely aligned with the scope of significant events for the purpose of making ad hoc reports (i.e. disclosure of PSI) specified in the CSRC Measures and exchange listing rules.⁷⁸

In addition, to further strengthen the prevention of insider dealing, issuers in the A-share market must apply to the exchanges for suspension of trading under a number of circumstances when disclosure of PSI is concerned. For example, suspension of trading can take place when any of the following circumstances arises:⁷⁹

- where a listed company anticipates that it will be difficult to maintain the confidentiality of a significant event under planning or the related event has already been leaked;
- where there is an unusual fluctuation in share trading when there is a market rumour involving the listed company or in the absence of any announcement of material PSI;
- where a listed company intends to implement a significant event for which there is no precedence and which contains material uncertainty and needs to consult the relevant government agencies.

Furthermore, A-share companies are also required to prove to the CSRC that insiders and their relatives have not conducted insider trading activities under certain circumstances, including the following:

- unless caused by large cap stock factors and inter-sector factors, when the accumulated price fluctuation range of an issuer's shares exceeds 20 per cent within 20 trading days prior to the announcement of material PSI, the listed company shall satisfy the CSRC with evidence that no insider trading was conducted by insiders or their direct relatives;⁸⁰

⁷⁸ Criminal Law, Art. 180; CSRC Measures, Art. 30; SHSE/SZSE Listing Rules, Chapter 7 and Chapter 11.

⁷⁹ CSRC, Notice on Regulating Information Disclosure of Listed Companies and Behavior of Relevant Parties (2007) (CSRC Notice) (關於規範上市公司信息披露及相關各方行為的通知), Art 4, Art 7.

⁸⁰ CSRC Notice, Art 5.

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- where a listed company encounters a significant event involving government approval, for which there is no precedence but with material uncertainty and requires consultation with relevant government agencies, the company must inform the CSRC whether insiders or their relatives have held or traded the company's shares within six months prior to the occurrence of the significant event, and provide evidence to prove that the relevant staff have not engaged in any insider trading.⁸¹

Currently, insider dealing is subject to both administrative and criminal liabilities. The CSRC can impose administrative sanctions and refer serious cases to the police for further criminal investigation and prosecution.

Turning first to the administrative liability, persons who have committed insider dealing shall be ordered to dispose of the securities illegally held. The illegal proceeds shall be confiscated and a fine of one to five times the illegal proceeds shall be imposed. Where there are no illegal proceeds or the illegal proceeds are less than RMB30,000, a fine of between RMB30,000 and RMB600,000 shall be imposed. Where an entity is involved in any insider trading, the person in charge and any other person directly responsible shall be given a warning and imposed a fine of between RMB30,000 and RMB300,000. Any functionary of the securities regulatory body who commits any insider dealing activity shall be given a heavier punishment. The administrative punishment does not seem to be an adequate deterrent in combatting insider trading when the benefits of making huge gains outweigh the potential cost of the liability.

The criminal liability is harsher, and can result in a fine of one to five times the illegal proceeds and ten years' in imprisonment at most.⁸² It seems that, on paper, the criminal liability is no less serious than that imposed under the SFO in Hong Kong.

Civil litigation against insiders brought by investors who suffer losses will be feasible once the Supreme People's Court issues a relevant judicial interpretation. It is widely anticipated that civil compensation will soon be instituted for investor losses resulting from insider dealing.⁸³

⁸¹ CSRC Notice, Art 8.

⁸² Criminal Law, Art 180.

⁸³ Ling Huawei and Qiao Xiaohui, "Empower Regulators to Fight Securities Crime", *Caijing*, 24 August 2007, online: www.caijing.com.cn/20071225/42912.shtml

In the PRC, the standards for bringing a criminal case to court against insider dealing have been clarified in a recent circular jointly issued by the Supreme People's Procuratorate (the highest prosecuting authority) and the Ministry of Public Security (the highest police authority). Criminal proceedings shall commence if the aggregated monetary amount involved in executing insider dealing in securities reaches RMB500,000; or the aggregated amount of deposit involved in insider dealings in futures reaches RMB300,000; or the amount of gains or loss avoided reaches RMB150,000; or if the suspect has been involved in insider dealings several times.⁸⁴ This clarification is expected to make criminal proceedings against insider dealing more standardised and effective, which is likely to result in an increased number of cases and convictions.

Remarks

Regulation of anti-insider trading seems stringent in both Hong Kong and the PRC. Both jurisdictions have over the past few years significantly tightened their anti-insider dealing laws and regulations to combat this specific type of market misconduct. In particular, both have made serious insider dealing activities a criminal offence; both impose harsh penalties; both set wide definitions of insiders.

The major differences lie in the types of penalties. While in Hong Kong both civil and criminal proceedings can be initiated to pursue insider dealing, administrative and criminal penalties are imposed in the PRC.

Meanwhile, while the SFC has the statutory powers to initiate criminal proceedings and to institute prosecution against insider dealing, its counterpart in the PRC, the CSRC, has not yet gained comparable powers and at present has to refer cases to the police if a criminal offence is involved.

Periodic financial reporting

Generally speaking, investors in both H-shares and A-shares in a dual-listed company are afforded the same level of access to financial information and the same volume of information, primarily due to requirements of dual-listed companies to provide simultaneous and the same disclosure by regulators on both markets. In addition, the accelerating pace of convergence in accounting and auditing standards between Hong Kong and the PRC is starting to promise significant reductions in the compliance costs for dual-listed companies.

Periodic financial reporting is where much of the convergence has been taking place between the Hong Kong and the PRC disclosure regimes.

⁸⁴ Supreme People's Procuratorate and Ministry of Public Security, Supplementary Provisions on the Standards of Commencing Criminal Proceedings against Economic Crimes, 5 March 2008 (《關於經濟犯罪案件追訴標準的補充規定》).

In addition to recent convergence in accounting and auditing standards, which is discussed below, another notable area of convergence is the proposed tightening of financial reporting standards in Hong Kong, including the shortening of financial reporting deadlines for half-year and annual reporting and adoption of mandatory quarterly reporting for SEHK Main Board issuers (GEM issuers are already subject to quarterly reporting obligation).⁸⁵ According to the HKEx, these changes are proposed in the hope of bringing Hong Kong's financial reporting practices in line with developments in overseas markets and accommodating the increasing trend of dual A-and H-share listings and increased cross-border capital flows between Hong Kong and the PRC.⁸⁶

(i) Shortening of reporting deadlines in Hong Kong

On 18 July 2008, the HKEx issued its consultation conclusions and introduced amendments to the Listing Rules to shorten the time allowed for the release of results by Main Board issuers. This brings Hong Kong's rules in line with the current practice in the A-share market.

Main Board issuers now have to release their half-year results in two months instead of three and their annual results in three months instead of four. This places a greater burden on listed issuers in Hong Kong than is currently required of their counterparts in the PRC because A-share companies are still subject to a four-month deadline for the release of their annual results.

(ii) Mandatory quarterly reporting by SEHK Main Board issuers

Under the HKEx proposals, upon implementation, quarterly reports would have to be published no more than 45 days after the end of the financial period (this is more relaxed than the current reporting deadline of one month for A-share companies). Listed companies would not have much room for flexibility in the form and content of their quarterly reports as the HKEx would mandate the key information to be included, such as a condensed consolidated income statement, a condensed consolidated balance sheet, a condensed consolidated cash flow statement and a narrative business review.⁸⁷ Quarterly reports would however not have to be audited and, unless a shareholder requests, would not have to be printed and mailed to the shareholders.⁸⁸

During the market consultation process, concerns were raised about the increased costs of compliance for issuers, as these may outweigh perceived benefits.⁸⁹ The Consultation Conclusions are still yet to be issued. Until then, there is still a great deal of uncertainty as to the exact timing and substantive standards of implementation.

⁸⁵ See HKEx Consultation Paper on Periodic Financial Reporting, August 2007.

⁸⁶ These remarks were made by the HKEx's Head of Listing Richard Williams. See "HKEx Publishes Consultation Paper on Periodic Financial Reporting", HKEx News Release, Updated: 31 August 2007, online: www.hkex.com.hk/news/hkexnews/0708312news.htm

⁸⁷ HKEx Consultation Paper on Periodic Financial Reporting, August 2007, p. 17.

⁸⁸ "HKEx Publishes Consultation Paper on Periodic Financial Reporting", HKEx News Release, Updated: 31 August 2007, online: www.hkex.com.hk/news/hkexnews/0708312news.htm

⁸⁹ See, for example, HKICS Submission to HKEx Re Consultation Paper on Periodic Financial Reporting, 5 November 2007.

(iii) Convergence between PRC accounting and auditing standards and Hong Kong Financial Reporting Standards (HKFRSs)

Hong Kong

Since 1 January 2005, Hong Kong's accounting and auditing standards have been fully converged with International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB) and International Auditing Standards issued by the International Auditing and Assurance Standards Board.⁹⁰ IFRSs are used or accepted in most of the capital markets worldwide.

The Listing Rules require that an issuer's financial statements shall conform to either Hong Kong Financial Reporting Standards (HKFRSs) or IFRSs. However, if this requirement is turned into statutory form under the proposed new disclosure regime, it might have the effect of giving statutory backing to HKFRSs or IFRSs, which are non-statutory standards published by self-regulatory professional bodies. To address this concern, the proposed general principle 5 in the Consultation Conclusions on Giving Statutory Backing to Major Listing Rules requires an issuer to disclose whether the financial statements are prepared in accordance with HKFRSs or IFRSs and, if not, details of any material respects in which the standards adopted deviate from HKFRSs or IFRSs.⁹¹

PRC

To tackle the widely observed problem of poor quality and lack of reliability of financial reporting by listed companies, PRC regulators have in recent years moved to establish stricter disclosure requirements and to adopt IFRSs. On 15 February 2006, the Ministry of Finance formally issued one basic accounting standard and 38 specific accounting standards for business enterprises; these apply to all listed Chinese companies from 1 January 2007.⁹² These new standards bring Chinese accounting practice largely in line with IFRSs (and hence HKFRSs as well), with two major exceptions.⁹³

These two remaining major differences are the reversal of impairment losses; and the treatment of related-party disclosure, which requires all transactions between related parties be disclosed in the financial report.⁹⁴ In particular, related-party transactions in the PRC (or connected transactions in the Hong Kong terminology) are widespread since most listed companies are at least partially state-owned or controlled. The expanded practice of enterprise grouping in recent years at the urging of the PRC government (via the orchestrating of the State-owned Assets Supervision

⁹⁰ HKICPA press release, "Joint Declaration on Converged Mainland and Hong Kong Accounting and Auditing Standards", 6 December 2007.

⁹¹ SFC Consultation Conclusions on Giving Statutory Backing to Major Listing Rules (February 2007).

⁹² CSRC Notice on Properly Making Financial Disclosure Relating to New Accounting Principles (關於做好與新會計準則相關財務會計信息披露工作的通知) (2006).

⁹³ May Chan, "Making the right connection", South China Morning Post, 18 January 2008, p. 8.

⁹⁴ Under Mainland standards, reversal of impairment losses, which recognise the loss in value of a fixed asset not related to its day-to-day use, is disallowed with no negotiations or exceptions. The international standard allows reversal of any impairment losses under certain clear conditions, except for goodwill. See May Chan, "Making the right connection", South China Morning Post, 18 January 2008, p. 8.

and Administration Commission) in its effort to restructure the state sector has also produced additional linkages between companies operating in diverse sectors through their common state-owned parent companies. A discussion on connected transactions in Section 4 further addresses this issue.

Convergence between the PRC and Hong Kong

A joint declaration on the substantial convergence between the PRC and Hong Kong accounting standards was signed by the China Accounting Standards Committee and the Hong Kong Institute of Certified Public Accountants (HKICPA) on 6 December 2007.⁹⁵ This convergence marked the beginning of a welcome process of achieving mutual acceptance of accounting standards in the other jurisdiction for listing by regulators in the PRC and Hong Kong.⁹⁶ On the same day, the HKICPA also signed a joint declaration with the China Auditing Standards Board which recognises mutual acceptance of auditing standards in the other jurisdiction in financial assurance and other related services, including the audit of financial statements.⁹⁷

According to the joint declarations between the mainland standards-setting bodies and the HKICPA, financial statements prepared using mainland standards should, after reconciling their differences, achieve substantially the same effect as if they were prepared using HKFRSs. In other words, full convergence between Hong Kong and mainland accounting and auditing standards will mean that accountants working for listed mainland companies will only need to prepare one set of financial reports instead of two.

A genuine concern is that if the treatment under current IFRSs/HKFRSs – in which there is no exemption for disclosures of a related party relationship and transactions for entities controlled or significantly influenced by the same state but with no other relationships that meets the criteria for disclosure in IAS24/HKAS24 – is implemented in the mainland, the sheer amount of record-keeping needed to comply would "bury most corporate finance departments under a sea of paperwork."⁹⁸

⁹⁵ "Joint Declaration of the China Accounting Standards Committee and the Hong Kong Institute of Certified Public Accountants on the converged China Accounting Standards for Business Enterprises and Hong Kong Financial Reporting Standards", 6 December 2007.

⁹⁶ Another example of global convergence on accounting and financial reporting standards is the recent removal of the US GAAP / IFRS reconciliation requirement by SEC. From November 2007, the US regulator allows IFRS financial statements for foreign private issuers (FPIs) without any reconciliation with US GAAP. However, this exemption will not apply to FPIs with financial statements prepared using HKFRSs.

⁹⁷ "Joint Declaration of the China Auditing Standards Board and the Hong Kong Institute of Certified Public Accountants on the converged China Auditing Standards and Hong Kong Auditing Standards", 6 December 2007.

⁹⁸ May Chan, "Making the right connection", South China Morning Post, 18 January 2008, p. 8.

However, this difference regarding related party disclosure is likely to be eliminated in the near future. In February 2007, the IASB published an Exposure Draft of proposed amendments to International Accounting Standard (IAS) 24, titled "Related Party Disclosures – State-controlled Entities and the Definition of a Related Party," and has completed the consultation process. This project aims to allow certain flexibility in treating state-owned enterprises in related party disclosure. The most important of the proposed changes for PRC entities is an exemption from the disclosure requirements in paragraph 17 of IAS 24 (which deals with disclosure of related party transactions) for entities that are related simply because of control or significant influence by the same state body. The final text of amended IAS 24 is expected to be issued by the end of 2008.⁹⁹

The implications of convergence in accounting and auditing standards are profound. Convergence not only strengthens Hong Kong's position as a regional financial hub and a gateway for fund raising by PRC companies, but also reduces and will eventually remove the information barrier faced by international investors interested in mainland listed companies as listing in Hong Kong and other international capital markets will be easier and less costly for these companies.¹⁰⁰

Despite the remarkable progress made with cross-border convergence, some material differences still remain between Hong Kong and PRC financial reporting standards and practices.

In addition to disclosure requirements in accounting standards, the CSRC has also set detailed rules on disclosures in financial statements, which are generally more demanding than those requirements in accounting standards. The financial statements of A-share companies for IPO, annual reporting and semi-annual reporting purposes should comply with the disclosure requirements of the CSRC as well as with accounting standards.

- Industry-specific requirements on financial reporting

Appendix 15 and Appendix 16 to the SEHK's Listing Rules contain specific provisions on the contents of periodic financial reports of banking companies¹⁰¹ and financial conglomerates.

⁹⁹ International Accounting Standards Board, project summary of "Amendments to IAS 24 - Related Party Disclosures", June 2008, online: www.iasb.org/NR/rdonlyres/5D737095-AA21-43F7-8D93-220FEA370807/0/RPDProjectUpdateJune08.pdf

¹⁰⁰ May Chan, "Making the right connection", South China Morning Post, 18 January 2008, p. 8.

¹⁰¹ In addition to the Listing Rules, listed banking companies in Hong Kong shall also comply with the Best Practice Guide on Financial Disclosure by Authorised Institutions issued by the Hong Kong Monetary Authority (the Best Practice Guide).

The SEHK has also published a Reference for Disclosure in Annual Reports to assist issuers' preparation of annual reports. This document contains references for specific disclosures in annual reports of listed issuers operating in specific industries. The specific industries include airlines, railroad operators, power plants, pharmaceuticals, iron and steel, petrochemical, telecommunications, infrastructure, retailing, construction, property development and investment, food and beverage, industrials and hotels. The document only serves as a source of reference for H-share companies and is not mandatory. The disclosures set out merely provide examples of financial disclosures already contained in existing annual reports.

In the PRC, the CSRC has the power to formulate specific rules on the disclosure of information by listed companies in special sectors such as the finance and real estate sectors.¹⁰² So far, for A-share companies, the CSRC has issued specific guidelines on information disclosure by certain types of issuers operating in the finance and real estate industries, including commercial banks, insurance companies, securities companies, real estate developers and foreign-invested joint stock companies.¹⁰³ These issuers must comply with those specific rules.

It can be seen that the types of listed issuers subject to industry-specific financial reporting rules differ between the two jurisdictions, although both include banks and real estate developers. In addition, while the financial disclosure requirements as set out in the SEHK Listing Rules are designed to be general in nature and do not take into consideration the specific needs of investors in different industries, Hong Kong regulators do realise these needs and are more advanced in providing useful references (although not mandating them) for issuers in their preparation of financial disclosure documents in order to encourage practical flexibility in financial disclosure to suit investors' needs.

By comparison PRC regulators still have some further work to do in this area, although the CSRC has been making progress in promulgating specific financial disclosure requirements for issuers operating in several industries, largely in an effort to align these requirements with existing financial reporting regulations issued by industry regulators to show specific risks and opportunities in these industries. These collaborating regulators routinely include the China Banking Regulatory Commission, which oversees financial institutions operating in both the banking industry and non-banking industries and the China Insurance Regulatory Commission, which regulates insurance companies.

- Announcement of preliminary results

H-share companies must issue both annual/interim reports and results announcements, which can be released at separate times. Annual and interim reports can be published after the release of the preliminary results.

¹⁰² See CSRC Measures (2007), Art 10.

¹⁰³ See, for example, CSRC, "Guidelines on the Contents and Format of Annual Reports of Securities Companies (2008 Revision)" [《中國證券監督管理委員會證券公司年度報告內容與格式準則(2008年修訂)》], which contain more requirements for securities companies on information disclosure.

A-share companies only need to disclose annual, interim and quarterly reports. They should announce preliminary results before the release of periodic reports if:

- they estimate that their net profit will be negative (ie they will make a loss); or
- they estimate that there will be a sharp fluctuation (this usually means more than 50 per cent more or less in net profit or turning from a loss to a profit) in their preliminary results as compared with that for the corresponding period of the previous year.¹⁰⁴

Companies listed on Small and Medium Sized Enterprises Board of the Shenzhen Stock Exchange (SZSE) must announce their preliminary results if their annual reports are scheduled to be released in March or April.

- Audit of accounts

H-share companies must have their financial accounts in annual reports audited under specific accounting standards; interim accounts are not subject to an audit.

A-share companies must ensure their annual accounts are audited by auditors with special qualifications in accordance with the Chinese Standards on Auditing. Interim accounts are not subject to an audit except in certain exceptional situations specified by section 6.5 of SHSE/SZSE Listing Rules.

- Form and content of periodic financial reports

In Hong Kong, the Listing Rules do not provide a sample format of periodic financial reporting for listed companies to follow or make reference to. Appendix 16 of the Listing Rules, which is specifically dedicated to the disclosure of financial information, spells out important definitions and minimum requirements on discloseable items and the contents of financial information that annual and interim reports shall include. Because the Listing Rules do not mandate a sample structure and format that annual and interim reports must take, listed companies have a great deal of discretion over how to arrange and present their disclosures in their annual and interim reports, subject to the minimum requirements. This choice and flexibility does not necessarily mean that implementation of financial disclosure is relatively easy – it can be challenging because listed companies must figure out for themselves whether they have made adequate minimum disclosure under the Listing Rules.

¹⁰⁴ SHSE/SZSE Listing Rules, 11.3.1.

The CSRC has issued regulations on the form and content of periodic financial reports which listed companies must adopt. To give clearer guidance to listed companies and to achieve a certain level of consistency in compliance, these regulations specify the sample format of annual, interim and quarterly reports by dividing the whole report into certain standard sections and sub-sections, with detailed specifications on the contents that each section and sub-section must contain; and by drawing out various standard forms for listed companies to fill out in the summary section of annual and semi-annual reports. A-share companies can simply prepare quarterly reports by filling in the prescribed forms. As noted above, in practice this less-flexible approach actually makes things easier for listed companies because filling out forms, although rather mechanical, is a more manageable exercise which offers a higher degree of certainty in compliance with the regulations. Usually, upon filling out all the required forms, listed companies can prima facie presume that the relevant disclosure requirements are satisfied.

The sample format of periodic financial reports available to A-share companies does seem to make their compliance more controllable and also provides a higher degree of self-assurance in measuring implementation of disclosure than H-share companies may experience. It is interesting that having more room for discretion may not necessarily be favoured by some companies if less flexibility translates to more certainty and less problems with compliance.

- Post-vetting of periodic financial reports

As mentioned earlier, unlike their PRC counterparts, the SEHK generally does not exercise post-vetting of periodic financial reports. The practical implication of this difference is that A-share companies may be required to make subsequent corrective or supplementary disclosure to remedy the defective disclosure previously made, which is not likely to happen to H-share companies under comparable circumstances.

Disclosure of notifiable transactions

Hong Kong specifies seven types of notifiable transactions: share transactions, discloseable transactions, major transactions (disposal), major transactions (acquisition), very substantial disposals, very substantial acquisitions and reverse takeovers. The classification of notifiable transactions is determined by the thresholds based on the five test percentage ratios, i.e. assets ratio, profits ratio, revenue ratio, consideration ratio and equity capital ratio (applicable only to an acquisition).¹⁰⁵ After identifying the category, the notification, publication and shareholder approval requirements applicable to each category of notifiable transaction can be ascertained¹⁰⁶. Generally, both an announcement and a circular (except in the case of a share transaction) will be required for notifiable transactions. In addition, shareholders' approval and an accountants' report are required for major transactions, very substantial disposals, very substantial acquisitions and reverse takeovers.

¹⁰⁵ SEHK Listing Rules, Rule 14.07 – 14.08.

¹⁰⁶ SEHK Listing Rules, Rule 14.33.

The categorisation method and the percentage ratios applicable to notifiable transactions – or, as they are more commonly referred to, discloseable transactions – in the PRC are distinctly different from those adopted in Hong Kong. Generally, there are two main sets of thresholds triggering off different requirements. The first type, with a lower threshold, i.e. more than 10 per cent under the various percentage ratios (with the consideration at the same time exceeding a certain corresponding amount) is subject to disclosure while the other type with the higher threshold, i.e. more than 50 per cent under the various percentage ratios (with the consideration at the same time exceeding a certain corresponding amount) is subject to both disclosure and shareholders' approval¹⁰⁷. The grant of a guarantee by the listed company is however singled out for special treatment¹⁰⁸.

In short, the rules that apply to notifiable transactions in both jurisdictions are highly detailed and remarkably long¹⁰⁹. It is not within the ambit of this study to conduct a comprehensive examination of the relevant rules. It is, however, worth noting that there are certain material differences between the notifiable transactions' disclosure regimes in Hong Kong and the PRC.

(i) Categories of transaction

The primary material difference is that Hong Kong and the PRC adopt two sets of categories of transactions and these are subject to different levels of disclosure and/or shareholder approval requirements. The categories specified in the SEHK Listing Rules are distinct from the categories spelled out in the relevant PRC regulations.

One example of the material differences, as noted above, is that while the SEHK Listing Rules treat the grant of a guarantee as one method of financial assistance and do not single it out as something to be especially watched for, the PRC regulations, particularly the exchanges' Listing Rules, set out lengthy stringent rules for the disclosure and shareholder approval for this category of transaction. This is largely due to the fact that A-share companies have a staggering history of being ripped off or stripped of their assets by offering guarantees to secure bank loans to their parent companies, and these loans were never repaid. The interests of minority shareholders and public investors have been greatly harmed by this kind of appalling practice and the regulators have put a heavy emphasis on curbing it.

(ii) Benchmarks for triggering disclosure and/or shareholder approval requirements

In addition, the benchmark percentage ratios and monetary amounts which trigger different levels of disclosure and/or shareholder approval requirements in the two jurisdictions are also markedly divergent, usually with the benchmarks in the PRC set higher (i.e. the rules are less onerous for listed companies) than in Hong Kong. While it may not be necessary to list every difference in those percentage ratios and monetary amounts on which transaction classifications are based,¹¹⁰

¹⁰⁷ SHSE/SZSE Listing Rules, Rule 9.2-9.3.

¹⁰⁸ SHSE/SZSE Listing Rules, Rule 9.11.

¹⁰⁹ SHSE/SZSE Listing Rules, Section 9 and SEHK Listing Rules, Chapter 14.

¹¹⁰ The transaction classifications are spelled out in SEHK Listing Rules, Rule 14.06 and SHSE/SZSE Listing Rules, Section 9, respectively.

it is nevertheless exemplary and indicative to note that the benchmarks in the PRC regarding significant purchases or sale of assets as well as guarantees for external entities seem to be significantly higher than in Hong Kong.¹¹¹ This renders a perception that PRC listed companies are subject to less demanding requirements in terms of the disclosure of notifiable transactions.

(iii) Implementation of shareholder approval

There are also different requirements for shareholder approval. The SEHK Listing Rules allow shareholder approval to be satisfied by passing resolutions both at general meetings and in some circumstances in written circulation. Though written resolutions may be allowed for major transactions, certain conditions need to be fulfilled. For example, no shareholder is required to abstain from voting and any written shareholders' approval has to be obtained from a shareholder or a closely allied group of shareholders who together hold more than 50 per cent of the voting shares.¹¹² In addition, a written resolution is not allowed for all types of notifiable transactions. For example, it is not allowed for a very substantial disposal, a very substantial acquisition or a reverse takeover.¹¹³

By comparison, shareholder approval by written circulation is not allowed for A-share companies. In order to obtain shareholder approval for certain notifiable transactions (for example, substantial acquisitions or disposal of assets and grant of guarantee) two-thirds of the shares with voting rights held by shareholders attending the general meeting must be cast in favour of the proposal.¹¹⁴ If the board of directors also need to approve certain notifiable transactions – specifically, involving the grant of guarantees – the required majority is:

- under SHSE Listing Rules, one-half of all directors AND two-thirds of attending directors;
- under SZSE Listing Rules, two-thirds of attending directors.¹¹⁵

Circulars must be delivered to shareholders for the disclosure/approval procedures for most categories of notifiable transactions in Hong Kong. However this is not regularly implemented in the PRC where publishing announcements in designated newspapers and websites is the prevailing practice.

¹¹¹ See Centre for Corporate Governance, Institute of World Economics and Politics, China Academy of Social Sciences (中國社會科學院世界經濟與政治研究所公司治理中心), Research Centre for Examinations, Assessments and Evaluations of Leaders, China National School of Administration (國家行政學院領導人員考試測評研究中心) and Protiviti Shanghai (上海甫瀚投資管理諮詢有限公司), "2008 Evaluation Report on Corporate Governance Performance of Top 100 Chinese Listed Companies" (《2008年中國上市公司100強公司治理評價報告》) online: www.cnstock.com/paper_new/html/2008-05/21/content_61806292.htm

¹¹² SEHK Listing Rules, Rule 14.44.

¹¹³ SEHK Listing Rules, Rule 14.49, 14.55.

¹¹⁴ SHSE/SZSE Listing Rules, Rule 9.10 – 9.11/ Rule 9.8, Rule 9.10 – 9.11 respectively.

¹¹⁵ SHSE/SZSE Listing Rules, Rule 9.11.

It should be noted that under Hong Kong's proposed new statutory disclosure regime, the new Schedule to the SFO will define terms used in the general principles as necessary. For example, it will define a specified transaction to mean a major transaction, a very substantial acquisition, a very substantial disposal or a reverse takeover. The Schedule will contain the more important listing disciplines as factors to be considered in determining whether a listed issuer has complied with the general principles as regards the announcements, circulars and voting on a specified transaction. The more detailed and technical provisions to be contained in the circulars will be found in the Listing Code.¹¹⁶

Disclosure of connected or related party transactions

Disclosure, shareholder approval, or both, of connected transactions is another area where there are notable differences between Hong Kong and PRC regulations.

It has been suggested that Hong Kong operates one of the toughest sets of rules on connected transactions in the world by, primarily, adopting a wide definition for connected persons, including all sorts of family interests, related trust interests and controlled company interests.¹¹⁷ The reason behind this strict regulatory stance is the prevailing pattern of family business in Hong Kong where minority shareholders' interests are vulnerable to abuses by majority shareholders. By comparison, the prevailing pattern of corporate governance of PRC listed companies is insider control and state-dominance in the shareholding structures of SOEs. Therefore, connected transactions (or related party transactions as they are usually called in the PRC) in the A-share market are frequently found to take place between companies with the same state parent.

Due to these fundamental structural differences between the Hong Kong and PRC markets, it is no surprise that there are cross-border gaps in the regulations on disclosure of connected transactions. The most important differences are the definition of connected person/related party and the procedures for disclosure, shareholder approval, or both, of connected transactions/related party transactions.

However, it is likely that there will be some new developments in the convergence of treatment of related party transactions between Hong Kong and the PRC. Specifically, the PRC members of the IASB have succeeded in persuading the IASB to take a flexible approach to accounting treatment of connected transactions between affiliated SOEs. As mentioned above, if the proposed amendments to IAS 24 (the standard on related party disclosure) can be adopted, an exemption from the disclosure requirements in paragraph 17 regarding related party transactions would be introduced for entities that are related simply because of control, or because of significant influence by the same state body – a common phenomenon in the PRC.¹¹⁸

¹¹⁶ SFC Consultation Conclusions on giving statutory banking to major Listing Rules (February 2007).

¹¹⁷ See Bauhinia Foundation Research Centre, "Hong Kong as a Preferred IPO Hub... Are We on the Right Track?", April 2008.

¹¹⁸ See discussion in Section 2 on periodic financial reporting.

(i) Definition of connected person/related party

Hong Kong

In Hong Kong, the definition of a connected person is very broad and includes all sorts of family interests, related trust interests and controlled company interests. According to the SEHK Listing Rules, the definition of a connected person includes any of the following¹¹⁹:

- 1 Director, chief executive or substantial shareholder of the listed issuer¹²⁰
- 2 Any person who was a director of the listed issuer in the preceding year
- 3 Any promoter or supervisor of a PRC issuer
- 4 Any associate of a connected person described in (1)-(3)¹²¹
- 5 Any non wholly-owned subsidiary of the listed issuer where any connected person(s) of the listed issuer (other than at the level of its subsidiaries) is/are (individually or together) entitled to exercise, or control the exercise of, 10 per cent or more of the voting power at any general meeting of the non wholly-owned subsidiary
- 6 Any subsidiary of a non wholly-owned subsidiary of the listed issuer referred to in (5) above.

The definition of a connected person does not include any wholly-owned subsidiaries of the company whose securities are listed on the SEHK, whether directly or indirectly held.¹²²

PRC

In the PRC, a connected person includes a connected legal person and a connected natural person, which are defined separately and broadly¹²³.

A legal person which satisfies any of the following conditions is deemed to be a connected legal person:

- 1 A legal person that is in direct or indirect control of the listed company.
- 2 A legal person, other than the listed company and its subsidiaries, which is controlled directly or indirectly by the legal person referred to in (1) above.
- 3 A legal person, other than the listed company and its subsidiaries, which is controlled directly or indirectly by a connected natural person of the listed company, or a legal person in which the connected natural person holds a directorship or a senior management position.

¹¹⁹ SEHK Listing Rule, 14A.11.

¹²⁰ In Chapter 14A, "listed issuer" shall include the issuer and its subsidiaries, unless the context otherwise required. See SEHK Listing Rule, 14A.10, 14.04(6).

¹²¹ SEHK Listing Rule 1.01, 19A.04.

¹²² SEHK Listing Rule, 14A.12.

¹²³ CSRC Measures, Art 71; SHSE/SZSE LR 10.1.2-10.1.6.

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- 4 A legal person that holds more than 5 per cent of the interest in the listed company or anyone acting in concert with that legal person.
 - 5 A legal person that has satisfied any of the conditions set out hereinabove over the past 12 months or will become so under a related agreement over the next 12 months.
 - 6 Other legal persons recognised, based on the substance-over-form principle, by the CSRC, stock exchanges or the listed company as having a special relationship with the listed company or being likely to receive or having already received preferential benefits accorded by the listed company.

A natural person which satisfies any of the following conditions is deemed to be a connected natural person:

- 1 A natural person who holds directly or indirectly over 5 per cent of the interest in the listed company.
- 2 A natural person who is a director, supervisor or senior manager of the listed company.
- 3 A director, supervisor or senior manager of a legal person which is in direct or indirect control of the listed company.
- 4 Family members closely related to the persons referred to in (1) and (2) above, including their spouses; parents; children over 18 and their spouses; brothers and sisters and their respective spouses; the parents, brothers and sisters of their spouses; and the parents of their children's spouses.
- 5 A natural person who has satisfied any of the conditions set out hereinabove over the past 12 months or will become so under a related agreement over the next 12 months;
- 6 Other natural persons recognised, based on the substance-over-form principle, by the CSRC, stock exchanges or the listed company as having a special relationship with the listed company or being likely to receive or having already received preferential benefits accorded by the listed company.

A senior manager and senior management position as included in the above definitions of connected legal person and connected natural person refer to managers, deputy managers, board secretaries, persons responsible for the financial affairs of the company and other persons recognised as senior managers by the company's articles of association.¹²⁴

Remarks

Some parties which are considered to be a connected person in Hong Kong may not be regarded as a connected person or a related party in the PRC, and vice versa. For example, a board secretary, by virtue of his/her being a senior manager, is deemed to be a connected person/related party in the PRC but not in Hong Kong. As a result of the difference in the scope of the definition of connected persons/related parties in both places, some transactions considered to be connected transactions in Hong Kong may not be regarded as related party transactions in the PRC.

¹²⁴ SHSE/SZSE LR 18.1.

For example, the SHSE and SZSE Listing Rules exempt legal persons controlled by the same state asset management organisation (i.e. the State-owned Assets Supervision and Administration Commission or its local bureaus) from being categorised as connected to each other. This indicates that transactions between business entities with the same state parent would not be considered connected transactions. This is not the case in Hong Kong where intra-group transactions¹²⁵ are regarded as connected transactions, but are not subject to any disclosure or independent shareholder approval requirements¹²⁶.

In reality, transactions between an H-share company and an affiliated entity in the same enterprise group controlled by the Chinese state are common and frequent; for example, a listed company depositing its funds in the financial services arm of the enterprise group to reduce operating costs and maintain business flexibility. These practices have raised the eyebrows of minority shareholders in Hong Kong and have in some cases been defeated in shareholder approval procedures, but there have also been a number of cases where the transactions have received shareholder approval.

The much publicised deposit controversy surrounding China Oilfield demonstrates investor concerns about related party transactions that take the form of deposits. In 2004, a fight over a request from China Oilfield, a Hong Kong-listed Chinese oil services company, to deposit up to 40 per cent of its 2003 revenue, about US\$148 million, with a finance company owned by its parent illustrated how China's approach to accessing global capital markets can generate corporate governance concerns among investors. Corporate governance advocates and some investors have asserted that it is poor corporate governance to put so much of the firm's cash into a company controlled by its main shareholder. Because its deposits would not be secured, China Oilfield would have no recourse if the finance company were to make bad investments.

There have also been examples in which shareholder approval was actually given in similar circumstances. When China Oilfield went public in 2002, Hong Kong regulators permitted it to deposit up to 10 per cent of its previous year's revenue at CNOOC Finance Ltd, which is controlled by China Oilfield's parent company. In April 2004, a sister company of China Oilfield, Hong Kong-listed CNOOC Ltd., won shareholder approval to deposit as much as RMB6.8 billion, which was equal to 17 per cent of its 2003 revenues, with the group's finance company.¹²⁷

¹²⁵ An "intra-group transaction" in Hong Kong is defined as a transaction between a listed issuer and a non-wholly-owned subsidiary or between its non-wholly owned subsidiaries where no connected person of the listed issuer (other than at the level of its subsidiaries) is/ are (individually or together) entitled to exercise, or control the exercise of, 10 per cent or more of the voting power of any general meeting of any of the subsidiaries concerned and none of the subsidiaries concerned is itself a connected person). See SEHK Listing Rule 14A.31(1).

¹²⁶ SEHK Listing Rule 14A.31(1).

¹²⁷ Kate Linebaugh, "China Oilfield Fight Highlights Questions about Governance", *Asian Wall Street Journal*, 2 November 2004, M.1.

Although similar deposit or loan plans had gained shareholder approval in the past, investors in China Oilfield regarded this type of practice as a veiled way for the parent company to effectively borrow from its listed subsidiary on an unsecured basis. According to an angered shareholder rights activist in Hong Kong, David Webb, it was simply "bad behaviour" to finance the parent company with the listed company's funds. Eventually, the deposit proposal was voted down by shareholders in China Oilfield.¹²⁸

(ii) Procedures for disclosure and/or shareholder approval

Hong Kong

In Hong Kong, a connected transaction primarily refers to any transaction between a listed issuer and a connected person. However, under certain circumstances, it also covers a transaction between a listed issuer and a person who is not a connected person.¹²⁹ A connected transaction can also be further classified into a one-off transaction and a continuing transaction.¹³⁰ If a connected transaction involves financial assistance, different rules will apply, depending on whether the financial assistance is granted to or by the listed issuer and whether the listed issuer is a banking company or not.¹³¹ If the financial assistance is granted to a listed issuer, provided that it is on normal commercial terms and no security is granted over the listed issuers' assets, the transaction is fully exempt. Otherwise it is subject to disclosure requirements and independent shareholder approval.¹³² On the other hand, if the financial assistance is granted by a listed issuer, then whether it is fully exempt or exempted from disclosure and/or shareholder approval requirements will depend on a few factors including whether it is on normal commercial terms and the level of the *de minimis* thresholds.

Connected transactions in Hong Kong are subject to two different levels of exemptions. Firstly, there are certain types of connected transactions which are exempt from both disclosure requirements and independent shareholder approval.¹³³ These include connected transactions (except those involving financial assistance and the granting of options) that are considered to be:

- (1) intra-group transactions
- (2) *de minimis* transactions¹³⁴

¹²⁸ Ibid.

¹²⁹ SEHK Listing Rules, LR 14A.13.

¹³⁰ SEHK Listing Rules, LR 14A.14.

¹³¹ SEHK Listing Rules, LR 14A.13 (2), (3) & (4), 14A.63 – 14A.66. A connected transaction involving financial assistance covers provision of financial assistance by/ to a listed issuer to/by a connected person or a company in which both the listed issuer and a connected person(s) (at the issuer level but not at the subsidiary level) are shareholders and the connected person(s), individually or together, hold(s) 10 per cent or more interest.

¹³² SEHK Listing Rules, LR 14A.65(4) & 14A.63.

¹³³ SEHK Listing Rules, LR 14A.31. For continuing connected transactions which are exempt from both disclosure and independent shareholders' approval requirements, please refer to SEHK Listing Rules, LR 14A.33.

¹³⁴ This exemption does not apply to the issue of new securities by a listed issuer to a connected person. See SEHK Listing Rules, LR 14A.31(2).

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- (3) the issue of new securities to connected persons pursuant to:
- a rights issue or bonus issue
 - a share option scheme
 - an underwriting agreement under which the connected person acts as an underwriter or sub-underwriter
 - top-up placing, i.e. securities are issued to a connected person within 14 days after the connected person has executed an agreement to reduce his holding in that class of securities, by placing securities to a third person who is not its associate
- (4) a transaction which comprises a dealing in securities listed on the SEHK or a recognised stock exchange in the ordinary and usual course of its business
- (5) purchase of its own securities by the listed issuer from a connected person on the SEHK or a recognised stock exchange; or under a general offer made in accordance with the Code on Share Repurchases
- (6) entering into of a service contract by a director of the listed issuer with the listed issuer
- (7) acquisition or realisation of consumer goods or services on normal commercial terms in the ordinary course of business where the total consideration or value represents less than 1 per cent of the total revenue or total purchases of the listed issuer as shown in its latest published audited accounts or latest published audited consolidated accounts, where they have been prepared
- (8) sharing of administrative services on a cost basis

Secondly, if satisfying any of the following conditions, connected transactions (other than those involving financial assistance or granting of options) on normal commercial terms can be exempt from independent shareholder approval but are still subject to reporting and announcement requirements¹³⁵:

- each of the relevant percentage ratios (except for profits ratio) is less than 2.5 per cent; or
- each of the relevant percentage ratios (except for profits ratio) is 2.5 per cent or more but less than 25 per cent and the total consideration is less than HK\$10 million.

However, this exemption does not apply to the issue of new securities by a listed issuer to a connected person.

¹³⁵ SEHK Listing Rule, 14A.32. For continuing connected transactions which are exempt from independent shareholders' approval, refer to SEHK Listing Rule 14A.34.

If transactions do not fall under any of the two categories mentioned above, they are subject to both disclosure requirements and independent shareholders' approval, which include the following¹³⁶:

- notifying the SEHK
- public announcement
- circular to shareholders
- independent shareholders' approval (either by general meeting, at which any votes taken must be taken by poll; or by written independent shareholders' approval on condition that no shareholder is required to abstain from voting and written approval is obtained from a shareholder or a closed allied group of shareholders holding more than 50 per cent of the voting rights)
- details of the transaction must be disclosed in the next published annual report and accounts

It should be noted that if a connected transaction is subject to independent shareholders' approval, the issuer shall establish an independent board committee to advise shareholders as to whether the terms of the relevant transaction are fair and reasonable and whether the transaction is in the interests of the issuer and the shareholders as a whole and to advise shareholders on how to vote, taking into account the views of the independent financial adviser who should be appointed by the issuer to make recommendations to the independent board committee and the shareholders¹³⁷.

PRC

In the PRC, related party transactions refer to those transactions made between a listed company (including its holding subsidiaries) and its connected person which transfer resources or obligations.¹³⁸ As with Hong Kong, some related party transactions are exempt from any disclosure requirements and shareholder approval, or do not need shareholder approval but are still subject to disclosure, or are subject to both disclosure and shareholder approval.

The exemptions include the following categories:

- Exempt from shareholders' approval but subject to disclosure¹³⁹
 - (1) A related party transaction (except the grant of guarantee by the listed company to a connected person which shall be subject to both disclosure and shareholder approval regardless of the monetary amount involved)¹⁴⁰ between the listed company and its connected natural person with consideration of more than RMB300,000 but less than RMB30 million and which represents in absolute terms less than 5 per cent of the listed company's latest audited net asset value.

¹³⁶ SEHK Listing Rules, 14A.17.

¹³⁷ SEHK Listing Rules 14A.21 and 13.39(6).

¹³⁸ SHSE/SZSE LR10.1.1.

¹³⁹ SHSE/SZSE LR10.2.3, 10.2.4, 10.2.5.

¹⁴⁰ SHSE/SZSE LR 10.2.6.

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- (2) A related party transaction (except the grant of guarantee by the listed company to a connected person, which shall be subject to both disclosure and shareholder approval regardless of the monetary amount involved) between the listed company and its connected legal person with consideration of more than RMB3 million and which represents in absolute terms more than 0.5 per cent of the listed company's latest audited net asset value but less than RMB30 million and represents in absolute terms less than 5 per cent of the listed company's latest audited net asset value.
- Exempt from disclosure and shareholders' approval ¹⁴¹
 - (1) Subscription in cash by one party for the shares, company debentures or corporate bonds, convertible corporate bonds or other types of derivative products issued by the other party for public subscription.
 - (2) Underwriting by one party as a member of an underwriting consortium of the shares, company debentures or corporate bonds, convertible corporate bonds or other types of derivative products issued by the other party for public subscription.
 - (3) Receipt of dividends, bonus or remuneration by one party based on a resolution approved at the other party's general meeting.
 - (4) A related party transaction arising from one party's participation in an open tender, an open auction or other activities.

As noted above, connected legal persons and connected natural persons are subject to different thresholds in so far as the disclosure requirement is concerned. However, this distinction will be removed:

- when the consideration of the related party transaction (other than cash given to or a guarantee provided by the listed company) has a value of more than RMB30 million and which represents in absolute terms more than 5 per cent of the listed company's latest audited net asset value; or
- when the listed company provides a guarantee to a connected person.

In both cases the transaction is subject to disclosure as well as requiring shareholder approval¹⁴².

¹⁴¹ SHSE/SZSE LR10.2.14/10.2.13.

¹⁴² SHSE/SZSE LR10.2.5.

In the PRC, disclosure of related party transactions requires submission to the exchanges of the announcement, relevant agreements, board resolutions, independent directors' approval and opinions, relevant government approval (if applicable), professional report issued by intermediaries (if applicable) and other documents required by the exchanges¹⁴³. Turning to the dissemination of relevant information to shareholders, the listed company does not have to deliver a circular to shareholders, as is mandated in Hong Kong, for independent shareholder approval. Instead, in practice listed companies usually post announcements on designated websites to notify shareholders of the need for their approval.

Remarks

There are several material differences between specific categories of transactions subject to different levels of disclosure and shareholder approval. The main difference is that, in the PRC, connected transactions involving guarantees for loans entered into by listed companies are in no circumstances exempt from either disclosure or shareholder approval, regardless of the monetary amount involved. In Hong Kong, the granting of guarantees by the listed issuer may be exempt, if the amount or percentage at stake does not reach the benchmarks for triggering disclosure and/or approval procedures.

PRC listed companies do not need to appoint an independent financial adviser tasked with making recommendations on the connected transactions to the independent board committee and shareholders. However, if the related party transaction (other than cash given to or guarantees provided by the listed company) has a value of over RMB30 million and which represents in absolute terms over 5 per cent of the listed company's latest audited net asset value, then, as well as ensuring timely disclosure and shareholders' approval, it is necessary for the listed company to appoint an intermediary qualified to conduct securities and futures-related business to evaluate or audit the subject matter of the transaction.¹⁴⁴

Under Hong Kong's proposed new statutory disclosure regime, the new Schedule to the SFO will define a connected transaction. The Schedule will contain the more important listing disciplines as factors for consideration in determining whether a listed issuer has complied with the general principles as regards the announcements, circulars and voting on a connected transaction. The more detailed and technical provisions to be contained in the circulars will be found in the Listing Code.

¹⁴³ SZSE LR10.2.7, 9.14; SHSE LR10.2.8,9.12.

¹⁴⁴ SHSE/SZSE LR10.2.5.

PART III: REVIEW AND COMPARISON OF COMPLIANCE BY H-SHARE AND A-SHARE COMPANIES

We now present data and statistics collected from both the Hong Kong and PRC securities markets on issuers' compliance with laws and regulations on continuing disclosure. Specifically, we examine the enforcement records for all types of breaches, especially disclosure-related breaches, during the three years from 2005–2007 as published by the SEHK (including both the Main Board and the GEM board) on the Hong Kong side, and by the SHSE, SZSE and CSRC on the PRC side. The exact assessment period for both markets is from 1 January 2005 to 17 January 2008.

In the following, we first review the overall patterns and notable features of enforcement actions relating to all types of breaches specified by the regulators. We then move to assess the specific characteristics of disclosure-related breaches and enforcement which involve both listed companies and their executives, as against the overall systemic backdrop. Comparisons will be made between Hong Kong and the PRC on a number of important dimensions of enforcement.

General patterns of enforcement in all types of breaches

There are some general patterns of enforcement displayed in both markets.

Parties subject to sanctions

Both listed companies and their executives are the subjects of enforcement sanctions or disciplines in both Hong Kong and the PRC.

Table 1: Parties subject to sanctions

SEHK

| | 2007 | 2006 | 2005 |
|---|------|------|------|
| Parties which were censured | | | |
| 1. The company | 7 | 9 | 7 |
| 2. Executive director | 8 | 7 | 5 |
| 3. Former executive director | 5 | 4 | 2 |
| 4. Non-executive director | 1 | | |
| 5. Former non-executive director | | | 4 |
| 6. Compliance officer | | | 1 |
| 7. Chairman | | 1 | 1 |
| Parties which were criticised | | | |
| 1. The company | 3 | 11 | 5 |
| 2. Chairman (as well as executive director) | | | 2 |
| 3. Executive director | 2 | 9 | 5 |
| 4. Former executive director | 5 | 2 | 3 |
| 5. Non-executive director | 1 | | 1 |
| 6. Former non-executive director | 1 | 1 | |
| 7. Independent non-executive director | | 1 | 1 |

SHSE

| | 2007 | 2006 | 2005 |
|---|------|------|------|
| 譴責人士 (Parties subject to censure/criticism) | | | |
| 1. 公司 (Company) | 9 | 20 | 18 |
| 2. 董事 (Director) | 4 | 14 | 18 |
| 3. 控股股東 (Controlling shareholder) | | 2 | |
| 4. 董事長 (Chairman of the board) | 4 | 14 | 13 |
| 5. 副董事長 (Deputy chairman of the board) | | 1 | |
| 6. 集團實際控制人 (Person in de facto control of the group) | | 1 | |
| 7. 獨立董事 (Independent director) | 3 | 7 | 7 |
| 8. 董事會秘書 (Board secretary) | 1 | 3 | 1 |
| 9. 監事 (Supervisor) | | 3 | 2 |
| 10. 財務總監/負責人 (Financial controller/person in charge) | 1 | 2 | 1 |
| 11. 高級管理人員 (Senior management) | | 1 | |
| 12. 總會計師 (Chief accountant) | | 2 | |
| 13. 總經理 (General manager) | 1 | 2 | 1 |
| 14. 副總經理 (Deputy general manager) | | 2 | |
| 15. 前任董事 (Ex-director) | 2 | 5 | 6 |
| 16. 前任董事長 (Ex-chairman of the board) | 1 | 5 | 4 |
| 17. 前任獨立董事 (Ex-independent director) | | 1 | 1 |
| 18. 前任監事 (Ex-supervisor) | 1 | | |
| 19. 前任財務總監/負責人 (Ex-financial controller/person in charge) | | 1 | |
| 20. 前任副董事長 (Ex-deputy chairman of the board) | | 1 | |
| 21. 一致行動人 (Parties acting in concert) | | 1 | |

SZSE

| | 2007 | 2006 | 2005 |
|---|------|------|------|
| 譴責人士 (Parties subject to censure/criticism) | | | |
| 1. 公司 (Company) | 17 | 27 | 34 |
| 2. 董事 (Director) | 8 | 27 | 32 |
| 3. 控股股東 (Controlling shareholder) | 4 | | |
| 4. 董事長 (Chairman of the board) | 8 | 2 | 1 |
| 5. 副董事長 (Deputy chairman of the Board) | 1 | | |
| 6. 集團實際控制人 (Person in de facto control of the group) | 1 | | |
| 7. 獨立董事 (Independent director) | 3 | 9 | 4 |
| 8. 董事會秘書 (Board secretary) | 6 | 4 | 1 |
| 9. 監事 (Supervisor) | 3 | 9 | |
| 10. 財務總監／負責人 (Financial controller/responsible person) | 6 | 1 | 1 |
| 11. 高級管理人員 (Senior management) | 1 | 8 | |
| 12. 總會計師 (Chief accountant) | | 1 | |
| 13. 總經理 (General manager) | 3 | | 2 |
| 14. 副總經理 (Deputy general manager) | 3 | 2 | |
| 15. 總工程師 (Chief engineer) | 1 | | |
| 16. 保薦代表人 (Representative of sponsor) | 1 | | |
| 17. 前任董事 (Ex-director) | 3 | 7 | 15 |
| 18. 前任董事長 (Ex-chairman of the board) | 1 | | |
| 19. 前任獨立董事 (Ex-independent director) | | 2 | |
| 20. 前任董事會秘書 (Ex-board secretary) | 1 | | |
| 21. 前任監事 (Ex-supervisor) | 1 | | |
| 22. 前任財務總監／負責人 (Ex-financial controller/person in charge) | 2 | | 1 |
| 23. 前任高級管理人員 (Ex-senior management) | 1 | | |
| 24. 前任總經理 (Ex-general manager) | 1 | | |

Overall frequency of enforcement

From the percentage of the number of sanctions to the number of listed companies, it can be seen that there are differences in the frequency of enforcement between the different listing venues.

In Hong Kong, the overall enforcement frequency was higher on the GEM than on the Main Board during the assessment period.

Table 2: Overall enforcement frequency

| | 2007 | 2006 | 2005 |
|----------------------|-------|-------|-------|
| Hong Kong Main Board | 1,048 | 975 | 934 |
| | 20 | 23 | 29 |
| | 0.019 | 0.024 | 0.031 |
| Hong Kong GEM | 193 | 198 | 201 |
| | 17 | 32 | 14 |
| | 0.088 | 0.162 | 0.070 |
| SHSE | 860 | 842 | 834 |
| | 21 | 51 | 59 |
| | 0.024 | 0.061 | 0.071 |
| SZSE | 670 | 579 | 544 |
| | 54 | 79 | 96 |
| | 0.081 | 0.136 | 0.176 |

Note: First row – number of listed companies as at the end of the year

Second row – number of breaches in the year

Third row – ratio of breaches to total number of listed companies

A case may consist of more than one breach

Readers are warned that it is risky to assume, on the basis of these statistics, that there are more violations on the SZSE than on the SHSE. There are two reasons for caution here.

Firstly, enforcement frequency does not translate and precisely correspond to the frequency of breaches; it is possible that enforcement is inconsistent so that not all breaches are subject to enforcement, sanctions or both.

Secondly, it is also possible that there are discrepancies in the vigour with which regulators enforce the rules. For example, it may well be the case that the SZSE has adopted a more rigorous approach toward enforcement than the SHSE, which has resulted in more investigations and sanctions in the former than the latter exchange. SZSE officials have suggested this when commenting on the current trend of emerging regulatory competition among the two PRC exchanges.¹⁴⁵

Of course, if we assume that the enforcement frequency accurately reflects the breach frequency (and therefore the quality of compliance), one possible explanation is that the SZSE lists more small and medium-sized companies, particularly private companies (minying qiye), which in general may tend to commit more breaches than large companies, especially than the large SOEs which form the majority of listed issuers on the SHSE. It is suggested that, due to their size and resource constraints, smaller issuers tend to have more difficulties in meeting regulatory requirements than large issuers do.¹⁴⁶

Categories of breach

Types of breach can be broadly categorised into five main groups, which in turn can be divided into a number of sub-categories, as demonstrated in Table 3. It should be noted that the categorisation here is based on the types of breaches commonly referred to in Hong Kong because the breaches in the A-share market can generally be categorised along similar lines. However note that several breach categories in the H-share market seem different to those in the mainland and may not apply to the A-share market.

Table 3: Categories of breaches

Type A: Failure or delay in meeting disclosure and/or approval requirements relating to PSI or certain transactions, including the following sub-categories:

1. The necessary disclosure and/or approval obligation in relation to a notifiable transaction or financial assistance
2. The necessary disclosure and/or approval obligation in relation to a connected transaction or financial assistance
3. Disclosure obligation in relation to an unusual price (or transaction) movement

¹⁴⁵ Benjamin Liebman and Curtis Milhaupt, "Reputational Sanctions in China's Securities Market", 108 Columbia Law Review 929 (2008).

¹⁴⁶ Benjamin Liebman and Curtis Milhaupt, "Reputational Sanctions in China's Securities Market", 108 Columbia Law Review 929 (2008). The authors also suggest that it is equally possible that rather than a weaker ability to perform compliance, smaller companies may be less well positioned than large companies, especially large SOEs, to seek political influence on the stock exchanges to persuade them not to impose sanctions.

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4. Disclosure obligation in relation to material/price sensitive information
 5. Disclosure obligation in relation to account receivables/borrowings/payables/guarantees in the financial statements
 6. Fair and professional disclosure obligation
 7. Obligation for accurate disclosure of material information

Type B: Failure or delay in performing periodic financial reporting obligations, including the following sub-categories:

1. On schedule disclosure of year-end financial report/result
2. On schedule disclosure of interim financial report/result
3. On schedule disclosure of quarterly financial report/result
4. Disclosure of financial information

Type C: Breaches of rules on specific types of share transaction, including the following sub-categories:

1. Not performing share transactions during a restrictive period
2. Not performing share transactions without giving advance notice to chairman of the board

Type D: Failure to comply with specific listing rules, including the following sub-categories:

1. Failure to notify the stock exchange
2. Failure to co-operate with the stock exchange
3. Failure to request a suspension of trading
4. Failure to maintain the minimum 25 per cent public float

Type E: Breaches of corporate governance, and of ethical and professional requirements for specific corporate offices, including the following sub-categories:

1. Default in the compliance officer's duties
2. Failure to put in place and comply with the necessary policies and procedures
3. Failure to provide the board with the necessary assistance/notification
4. Breach of fiduciary duty/failure to avoid conflicts of interest
5. Illegal/fraudulent activities

Breakdown of breach categories

The statistics below indicate that the majority of breaches on the SEHK are related to compliance failures or deviations when performing disclosure obligations. These breaches are generally either Type A or Type B breaches. It is remarkable that the ratio of disclosure-related breaches to total number of breaches was 75 per cent on the Main Board and 73.1 per cent on the GEM board during the assessment period (see Table 4).

In the PRC, the pattern is consistent with that in Hong Kong in that disclosure-related breaches account for 64.9 per cent of breaches on the SHSE and 57.7 per cent on the SZSE, (see Table 5), pointing to the same problem of prevailing compliance failure in disclosure. This warrants a close examination of disclosure-related breaches on both markets, which we turn to shortly.

Table 4: Breakdown of breach categories in Hong Kong

| 2005–2007 | Category of Breach | | | | | Total |
|----------------------|--------------------|-------|------|-------|------|-------|
| | A | B | C | D | E | |
| Hong Kong Main Board | 38 | 16 | 3 | 11 | 4 | 72 |
| | 52.8% | 22.2% | 4.2% | 15.3% | 5.6% | 100% |
| Hong Kong GEM | 35 | 11 | 3 | 9 | 5 | 63 |
| | 55.6% | 17.5% | 4.8% | 14.3% | 7.9% | 100% |

Note: First row – number of relevant breaches

Second row – percentage of a particular type of breach to the total number of breaches (the same incident can be categorised under more than one type of breach)

Table 5: Breakdown of breach categories in the PRC

| 2005–2007 | Category of Breach | | | | | Total |
|-----------|--------------------|-------|------|------|-------|-------|
| | A | B | C | D | E | |
| SHSE | 65 | 20 | 0 | 0 | 46 | 131 |
| | 49.6% | 15.3% | 0.0% | 0.0% | 35.1% | 100% |
| SZSE | 95 | 37 | 2 | 7 | 88 | 229 |
| | 41.5% | 16.2% | 0.9% | 3.1% | 38.4% | 100% |

Note: First row – number of relevant breaches

Second row – percentage of a particular type of breach to the total number of breaches (the same incident can be categorised under more than one type of breach)

Examination of specific disclosure-related breaches

Below are a few indicative observations about disclosure-related Type A and Type B breaches in both Hong Kong and the PRC.

Type A breaches

Type A breaches comprise the largest number of breaches seen by regulators in both Hong Kong and the PRC. In both markets, the most frequently-seen breaches fall within the following four sub-categories (see Table 6):

Sub-category* descriptions

- Disclosure or approval of notifiable transactions
- Disclosure or approval of connected transactions
- Disclosure obligation in relation to material/price sensitive information
- Disclosure of account receivables/borrowings/guarantees

Note *: Sub-categories as referred to in Table 3.

Table 6: The four most frequent Type A breaches

| The four most frequent breaches (Type A) | HK Main Board | HK GEM | SHSE | SZSE |
|---|---------------|--------|-------|-------|
| Disclosure or approval of notifiable transactions | 23.0% | 22.9% | 32.3% | 13.7% |
| | (2) | (2) | (1) | (2) |
| Disclosure or approval of connected transactions | 44.7% | 17.1% | 23.1% | 33.7% |
| | (1) | (3) | (3) | (1) |
| Disclosure obligation in relation to material/price sensitive information | 7.9% | 17.1% | 27.7% | 33.7% |
| | (4) | (3) | (2) | (1) |
| Disclosure of account receivables/borrowings/guarantees | 10.5% | 28.6% | 9.2% | 10.5% |
| | (3) | (1) | (4) | (3) |

Note: Items bracketed are ranked in descending order from the highest ratio

On the SEHK Main Board, the most serious type of breach in terms of frequency of commitment is violations of disclosure or approval requirements for connected transactions, which account for 44.7 per cent of Type A violations. Ranking next are breaches of disclosure and approval requirements for notifiable transactions, responsible for 23.0 per cent of Type A breaches. On the GEM, breaches of disclosure in relation to account receivables/borrowings/guarantees stand at 28.6 per cent, making this the most frequent offence under Type A; ranking second are breaches of disclosure and approval requirements for notifiable transactions, at 22.9 per cent.

By comparison, on the SHSE, of the most common breaches are those of disclosure and approval requirements for notifiable transactions, with a ratio of 32.3 per cent, while breaches involving disclosure obligations in relation to material/price sensitive information come next, accounting for 27.7 per cent of Type A violations. On the SZSE, both violations of disclosure or approval requirements for connected transactions and breaches involving disclosure obligations in relation to material/price sensitive information are the most frequent violations, both accounting for 33.7 per cent of total Type A breaches.

Type B breaches

On the SEHK Main Board, the most frequent Type B breach is failure or delay in disclosing annual reports and results, with an overwhelming breach ratio of 62.5 per cent. This is also the leading sub-category of Type B breach on the GEM Board, as well as on the SHSE and the SZSE. Meanwhile, on the GEM Board in Hong Kong and the SHSE and SZSE in the PRC, breaches associated with quarterly reporting are the second most common Type B violation. Table 7 below shows the most frequent Type B breaches.

Table 7: The four most frequent Type B breaches

| The four most frequent breaches (Type B) | HK Main Board | HK GEM | SHSE | SZSE |
|--|---------------|--------|-------|-------|
| On schedule disclosure of year-end financial report/results | 62.5% | 36.4% | 40.0% | 43.2% |
| On schedule disclosure of interim financial report/results | 31.3% | 18.2% | 5.0% | 8.1% |
| On schedule disclosure of quarterly financial report/results | 0.0% | 27.3% | 35.0% | 43.2% |
| Disclosure of financial information | 6.3% | 18.2% | 20.0% | 5.4% |

It is possible that there will be an increase in Type B breaches after the HKEx adopts its proposals to shorten the reporting deadlines for annual and interim reports and results, as well as phase in quarterly reporting for the Main Board issuers, if companies do not dedicate additional effort and resources to ensure proper compliance.

Parallel enforcement in the PRC

Unlike in Hong Kong where the stock exchange is the primary enforcement body for disclosure, in the PRC both the stock exchanges and the CSRC have enforcement jurisdiction over breaches of disclosure rules, although this parallel enforcement has not led to a significant overlap.

For example, during the assessment period, of the total 55 cases involving all identified types of enforcement sanctions by the SHSE (including enforcement directed against breaches of disclosure rules), seven were also subject to CSRC enforcement. During the same period, 12 of the 91 enforcement cases handled by the SZSE also involved CSRC sanctions. All of the parallel enforcement incidents related to the issuer's failure to perform its continuing disclosure obligations. It may be reasonable to conclude, therefore, that exchange enforcement largely supplements, and does not duplicate, CSRC enforcement.¹⁴⁷

Corporate governance practices of A&H companies

A recent report jointly released by several reputable research institutions in the PRC reviewed corporate governance performance of the top 100 Chinese listed companies in 2008. A total of 12 of the top 20 performers were dual-listed A&H companies.¹⁴⁸ The report also stated that, among all types of listed Chinese companies assessed, the overall corporate governance performance rating was the highest for A&H companies and the lowest for companies issuing only A-shares, with companies issuing only H-shares ranking in the middle.¹⁴⁹ The primary reason suggested for the superior performance of A&H companies, as compared with companies listed only on the A-share market or only on the H-share market, is the stronger regulatory scrutiny, market discipline and higher compliance requirements imposed by regulators in more than one market.¹⁵⁰

¹⁴⁷ This conclusion echoes the same finding in a recent empirical study on reputational sanctions in China's securities market. See Benjamin L. Liebman and Curtis J. Milhaupt, "Reputational Sanctions in China's Securities Market", 108 Columbia Law Review 929 (2008).

¹⁴⁸ See Centre for Corporate Governance, Institute of World Economics and Politics, China Academy of Social Sciences (中國社會科學院世界經濟與政治研究所公司治理中心), Research Centre for Examinations, Assessments and Evaluations of Leaders, China National School of Administration (國家行政學院領導人員考試測評研究中心) and Protiviti Shanghai (上海甫瀚投資管理諮詢有限公司), "2008 Evaluation Report on Corporate Governance Performance of Top 100 Chinese Listed Companies" (《2008年中國上市公司100強公司治理評價報告》), online: http://www.cnstock.com/paper_new/html/2008-05/21/content_61806292.htm

¹⁴⁹ Ibid.

¹⁵⁰ Ibid.

Summary assessment of empirical findings

Overall, it seems that the annual breach ratio of the SEHK Main Board during the assessment period was the lowest among all the listing venues examined, and that the ratio has declined during the three-year period studied. This may imply better compliance quality, including on disclosure-related matters, on the Main Board than on other exchanges in both Hong Kong and the PRC. For all listing venues, however, it is clear that disclosure-related breaches are indeed the most serious and frequent of all types of breach. This calls for closer attention from all stakeholders to seek improvements and solutions in this particular area to ensure greater market transparency and investor protection.

PART IV: PROSPECTS FOR REGULATORY COMPLIANCE

How regulatory gaps can be reduced: strategies for realistic co-ordination and convergence

- (1) The A-share and H-share markets are two different and separate regimes with distinct characteristics; therefore it is reasonable to expect there to be differences, including material differences, in their regulatory regimes.
- (3) Chapter 19A of SEHK Listing Rules already sets out specific rules concerning the listing and continuing obligations of PRC issuers, including both exemptions and additional requirements, to accommodate PRC issuers. Non-PRC issuers are not affected by these specific arrangements.
- (3) A great deal of convergence has already taken place, especially in relation to financial reporting and the disclosure of PSI. Future steps may move the two regimes closer in how they deal with connected transactions.
- (4) On the whole, there is not much difference between the regulatory vigour over disclosure exercised in Hong Kong and the mainland. It is difficult to make a clear-cut judgment about which disclosure regime is more rigid or stricter. The PRC disclosure regime has largely been built on learning from overseas experiences, including that of Hong Kong, as well as from international best practice, such as the OECD Corporate Governance Principles. As our analysis in Part III reveals, in practice, the exchanges are very active in monitoring violations of disclosure rules in the A-share market, showing an improving quality of market self-regulation.

PART V: CONCLUSIONS

From our review of regulations governing continuing disclosure in Hong Kong and the PRC, we see that there are some material differences in a number of substantive and procedural areas, particularly in PSI disclosure and the disclosure of notifiable/connected transactions. However, some signs of convergence have emerged in recent years, primarily in relation to financial reporting standards. In the light of these observations, several conclusions can be drawn regarding the current extent of regulatory gaps, the compliance of listed companies, future prospects for the cross-border integration of capital markets, and possible strategies that Hong Kong can consider to maintain its competitiveness as an international financial centre.

A tale of two markets: Fundamental and entrenched differences vs. technical and adaptable differences

First, the fundamental differences in the regulatory framework, regulatory philosophy and approach, level of market liberalisation and market structure (both of listed companies and of investors) between the Hong Kong and PRC capital markets have produced certain deep-rooted differences between the two disclosure regimes. It would appear difficult for these to be removed through formal convergence, at least within a short period of time. A typical example is the prevailing practice of form filling in the PRC market when disclosing information.

Second, there are also material differences at a technical level. Some of these gaps may be reduced by formal convergence of rules where necessary, such as by a better synchronised cross-border suspension policy to mitigate the risk of harmful regulatory arbitrage.

Differences in specific areas: Discrepancies, not conflicts

As already indicated, although material differences can be found in all of the four areas examined – disclosure of PSI, periodic financial reporting, disclosure of notifiable transactions and disclosure of connected transactions – there is also a visible and growing trend towards convergence in these areas between Hong Kong and the PRC. Overall, rule discrepancies tend to dominate rule conflicts (indeed, no significant conflicts were discovered while researching this report).

Compliance in dual-listed companies: No serious difficulties, but concern with costs

Even though they operate under two different disclosure regimes, the compliance record of A&H companies has been remarkably strong despite potentially significant additional costs. Indeed, a representative view from A&H companies on the widely perceived challenge they face in meeting two sets of sometimes diverging regulatory requirements is that there do not seem to be serious technical difficulties in achieving competent implementation of simultaneous and equal disclosure to investors in both the Hong Kong and PRC markets.

In practice, dual-listed companies have chosen to opt to comply with higher reporting and disclosure standards whenever they are subject to simultaneous and equal disclosure obligations. This pragmatic strategy has proven to be effective and has greatly reduced the risk of compliance failures.

Another typical view among A&H companies on the regulatory gaps between the Hong Kong and PRC markets is their occasionally (if not yet frequently) voiced concern that sometimes it is more burdensome and more costly to fulfil certain disclosure obligations in Hong Kong, particularly regarding communication with shareholders. For example, requirements to print and deliver hard copies of annual reports to shareholders, and to send circulars to shareholders when their approval is needed for certain types of transactions, are considered to be in need of reform.

Of course, listed companies have a natural tendency to favour lower compliance costs and less (or less strict) regulations, which they often associate with higher operational efficiency. This may sometimes run counter to the concepts of stronger market transparency and tighter standards of investor protection which have firmly established their legitimacy in many of the world's advanced capital markets. But reservations about unwarranted or unnecessary over-rigidity in regulation may not necessarily be detrimental to shareholder interests and the two can be made compatible if there are significant benefits deriving from eased compliance to increased shareholder value; this may be achieved without compromising the value of shareholder protection.

Meanwhile, it should also be pointed out that as the number of A&H dual-listed companies grows and the profiles of these issuers start to significantly diversify, sustained quality disclosure may not be guaranteed among all issuers. This is likely to be the cause of genuine future concern to Hong Kong regulators in effective monitoring and assistance in the compliance process.

What has been driving reforms to disclosure regulations? Two markets, two approaches

The motivations and driving forces behind the regulatory reform of disclosure regimes in Hong Kong and the PRC are different, and these forces should be carefully compared in assessing the prospects for future convergence in disclosure regulations between the two markets.

Hong Kong

- (1) The first motivation is improving market transparency and increasing investor protection to make Hong Kong stay in line with prevailing international practice in many advanced markets.
- (2) A relatively high level of retail participation is one of the major features of the Hong Kong market. Therefore stricter disclosure requirements (as compared with other advanced international markets, such as London) are needed. It is especially worth noting that according to a recent survey conducted by the HKEx and concluded in July 2008, the level of retail participation in Hong Kong is 35.8 per cent, having risen from 28.8 per cent in 2005; one in three adults in Hong Kong are stock investors.¹⁵¹
- (3) The third motivation is accommodating the growing trend of A&H cross-border listings to reduce compliance costs for issuers (e.g. the proposal for mandatory quarterly reporting).

PRC

- (1) A retail-driven market with a high level of participation by individual investors requires tighter disclosure requirements to protect investors and improve market quality and transparency.
- (2) The unique market structure, with the dominance of SOEs, has led to an increased likelihood of rule-breaking in relation to disclosure, which in turn calls for a strict disclosure regime. This can be seen from the fact that one of the most cited examples of corporate governance deficiencies is widespread insider control of listed companies due to state-dominated share structures.
- (3) Idiosyncratic current market conditions and movements are driving reforms toward tighter disclosure regulation. In particular, share structure reform (gu gai) has prompted more and tighter regulations on disclosure upon imminent removal or relaxation of lock-up restrictions on the sale of previously non-tradable shares.

¹⁵¹ HKEx, news release, "One in three Hong Kong adults invests in the Hong Kong stock market", 7 July 2008, online: www.hkex.com.hk/news/hkexnews/080707news.htm

(4) Building a strong disclosure regime has been one of the major regulatory efforts to bring market practices in the domestic market into line with international best practice. This driving force is associated with the transplantation of rules from advanced markets (e.g. public censure by stock exchanges was initially borrowed from the London Stock Exchange and the SEHK). There seems to be an urgent need to make the domestic disclosure regime capable of accommodating new market movements and phenomena brought about by ongoing or future initiatives of capital market liberalisation, such as the expanded qualified foreign institutional investor programme and the proposed admission of foreign issuers to the A-share market.

Competing perspectives: Regulators vs. issuers

Regulators are concerned with increasing market transparency and investor protection and keeping in line with international best practice, while issuers complain about over-regulation.

Regulators in Hong Kong and the mainland hope to strengthen their home market's competitiveness in attracting new listings. Hong Kong regulators will face a particular challenge in accepting PRC private enterprises at the next stage of cross-border listings, as large, generally better-governed SOEs have largely completed their H-share listings. The expected change in the landscape of mainland issuers may give rise to increased monitoring costs for compliance with disclosure rules on the H-share market.

The role of company/board secretary

The importance of the company secretary/board secretary to effective management of disclosure at listed companies cannot be underestimated. Earlier discussions in this report stress at length what a critical job this office entails. In view of the tremendous responsibility of the company/board secretary with regard to disclosure laws and regulations, continuing professional training is absolutely vital.

Final comments: Where next for Hong Kong?

Future trends in cross-border listings between Hong Kong and the PRC

It is widely anticipated that once the large SOEs have completed their H-share listings, the next wave of PRC issuers coming to Hong Kong to list will be primarily smaller private enterprises (minying qiye). This will pose new challenges for Hong Kong regulators in monitoring these companies' disclosure practices; recent research indicates that smaller firms listed in the A-share market tend to have committed a higher proportion of violations of the listing rules.¹⁵²

¹⁵² See Benjamin L. Liebman and Curtis J. Milhaupt, "Reputational Sanctions in China's Securities Market", 108 Columbia Law Review 929 (2008).

A misconceived sense of crisis?

Hong Kong still maintains considerable advantages over other competitors in attracting mainland issuers. For example, the Singapore Stock Exchange's (SGX) attractiveness to international issuers, especially PRC issuers, has been declining over the past couple of years.¹⁵³

This observation casts doubt on the alarming calls from some observers in Hong Kong that the SEHK faces a number of challenges in maintaining a competitive edge over its Asian counterparts, especially the SGX, in attracting international issuers, particularly PRC issuers. It may be true that the SGX is starting to show its strength over Hong Kong in attracting smaller mainland issuers,¹⁵⁴ but this factor may be insignificant in assessing the comparative strength of Hong Kong which has been very successful in listing large, well-known PRC companies that not only have a huge market capitalisation but can also stimulate active trading by international investors.¹⁵⁵

Therefore, it is time to assess whether there is a misconceived sense of crisis in the Hong Kong securities market and how to better attract smaller PRC companies, especially private companies, to list on the SEHK in the light of regional and global competition.

What does being an international financial centre mean?

Based on latest advances in academic research on cross-border listings and international competition among stock exchanges, there seems to be a counter-argument against the call for Hong Kong to expand its sources of international listings. This counter-argument may not be politically correct, but it appears to be economically sensible.

The basic assumption in this counter-argument is that it is not necessary to be able to attract foreign issuers across the globe in order to qualify as an international financial centre. Research by the internationally renowned top scholar on comparative corporate and securities law John Coffee Jr of Columbia Law School indicates that the international competition among stock exchanges for cross-border listings has increasingly moved to a prevailing pattern of specialised markets catering for their respective unique client bases in building, and using, comparative advantages.¹⁵⁶ This kind of pattern may be economically more efficient than an indiscriminate approach toward winning all cross-border listings.

¹⁵³ See P.R. Venkat, "SGX Outlook Remains Cloudy", Wall Street Journal, 1 May 2008, online: <http://chinese.wsj.com/gb/20080501/ahr174123.asp?source=whatnews1>. According to this report, the SGX has tried to win Chinese listings but has not had great success. It has attracted dozens of such listings but not the type of huge issues that have boosted Hong Kong's market. In 2006, 24 of Singapore's 63 new listings were by Chinese companies. In 2007, they accounted for 31 of 66 new listings. In the first quarter of 2008, the SGX attracted 11 listings, of which four were by mainland Chinese companies. The exchange's chief executive, Hsieh Fu Wah, says he expects listings from China to slow in 2008. Analysts say that current market conditions – slowing share offerings world-wide – make it unlikely that the SGX will be able to match its 2007 listing numbers.

¹⁵⁴ Bauhinia Foundation Research Centre, "Hong Kong as a Preferred IPO Hub... Are We on the Right Track?", April 2008.

¹⁵⁵ P.R. Venkat, "SGX Outlook Remains Cloudy", Wall Street Journal, 1 May 2008, online: <http://chinese.wsj.com/gb/20080501/ahr174123.asp?source=whatnews1>

¹⁵⁶ John Coffee Jr, "Competition Among Securities Markets: A Path Dependent Perspective", Columbia Law School, Centre for Law and Economics Studies, Working Paper No. 192, April 2002.

Hong Kong has unparalleled expertise in listing mainland companies and should continue to capitalise on this critical advantage over its international peers. It is more important for Hong Kong to continue to explore the tremendous opportunity in attracting mainland private enterprises, as well as smaller SOEs, than trying to winning foreign issuers from other parts of the world. The sheer size of the PRC market, and its continually developing nature, offers an unparalleled premium on Hong Kong's expertise which is not available in other emerging markets. It is therefore perhaps premature to worry about Hong Kong's vulnerability when it is critical that the city continues to build upon its specialised competitive edge.

Given the context of this strategic reflection, this report shows that the regulatory gaps between Hong Kong and the PRC disclosure regimes need to be addressed to achieve better co-ordination and synchronisation of regulation across the border. This will benefit Hong Kong's position in international competition for cross-border capital flows because, inter alia, it will help improve the disclosure of A&H dual-listed companies, which are growing in number, by creating the prospects of consistent compliance. We believe resources spent on this course will be well rewarded by supporting, and enhancing, Hong Kong's standing in regional and international capital markets. We expect that these efforts will contribute in no small part to Hong Kong's global recognition as a major international financial centre.

APPENDICES

Appendix A – List of A&H Dual Listed Issuers

| | Stock Code (A share) | Listing venue | Stock Code (H share) | Stock Name | Listing Date (A share) | Listing Date (H share) | Market cap. (as at 12/08/08) |
|----|-------------------------|---------------|-------------------------|---|---------------------------|---------------------------|---------------------------------|
| 1 | 601111 | Shanghai | 753 | Air China Ltd. | 18/08/2006 | 15/12/2004 | HKD 16,345,085,280 |
| 2 | 601600 | Shanghai | 2600 | Aluminum Corporation of China Ltd. | 30/04/2007 | 12/12/2001 | HKD 25,162,502,876 |
| 3 | 898 | Shenzhen | 347 | Angang Steel Co. Ltd. | 25/12/1997 | 24/07/1997 | HKD 12,226,108,000 |
| 4 | 600585 | Shanghai | 914 | Anhui Conch Cement Co. Ltd. | 07/02/2002 | 21/10/1997 | HKD 16,461,600,000 |
| 5 | 600012 | Shanghai | 995 | Anhui Expressway Co. Ltd. | 07/01/2003 | 13/11/1996 | HKD 2,504,490,800 |
| 6 | 601988 | Shanghai | 3988 | Bank of China Ltd. | 05/07/2006 | 01/06/2006 | HKD 263,790,271,903 |
| 7 | 601328 | Shanghai | 3328 | Bank of Communications Co., Ltd. | 15/05/2007 | 23/06/2005 | HKD 218,881,802,611 |
| 8 | 601588 | Shanghai | 588 | Beijing North Star Co. Ltd. | 16/10/2006 | 14/05/1997 | HKD 1,315,057,200 |
| 9 | 600860 | Shanghai | 187 | Beiren Printing Machinery Holdings Ltd. | 06/05/1994 | 06/08/1993 | HKD 113,000,000 |
| 10 | 601998 | Shanghai | 998 | China CITIC Bank Corporation Ltd. | 27/04/2007 | 27/04/2007 | HKD 62,381,066,479 |
| 11 | 601898 | Shanghai | 1898 | China Coal Energy Co. Ltd. | 01/02/2008 | 19/12/2006 | HKD 50,101,288,600 |
| 12 | 601939 | Shanghai | 939 | China Construction Bank Corporation | 25/09/2007 | 27/10/2005 | HKD 1,500,923,081,120 |
| 13 | 601919 | Shanghai | 1919 | China COSCO Holdings Co. Ltd. | 26/06/2007 | 30/06/2005 | HKD 34,786,488,000 |
| 14 | 600115 | Shanghai | 670 | China Eastern Airlines Corporation Ltd. | 05/11/1997 | 05/02/1997 | HKD 3,086,891,500 |
| 15 | 601628 | Shanghai | 2628 | China Life Insurance Co. Ltd. | 09/01/2007 | 18/12/2003 | HKD 210,957,311,250 |
| 16 | 600036 | Shanghai | 3968 | China Merchants Bank Co., Ltd. | 09/04/2002 | 22/09/2006 | HKD 70,809,200,000 |
| 17 | 601808 | Shanghai | 2883 | China Oilfield Services Ltd. | 28/09/2007 | 20/11/2002 | HKD 14,703,882,160 |
| 18 | 600028 | Shanghai | 386 | China Petroleum & Chemical Corporation | 08/08/2001 | 19/10/2000 | HKD 140,620,489,440 |
| 19 | 601186 | Shanghai | 1186 | China Railway Construction Corporation Ltd. | 10/03/2008 | 13/03/2008 | HKD 23,586,722,560 |
| 20 | 601390 | Shanghai | 390 | China Railway Group Ltd. | 03/12/2007 | 07/12/2007 | HKD 24,571,157,600 |
| 21 | 601088 | Shanghai | 1088 | China Shenhua Energy Co. Ltd. | 09/10/2007 | 15/06/2005 | HKD 81,396,050,875 |
| 22 | 601866 | Shanghai | 2866 | China Shipping Container Lines Co. Ltd. | 12/12/2007 | 16/06/2004 | HKD 7,839,590,000 |
| 23 | 600026 | Shanghai | 1138 | China Shipping Development Co. Ltd. | 23/05/2002 | 11/11/1994 | HKD 23,535,360,000 |
| 24 | 600029 | Shanghai | 1055 | China Southern Airlines Co. Ltd. | 25/07/2003 | 31/07/1997 | HKD 3,158,538,820 |
| 25 | 601005 | Shanghai | 1053 | Chongqing Iron & Steel Co. Ltd. | 28/02/2007 | 17/10/1997 | HKD 1,366,843,088 |
| 26 | 601991 | Shanghai | 991 | Datang International Power Generation Co., Ltd. | 20/12/2006 | 21/03/1997 | HKD 14,788,268,726 |
| 27 | 600875 | Shanghai | 1072 | Dongfang Electric Corporation Ltd. | 10/10/1995 | 06/06/1994 | HKD 3,910,000,000 |
| 28 | 601333 | Shanghai | 525 | Guangshen Railway Co. Ltd. | 22/12/2006 | 14/05/1996 | HKD 4,666,038,000 |
| 29 | 600332 | Shanghai | 874 | Guangzhou Pharmaceutical Co. Ltd. | 06/02/2001 | 30/10/1997 | HKD 1,011,540,000 |
| 30 | 600685 | Shanghai | 317 | Guangzhou Shipyard International Co. Ltd. | 28/10/1993 | 06/08/1993 | HKD 2,383,005,720 |
| 31 | 921 | Shenzhen | 921 | Hisense Kelon Electrical Holdings Co. Ltd. | 13/07/1999 | 23/07/1996 | HKD 409,034,929 |
| 32 | 600027 | Shanghai | 1071 | Huadian Power International Corporation Ltd. | 03/02/2005 | 30/06/1999 | HKD 3,176,882,160 |
| 33 | 600011 | Shanghai | 902 | Huaneng Power International, Inc. | 06/12/2001 | 21/01/1998 | HKD 17,079,364,016 |
| 34 | 601398 | Shanghai | 1398 | Industrial and Commercial Bank of China Ltd. | 27/10/2006 | 27/10/2006 | HKD 474,252,626,203 |
| 35 | 600377 | Shanghai | 177 | Jiangsu Expressway Co. Ltd. | 16/01/2001 | 27/06/1997 | HKD 7,380,880,000 |
| 36 | 600362 | Shanghai | 358 | Jiangxi Copper Co. Ltd. | 11/01/2002 | 12/06/1997 | HKD 15,345,550,920 |
| 37 | 666 | Shenzhen | 350 | Jingwei Textile Machinery Co. Ltd. | 10/12/1996 | 02/02/1996 | HKD 254,928,000 |
| 38 | 600876 | Shanghai | 1108 | Luoyang Glass Co. Ltd. | 31/10/1995 | 08/07/1994 | HKD 217,500,000 |

| | Stock Code (A share) | Listing venue | Stock Code (H share) | Stock Name | Listing Date (A share) | Listing Date (H share) | Market cap. (as at 12/08/08) |
|----|-------------------------|---------------|-------------------------|---|---------------------------|---------------------------|---------------------------------|
| 39 | 600808 | Shanghai | 323 | Maanshan Iron & Steel Co. Ltd. | 06/01/1994 | 03/11/1993 | HKD 6,359,853,100 |
| 40 | 600775 | Shanghai | 553 | Nanjing Panda Electronic Co. Ltd. | 18/11/1996 | 02/05/1996 | HKD 423,500,000 |
| 41 | 585 | Shenzhen | 42 | Northeast Electric Development Co. Ltd. | 13/12/1995 | 06/07/1995 | HKD 196,042,000 |
| 42 | 601857 | Shanghai | 857 | PetroChina Co. Ltd. | 05/11/2007 | 07/04/2000 | HKD 214,786,802,000 |
| 43 | 601318 | Shanghai | 2318 | Ping An Insurance (Group) Co. of China Ltd. | 01/03/2007 | 24/06/2004 | HKD 127,932,184,900 |
| 44 | 488 | Shenzhen | 1812 | Shandong Chenming Paper Holdings Limited | 20/11/2000 | 18/6/2008 | HKD 2,425,874,000 |
| 45 | 756 | Shenzhen | 719 | Shandong Xinhua Pharmaceutical Co. Ltd. | 06/08/1997 | 31/12/1996 | HKD 234,000,000 |
| 46 | 600806 | Shanghai | 300 | Shenji Group Kunming Machine Tool Co. Ltd. | 03/01/1994 | 07/12/1993 | HKD 625,572,968 |
| 47 | 600548 | Shanghai | 548 | Shenzhen Expressway Co. Ltd. | 25/12/2001 | 12/03/1997 | HKD 2,975,050,000 |
| 48 | 600688 | Shanghai | 338 | Sinopec Shanghai Petrochemical Co. Ltd. | 08/11/1993 | 26/07/1993 | HKD 5,755,100,000 |
| 49 | 600871 | Shanghai | 1033 | Sinopec Yizheng Chemical Fibre Co. Ltd. | 11/04/1995 | 29/03/1994 | HKD 1,372,000,000 |
| 50 | 600874 | Shanghai | 1065 | Tianjin Capital Environmental Protection Co. Ltd. | 30/06/1995 | 17/05/1994 | HKD 612,000,000 |
| 51 | 600600 | Shanghai | 168 | Tsingtao Brewery Co. Ltd. | 27/08/1993 | 15/07/1993 | HKD 9,288,880,944 |
| 52 | 338 | Shenzhen | 2338 | Weichai Power Co. Ltd. | 30/04/2007 | 11/03/2004 | HKD 4,332,625,000 |
| 53 | 600188 | Shanghai | 1171 | Yanzhou Coal Mining Co. Ltd. | 01/07/1998 | 01/04/1998 | HKD 23,579,136,000 |
| 54 | 601899 | Shanghai | 2899 | Zijin Mining Group Co., Ltd. | 25/04/2008 | 23/12/2003 | HKD 19,266,112,000 |
| 55 | 63 | Shenzhen | 763 | ZTE Corporation | 18/11/1997 | 09/12/2004 | HKD 8,452,771,891 |

Appendix B

Major laws and regulations governing the continuing disclosure of H-share companies

- SFO, particularly:
Part XV (Disclosure of Interests)
- SEHK Main Board Listing Rules (MLR), particularly:
Chapter 13 (Continuing Obligations)
Chapter 14 (Notifiable Transactions)
Chapter 14A (Connected Transactions)
Chapter 19A (Issuers Incorporated in the PRC): inter alia, setting out some specific requirements on continuing obligations of PRC issuers
Appendix 16 (Disclosure of Financial Information)
Appendix 14 (Code on Corporate Governance Practices)
Appendix 23 (Corporate Governance Report)
- HKEx Guide on Disclosure of Price-Sensitive Information (2002)
- SFC Consultation Paper on the Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules (SMLR) (January 2005) and Consultation Conclusions (February 2007):
 - discussing legislative proposals to give statutory backing to major requirements of SEHK Listing Rules on disclosure by way of codifying these requirements into provisions in the SMLR as subsidiary legislation under the SFO
- HKEx Consultation Paper on Periodic Financial Reporting (August 2007)
 - proposing shortening of reporting deadlines and adoption of quarterly reporting by Main Board issuers
- HKEx Consultation Conclusion on shortening the deadlines for half-year and annual reporting by Main Board issuers (July 2008)
- HKEx Combined Consultation Paper (January 2008)¹
 - publication of consultation conclusions expected in the third quarter of 2008
 - among the 18 proposals to amend the MLR and GLR, some address continuing disclosure obligations

¹ "HKEx Publishes Combined Consultation Paper", HKEx News Release, Updated: 11 January 2008, online: www.hkex.com.hk/news/hkexnews/080111news.htm

Appendix C

Major laws and regulations governing continuing disclosure of A-share companies

- PRC Securities Law (2005), particularly:
Chapter 3 (Trading of Securities): Section III (Continuing Disclosure) and Section IV (Prohibited Trading Acts)
- CSRC regulations concerning continuing disclosure, particularly:
 - CSRC Measures for Regulating Information Disclosure of Listed Companies (上市公司信息披露管理辦法) (2007)
 - CSRC Notice on Regulating Information Disclosure of Listed Companies and Behavior of Relevant Parties (關於規範上市公司信息披露及相關各方行為的通知) (2007)
 - CSRC Notice on Properly Making Financial Disclosure Relating to New Accounting Principles (關於做好與新會計準則相關財務會計信息披露工作的通知) (2006)
 - CSRC《上市公司重大資產重組管理辦法》(2008)
 - CSRC《上市公司董事、監事和高級管理人員所持本公司股份及其變動管理規則》(2007)
 - CSRC《上市公司收購管理辦法》(2006):《上市公司收購管理辦法》為上市公司股權變動提供了系統性的規定。
 - CSRC Measures for the Administration of Stock Incentive Plans of Listed Companies (Trial Implementation) (《上市公司股權激勵管理辦法(試行)》) (2005)
- Listing Rules of Shanghai Stock Exchange (上海證券交易所股票上市規則) (SHSE LR) and Listing Rules of Shenzhen Stock Exchange (深圳證券交易所股票上市規則) (SZSE LR), particularly:
Chapter 2 (General Principles and Provisions on Information Disclosure)
Chapter 6 (Periodic Reports)
Chapter 7 (General Provisions on Ad-hoc Reports)
Chapter 8 (Board of Directors, Board of Supervisors and Shareholders' Meeting)
Chapter 9 (Discloseable Transactions)
Chapter 10 (Related Party Transactions)
Chapter 11 (Other Major Events)
- SHSE and SZSE regulations (including rules, circulars, notices and working guidelines) on continuing disclosure, particularly:
 - SHSE Guidelines for Establishing Bylaws of Listed Companies on Information Disclosure (上海證券交易所上市公司信息披露事務管理制度指引) (2007)
 - SZSE Guidelines for Equal Information Disclosure (深圳證券交易所上市公司公平信息披露指引) (2006)
 - Various SHSE and SZSE practice circulars/notices/guidelines on format and content of disclosure documents (these are numbered and subject to constant revisions; they are not primarily covered in this report)

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