SFC commences proceedings against CITIC, its former chairman and executive directors

11 Sep 2014

The Securities and Futures Commission (SFC) has instituted proceedings today in both the Court of First Instance and the Market Misconduct Tribunal (MMT) against CITIC Limited (CITIC) and five of its former executive directors, namely chairman Mr Larry Yung Chi Kin, managing director Mr Henry Fan Hung Ling, deputy managing directors Mr Leslie Chang Li Hsien and Mr Peter Lee Chung Hing, and executive director Mr Chau Chi Yin (the five directors) (Note 1).

The SFC alleges CITIC and the five directors engaged in market misconduct involving disclosure of false or misleading information on CITIC's financial position arising from the massive losses incurred by CITIC over its investment in leveraged foreign exchange contracts in 2008.

The SFC is seeking restoration or compensation orders in the Court of First Instance to restore or compensate up to 4,500 investors who purchased CITIC shares between the date on which the SFC alleges the false or misleading information was announced and the date the true financial position was disclosed. The SFC is also seeking that CITIC and the five directors be sanctioned by the MMT.

The SFC alleges that CITIC issued a circular on 12 September 2008 that contained a false or misleading statement about CITIC's financial position (the Circular).

The Circular, which concerned an unrelated transaction, disclosed that “the Directors are not aware of any adverse material change in the financial or trading position of the Group since 31 December 2007…” (Note 2).

However, in a market announcement on 20 October 2008, CITIC disclosed that it suffered a massive realised and mark to market loss up to that date arising from a number of leveraged foreign exchange contracts which CITIC had entered into to manage currency risk of its Australian iron ore mining project exposure (the Profit Warning). The Profit Warning revealed that CITIC had become aware of the exposure arising from those contracts on 7 September 2008 i.e. before the Circular which contained the alleged false or misleading statement was issued (Note 3).

The prices of CITIC shares, which were suspended from trading on 20 October 2008 before the Profit Warning, fell 55% from $14.52 to close at $6.52 on 21 October 2008 when trading resumed.

The SFC alleges the statement in the Circular issued on 12 September 2008 was false or misleading and that CITIC and the five directors were aware of huge financial exposure arising from the leveraged foreign exchange contracts before the Circular was issued (Note 4).

The SFC alleges CITIC and the five directors are liable for issuing the Circular containing the false or misleading statement and seeks orders in the Court of First Instance under section 213 of the Securities and Futures Ordinance to restore investors who were buyers of CITIC shares after market close on 12 September 2008 and before the date of the Profit Warning, 20 October 2008, to their pre-transaction positions or be compensated for their losses.

The amount that may be required to be paid to restore these investors to their pre-transaction positions or to compensate them will need to be the subject of assessment by the Court of First Instance if liability is established (Note 5). This will establish an important precedent governing the calculation of what may be required to restore a shareholder who has traded in a market affected by false or misleading information.

End

Notes:

1. CITIC was formerly known as CITIC Pacific Limited.

2. The Circular was published on the Stock Exchange of Hong Kong Limited listed company announcement system on the Hong Kong Exchanges and Clearing Limited website on 12 September

2008 after market close and distributed to its shareholders on 16 September 2008. It related to a disclosable and connected transaction in respect of an acquisition by its subsidiary, Dah Chong Hong Holdings Limited, of a 49% interest in FAW Toyota 4S company and a 50% interest in Lexus 4S Company and related shareholders' loans.

3. CITIC disclosed in the Profit Warning that its results for the financial year ending 31 December 2008 were expected to be affected by a loss arising from certain leveraged foreign exchange contracts entered into by the Group with a view to minimizing currency exposure of its iron ore mining project in Australia. It was also disclosed that from 1 July to 17 October 2008, CITIC incurred an aggregate realised loss of $807.7 million as a result of the termination of the leveraged foreign exchange contracts, actions relating to managing the exposure to Australian dollar (AUD) and taking delivery of foreign currencies including AUD pursuant to the leveraged foreign exchange contracts. As at 17 October 2008, the mark to market loss of the outstanding leveraged foreign exchange contracts amounted to $14.7 billion.

The leveraged foreign exchange contracts entered into by CITIC included, among others, target redemption forward contracts. Under a target redemption forward contract, the strike rates for buying a specific foreign currency during the contract period are fixed. If the spot rate on any given day during the contract period is equal to or above the strike rate, a notional amount of the foreign currency will be delivered at the strike rate. The difference between the strike rate and the spot rate will be treated as a profit in respect of that particular contract and when the cumulative profit reaches the maximum profit stipulated in the contract, that particular contract will be knocked-out (i.e. the obligation of the counterparty to deliver the foreign currency will cease). If the spot rate is below the strike rate, a pre-determined amount of the foreign currency (which is greater than the notional amount) will be delivered at the strike rate. In this case, the value of the foreign currency delivered will be less than the strike rate paid for it, creating losses. However, there is no similar knock-out feature for losses.

4. In relation to the proceedings in the Court of First Instance, the SFC alleges that there has been a contravention of sections 277 or 298 of the Securities and Futures Ordinance. Both are market misconduct provisions which prohibit the distribution of materially false or misleading information that is likely to induce another person to subscribe for or buy securities or is likely to have a price effect on the company's securities.

5. During the period between the date of the Circular and the date of the Profit Warning, there were total purchases over approximately $1.9 billion at various acquisition prices between $14.26 and $24.5 with an average acquisition price of $18.97. The restoration or compensation amount, if any, may depend on a number of additional variables, including each purchaser's acquisition price, whether the purchaser continues to hold the shares or, alternatively, the sale price.

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