

Changes and Events
in the Hong Kong Securities Markets
During the Last Year

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The Closing Auction Saga

- 26-May-08: Closing auctions launched, 16:00-16:10.
- 30-May-08: MSCI index rebalancing causes gyrations in CAS.
- 28-Nov-08: to address concerns of manipulation, HKEx proposes limiting prices in CAS to:
 - 5% or 10% from 16:00 price; or
 - a set number of ticks from 16:00 price; or
 - a set number of ticks above/below day's high/low.
- Webb-site.com calls this the “square wheel” approach - no other market has done this, because it would just shift manipulation to pre-16:00.
- Other markets have introduced random closing times during auctions, to make manipulation expensive.
- Why reinvent the wheel?

Closing auction: part 2

- 13-Feb-09: HKEx announces even tighter restriction than proposed: 2% price limit relative to 16:00 price, tentatively scheduled for Q2.
- 5-Mar-09: HKEx sets implementation date of 22-Jun-09.
- 9-Mar-09: HSBC plunges 12.5% during closing auction, closes at \$33, down 24.1% on the day.
- HSI closes that day at YTD daily low of 11,344. That night, S&P500 closes at post-crash daily low of 676.53.
- 12-Mar-09: HKEx announces suspension of CAS from 23-Mar. “HKEx will continue to explore possible alternative CAS arrangements, including improvements to the 2 per cent price control mechanism”.
- 23-Mar-09: market reverts to 4pm close.

Lehman Collapse

- 16-Sep-08: Lehman collapses, leaving holders of “minibond” products backed by Lehman CDOs with possibly worthless paper.
- About 40,000 people, or 1% of HK’s adult population, hold the products, most of which contained short interests in credit-default swaps. Face value about US\$2.0bn.
- Products were distributed through retail banks.
- This prompts a review of consumer-facing regulation in HK.
- HK has too many regulators – at primary level we have SFC, HKMA, OCI, MPFA. At secondary level we have SEHK (listed companies), HKFI (insurance agents), HKCIB and PIBA (insurance brokers).

Lehman lessons

- We need a unified financial services regulator, absorbing SFC, OCI, MPFA and services side of HKMA, leaving HKMA as central bank, capital adequacy and sovereign wealth manager.
- This will remove regulatory gaps and overlaps, ensuring a consistent approach to regulation and accountability for it.
- We need mandatory disclosure of intermediary commissions in all marketing and contracts.
- We need a mandatory cooling-off period for retail financial products.

CITIC Pacific

- Massive losses on “unauthorised” AUD accumulator contracts.
- Co was aware of situation on 7-Sep-08, but didn’t disclose it till 20-Oct-08. Meanwhile the AUD situation worsened.
- 12-Sep-08: Co publishes circular, states there had been “no material adverse change” since 31-Dec-07.
- 22-Oct-08: SFC confirms formal investigation.
- 3-Apr-09: Police Commercial Crime Bureau searches premises, investigates alleged offences of “false statements by company directors” and/or “conspiracy to defraud under the common law”.

CITIC Pacific lessons

- HK still suffering from “dual filing” listed company regulation: non-statutory Listing Rules (SEHK), with SFC handling false disclosures.
- If you fail to keep investors informed, it is a breach of Listing Rules. Maximum practical penalty is being told off.
- If you make a false or misleading statement in a circular, it is a breach of the law with a maximum penalty of 10 years’ jail.
- Incentive is thus to say nothing rather than risk being wrong.
- Case has caused renewed interest in statutory backing for Listing Rules, which has been “in consultation” since 2003, with successive watering down of proposals.
- 1st proposal was to transfer regulation to SFC (2003). 2nd Second proposal was to transfer some regulations to SFC and put them in law. Third proposal was to put “10 commandments” in law and rest in codes and guidelines.

PCCW

- 30-Oct-08: PCRD & China Unicom launch bid to privatise PCCW, using “Scheme of Arrangement” under Companies Ordinance
- To get to court sanction stage, it requires:
 - 75% of voted shares to be in favour; and
 - not more than 10% of all independent shares to be voted against; and
 - a majority of registered shareholders who vote to be in favour
- The third test is archaic, but must be implemented fairly until abolished. It’s a perk of being a small but registered shareholder when most beneficial owners hold through HKSCC Nominees Ltd.
- Shareholder meeting is adjourned when a higher offer is made on the day.
- 14-Jan-09: Webb-site.com gets anonymous tip that hundreds of Fortis Agents would receive 1,000 registered shares each to vote in favour of the deal.
- After assessment of credibility, we pass it on to SFC, recommending that they inspect the register before the meeting.

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PCCW

- Just in case they hadn't (and they hadn't) I went down to the Hopewell Centre and inspected the register on 29-Jan-09, 2 days before meeting closure.
- A sample showed that hundreds of new shareholders had appeared on the same day with 1,000 shares each. I matched those against the register of insurance agents, and found many of them worked for Fortis. I reported the evidence to the SFC, which had not taken any action until then.
- At second meeting on 4-Feb-09, SoA gets required votes. SFC seizes voting records and is now clearly up to speed. A full-scale investigation ensues.
- 24-Feb-09: court consents to SFC intervention, delays hearing to 1-Apr.
- 2-Apr-09: Court of First Instance rejects SFC claim. SFC appeals.
- 22-Apr-09: Court of Appeal unanimously overturns ruling, says vote-splitting is unfair.
- Bid lapses, but PCCW will go to Court of Final Appeal.

Political background

- 800-member Election Committee chooses HK chief executive
- 60-seat legislature: 30 elected directly, 30 “functional”. Each has a vote in the EC
- Brokers (firms, not people) elect 12 EC members and the “financial services” legislator (who has a criminal record)
- If you are an individual licensed by the SFC, you are trusted with other people’s money but have no vote in the LegCo or EC elections
- Banks elect 12 EC members and the “finance” legislator (currently David Li, former Dow Jones director)
- Insurers elect 12 EC members and the “insurance” legislator
- Government appoints a majority of the HKEx board (including several cabinet members) and all the directors of the SFC. It also owns about 6% of HKEx bought by HKMA.

Thank you. Any questions?



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