



**SETTLEMENT OF STOCK EXCHANGE  
DISCIPLINARY MATTERS INVOLVING  
LISTING RULE BREACHES**

**June 2007**

---

## INTRODUCTION

Enforcement is an important tool in the performance of The Stock Exchange of Hong Kong Limited (the Exchange), a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited (HKEx), of its regulatory duties as a frontline regulator of listed issuers. Disciplinary actions pursuing breaches of Listing Rules are one visible element of work undertaken by the Exchange to promote compliance with the Listing Rules.

The year to 31 December 2006 saw an increased number of disciplinary matters being concluded by settlement as noted from the statistics below:

	Settled Cases	Total Number of Disciplinary Cases	Settled Cases as % of the Total
2003	3	15	20%
2004	2	24	8%
2005	4	26	16%
2006	7	26	27%

In seeking to enhance transparency and promote greater awareness and usage of settlement of disciplinary matters, the Exchange outlines in this statement the fundamental principles and criteria governing the Exchange's approach towards settlement.

## ENFORCEMENT OBJECTIVES

As the frontline regulator of listed issuers in Hong Kong, the Exchange has the duty to ensure, as far as reasonably practicable, an orderly, informed and fair securities market in Hong Kong. In seeking to achieve this objective, the Exchange makes and enforces the Listing Rules. Disciplinary action is one regulatory response to rule breaches, to be deployed in appropriate cases. There is already posted on the Exchange's website "*The Stock Exchange's Strategy for Enforcing the Listing Rules*" which outlines, among other things, the major criteria for determining whether to take disciplinary actions.

Through disciplinary actions, the Division seeks to:

- (1) deter future breaches conveying clear messages that certain conduct is unacceptable and will not be tolerated by the Exchange; that there are consequences to follow from a rule breach;
- (2) educate the market; and
- (3) ultimately influence and bring about change of attitude and behaviour towards an enhanced compliance culture and improved corporate governance.

## BENEFITS OF SETTLEMENT

Settlement has the benefit of saving the costs and time otherwise involved in a disciplinary action on the part of both the Exchange and the relevant parties. Settlement thus allows swifter and speedier resolution and disposal of disciplinary matters and in turn, contributes towards efficient and effective use of the Exchange's limited regulatory resources.

---

Where a settlement involves publication of a press release on the settlement, the parties have an opportunity and a greater degree of control to negotiate and comment on the content of the press release through a settled outcome, thus offering the parties the advantages of predictability of outcome and greater control over damage to reputation than in the case of full scale disciplinary actions.

## **APPROACH AND CRITERIA FOR SETTLEMENT**

### **Settlement agreed must not compromise the Exchange's regulatory objectives**

No settlement proposal is acceptable to the Exchange if it compromises or undermines the enforcement objectives of the Exchange as identified above.

Essentially, settlement is acceptable only if it results in an acceptable regulatory outcome taking into account all circumstances of the breach. The disciplinary sanction and any remedial action to be taken as agreed in settlement:

- (1) must be proportionate to the breach;
- (2) represent a fair disposal of the breach in the given circumstances of the breach; and
- (3) absent a need to escalate the Exchange's response, are broadly consistent with the sanctions and directions imposed or made for similar breaches in the past.

As part of the regulatory response to serious rule breaches, in disciplinary context and in addition to imposing sanctions for past breaches, the Listing Division (the "Division") and the Listing Committee (the "Committee") have recently been moving in the direction of requiring, in appropriate cases, listed issuers which breached the Listing Rules and directors responsible for the breaches to undertake remedial actions with a view to ensuring and enhancing future compliance.

The Committee is empowered under the Listing Rules to make directions regarding remedial action (the "Directions"). Examples of the Directions made include requirements that:

- (1) directors attend a specified hours of training on directors' duties, the Listing Rules and other laws and regulations applicable to them and/or listed issuers ("Directors' Training");
- (2) the listed issuer (i) engage an independent professional firm (the "Firm"), satisfactory to the Division, to conduct internal controls review and (ii) implement the recommendations to improve internal controls as recommended by the Firm within a specified period of time; and
- (3) the listed issuer appoint a Compliance Adviser to provide advice and guidance to the listed issuer and its senior management on Listing Rule compliance for a specified period of time.

---

The Division adopts this same approach of giving consideration to the need for and requiring remedial actions in appropriate cases in settlement. The Division recommends in disciplinary action and requires as a term of settlement:

- (1) Directors' Training if the Division is satisfied that serious rule breaches which have occurred are clearly attributable to, if not directly resulted from, certain directors' lack of proper knowledge of or regard towards Listing Rule compliance; and
- (2) that the listed issuer retain a Compliance Adviser and conduct an independent internal controls review if the Division is satisfied that the internal controls of a listed issuer are inadequate or ineffective or the directors do not have proper or adequate understanding of the Listing Rule requirements and their application.

### **Publicity**

The Exchange recognises the significance of giving publicity to settlement in order to get the regulatory message out to the market. In all circumstances publicity is a necessary element in any settlement. This is achieved by way of a press release as agreed by the parties subject to approval and any changes as directed by the Committee in approving the settlement. Publicity attaches only to public sanctions and any directions which the Committee directs are to be given publicity.

## **SETTLEMENT PROCESS**

### **Settlement terms are subject to the Committee's approval**

The terms of settlement involving the deployment of the range of regulatory tools found in Rule 2A.09 of the Main Board Listing Rules and Rule 3.10 of the Growth Enterprise Market Listing Rules are subject to the approval of the Committee which is vested with the power to exercise the Exchange's disciplinary jurisdiction to impose disciplinary sanctions and make directions or take any action as prescribed in those rules.

If the Committee declines to endorse the settlement, either a fresh settlement proposal is negotiated and agreed for consideration by the Committee or a disciplinary action is commenced to pursue the breaches.

### **Timing for settlement negotiation**

Settlement may be proposed and negotiated at any stage of an investigation or in the course of a disciplinary action. However,

- (1) it must be easily appreciated that the earlier a settlement is struck, the greater the saving of costs and resources the Exchange and the parties may achieve in tackling a disciplinary matter; and
- (2) the Division is prepared and in a position to engage in a settlement discussion only after it has acquired sufficient understanding of the facts, seriousness of rule breaches as well as the parties' responsibilities for the breaches.

---

### **Admission or no contest of breach**

Settlement negotiation must be based upon the following premises:

- (1) the parties' admission of breach or the parties do not contest the breach; and
- (2) the parties' acceptance of the sanctions and all other terms as identified in the written settlement terms signed by the Division and all parties to the settlement.

### **Without prejudice**

All communications to explore the potential of a settlement and the ensuing settlement negotiation are conducted on a without prejudice basis. Neither the Division nor any of the relevant parties involved in the settlement negotiation may subsequently rely against the other on admissions or statements made in the course of the settlement discussions including in particular in subsequent disciplinary action commenced in relation to the same subject matters absent any concluded settlement.

### **Global settlement**

As a rule of thumb, where a disciplinary matter involves more than one party, all parties to the disciplinary action or proposed disciplinary action must join as parties to the settlement. Any basis or form of settlement other than a global settlement with participation and consent of all relevant parties is unlikely to be acceptable to the Division.

However each case is to be considered on the facts and circumstances of the case. Where the Division is satisfied that there are sufficient grounds or reasons, the Division may be prepared to relax its position on this aspect. Having said that, such an exception must be rare and arises only in exceptional circumstances.

### **Settlement terms in writing**

Communications to explore possible settlement may be verbal and/or in writing. If the settlement negotiation results in a proposed settlement, the Division will put the terms of the proposed settlement in writing for agreement and signature by all parties concerned to signify their consent to the settlement terms.

### **Agree facts of breach and sanction/directions**

The Division and the parties must agree the facts of the breach and if a press release is to be published on the settlement, the content of the draft press release. The Committee has ultimate control over the content of the press release for publication.

### **COMMITTEE: NO KNOWLEDGE OF OR INVOLVEMENT IN SETTLEMENT NEGOTIATION**

Where settlement dialogue ensues after a disciplinary action has been commenced, the Secretary to the Listing (Disciplinary) Committee (the "Committee Secretary") and the Committee are not involved or informed of the existence or substance of the settlement

---

discussion and its progress. Exception is there may be circumstances when it becomes necessary to notify the Committee Secretary of the fact that a settlement negotiation is taking place on account of its impact or likely impact on the pending disciplinary action.

Irrespective of whether a disciplinary action is on foot when a settlement is submitted to the Committee to consider, in the event a settlement is not endorsed by the Committee and the matter subsequently proceeds to a disciplinary hearing, the members constituting the Listing (Disciplinary) Committee present at the disciplinary hearing will be different from those who considered the settlement proposal.

## **CONCLUDING REMARKS**

The Exchange believes it is in the Exchange's interest as much as those the Exchange regulates to settle disciplinary matters in appropriate cases. The Exchange will continue to monitor and review the effectiveness and usage of settlement in disciplinary matters as a part of its ongoing efforts to improve timeliness and effectiveness of its enforcement actions.