



CFRED's Sixth Securities Law Colloquium : REGULATING
GATEKEEPERS IN HONG KONG

*Comparing Gatekeepers in Hong Kong and
Mainland China*

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The Chinese Stock Market

- SSE, SZSE and, the regulator, CSRC were established in the early 1990s.
- SSE is the sixth largest exchange behind SEHK. Market capitalization: 2,547 billion USD.
- World's worst performers and perhaps even worse than a casino.
- Shanghai Stock Exchange Composite Index: 6124 (16/10/2007); 2021 (25/07/2013).
- Gatekeepers: sponsor, corporate attorney, auditor and CRA.

The Sponsor System

- 1993 – 2001: quota system.
- 2001 – 2004: review system.
- 2004 – present: sponsor system.
- Strong government influence: of all 78 sponsors, around 60 are formed and financed by local governments or governmental departments, and only 7 foreign invested securities firms were authorized to be sponsors.
- IPO scandals, eg. Ping An Securities: having sponsored around 100 IPOs, around 70 have a major negative change in their financial positions, 60 fell below offer price, some made false disclosure.

Corporate Attorney

- Gatekeeper: transaction engineers with little direct involvement with litigations, having special skills including the verification of disclosure.
- Pre-reform era: condemned as “capitalists” for standing on the wrong side of criminals and only being there to obstruct justice. In 1978: only 212 lawyers in the country.
- Post-reform era: 200,000 lawyers in 2013. China: 1/689; Hong Kong: 1/850; US: 1/300.
- Mindsets: more prepared to work as government officials rather than autonomous legal practitioners and not competent enough to handle financial issues
- Foreign law firms: not permitted to practice Chinese law.
- Corporate scandal, eg. Beijing Tianyin.

Auditor

- Auditors ensure that the company's financial statements reflect the legal and accounting standards.
- Pre-reform era: the use of western accounting methods is traced to the 19th century. After 1949, the state became the sole owner of all economic entities, and the audit profession was replaced by a system of internal supervision and control within the state.
- Post-reform era: expansion of the profession, CASs achieved overall convergence with IASs.
- Widespread audit fraud: conflict of interests, shortage of well-educated auditors.
- Dual-audit mechanism (2001-2007): audited by a Chinese audit firm in accordance with Chinese standards and then by a foreign audit firm in accordance with international standards.

Credit Rating Agencies

- Credit Rating: a CRA's opinion on the creditworthiness of a particular company, security or obligation.
- Closely linked to reputation capital because the concept of credit itself emphasizes the notion of trust and credibility and the function of a CRA depends on its reputation for objectivity and accuracy.
- Credit rating in China: a relatively short history and a small part of the gatekeeping system.
- Major CRAs: Lianhe, Chengxin, Dagong, Shanghai Far East and Shanghai Brilliance.
- Foreign CRAs are allowed to build partnership or purchase shares of domestic CRAs, and yet not to conduct ratings independently.
- Most ratings are conducted on corporate bonds.
- Close connection with government agencies.
- Sector-based regulatory framework: NDRC for corporate bond market, PBOC for banking market, CSRC for securities market.
- Reform: Administrative Regulations for Credit Ratings.

Summary

- Reputation capital
- Involvement in corporate fraud
- Conflict of interests
- Restrictions on foreign participation
- Inadequate regulatory oversight