



The Securities and Futures Bill

An Overview

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11 April 2000



Reform is not a choice but a necessity

- ❖ Paradigm shifts in economies and markets brought by globalization, technological advances and market innovations.
- ❖ Competition has become global. Markets no longer restricted by geographical boundaries.
- ❖ Existing laws out-dated. Legislative gaps widening. Regulatory framework lacks clarity and coherence.



Competition and Survival

- ❖ Hong Kong needs a modern, coherent, and flexible regulatory framework to respond to rapid changes.
- ❖ Market intermediaries need to raise their standards to meet competition brought by convergence of world markets.



Key considerations in the legislative reform

- ❖ Modern regime
- ❖ One single, coherent statute
- ❖ Clear regulatory objectives
- ❖ Accountable and transparent regulator
- ❖ Regulatory standards to be on a par with, but not to exceed, international standards



Key Proposals of the Bill

- ❖ maintain market integrity - combat market misconduct
- ❖ raise industry standards - better risk management
- ❖ promote market transparency - better disclosure of information
- ❖ facilitate market innovation - flexible approach to regulation of new products and trading systems
- ❖ empower investors - education and third party actions



1. Setting Regulatory Objectives

- ❖ Bill sets out regulatory objectives of SFC
- ❖ SFC to carry out its regulatory functions in manner compatible with and appropriate for meeting objectives
- ❖ Objectives serve as benchmarks to measure SFC's performance



1a. Regulatory Objectives

- ❖ Maintain and promote fair, efficient, transparent and orderly securities and futures markets
- ❖ Promote public confidence; secure appropriate degree of protection for investors
- ❖ Minimize crime and misconduct
- ❖ Reduce systemic risks
- ❖ Assist Government in maintaining financial stability of Hong Kong



2. Combating Market Misconduct

Market misconduct damages market integrity and hurts investors' interest

- a. enhance SFC powers to inquire into a listed corporation
- b. establish a Market Misconduct Tribunal
- c. improve the criminal route to further deter market misconduct
- d. immunity for auditors who report to SFC



2a. Inquiry into a Listed Corporation

- ❖ SFC has difficulties verifying records of a listed corporation when inquiring into misconduct
- ❖ Empower SFC to
 - inquire with contractual counter-parties
 - request for access to audit working papers
- ❖ Safeguards:
 - clear definition of audit working papers to restrict to only audit related documents
 - raised thresholds before SFC could trigger the request



2b. Market Misconduct Tribunal

- ❖ Establish an MMT to address market misconduct through civil proceedings
- ❖ Market misconduct clearly defined. Includes insider dealing, creation of false or misleading appearance of trade or market price, etc.



2b. Market Misconduct Tribunal (Con't)

- ❖ MMT civil sanctions include
 - ↪ disgorgement of profits/losses
 - ↪ disqualification of a person from being a director or involved in management for up to 5 years
 - ↪ “cold shoulder” order for up to 5 years
 - ↪ “cease and desist” order
 - ↪ referral to relevant professional bodies for disciplinary action



2c. Criminal Route

- ❖ Some public concern that market misconduct should not be completely decriminalized as this would send wrong message
- ❖ In response, the Bill will preserve and expand criminal route to address specified misconduct
- ❖ Bucketing, and fraud or deception targeting investors will remain criminal offences
- ❖ In addition, any market misconduct (which can be dealt with by MMT) may, as an alternative, be prosecuted where:
 - sufficient proof to a criminal standard
 - in the public interest to do so



2c. Criminal route (Con't)

- ❖ Civil and criminal routes to operate in parallel, but no double jeopardy of MMT inquiry and criminal prosecution
- ❖ Due protection consistent with human rights requirements will be afforded to all defendants
- ❖ The US, Australia and UK all have a dual route for market misconduct “offences”



2d. Immunity for Auditors

- ❖ Statutory provision of immunity to voluntary reporting of fraud to SFC
- ❖ Taking in comments from HKSA,
 - **widened scope of immunity:** covers all liabilities that may arise under common law
 - **clarified circumstances for reporting:** subjective test as to circumstances warranting reporting



3. Regulation of Intermediaries

- a. Streamline licensing requirements
- b. Raise standards and improve business practices
- c. Reduce regulatory overlap
- d. Introduce a broader range of disciplinary sanctions against misconduct
- e. Protect clients' assets



3a. A Single Licence

- ❖ Replace multiple registrations (currently 9 different categories) with a single licence
 - all licensed persons to be corporations, with licensed representatives
 - lower regulatory and administrative costs for intermediaries
- ❖ Management responsibility and liability
 - at least two “responsible officers” per corporation
 - to be held liable if licensed corporation breaches fundamental licensing requirements



3b. Raising standards

- ❖ Code of Conduct will set out practices and standards for intermediaries and their representatives to ensure
 - better operations and risk management
 - proper ethical standards
 - continuous professional training



3c. Reducing Regulatory Overlap

- ❖ HKMA to regulate the securities business of exempt authorized institutions using SFC codes and standards for
 - ↪ investor protection
 - ↪ level playing field
 - ↪ minimizing regulatory overlap
- ❖ Underpinned by a new MOU between SFC and HKMA



3d. Disciplinary Sanctions

- ❖ Introduce more proportionate disciplinary sanctions against misconduct of intermediaries
 - ↳ civil fines of up to \$10m or 3 times profits/losses
 - ↳ partial suspension and revocation to minimize adverse effect on innocent third parties
- ❖ Civil fines not a departure from existing disciplinary regime but enables SFC to better calibrate the sanction to the gravity and circumstances of the misconduct



3e. Protect Clients' Assets

- ❖ Empower SFC to transfer the custody of client property or other business property of an intermediary to an appropriate custodian to avoid dissipation
 - ↪ Basic Law protection of private rights of property, thus additional safeguards introduced - SFC must go to court as soon as reasonably practicable to get court directions



4. Enhancing Market Transparency

Promote timely and accurate disclosure of price sensitive information

- a. Upgrade the existing disclosure regime for interests in securities
- b. Reporting requirements on large positions in futures and options held by professional investors



4a. Promoting Disclosure

- ❖ Bringing Hong Kong in line with International standards
 - Reduce disclosure threshold for substantial shareholders from 10% to 5%
 - Shorten notification period from 5 days to 3 business days



4b. Enhancing Transparency

- ❖ Dramatic growth in the use of equity derivatives
- ❖ Investors only see part of the picture if some derivative interests in shares are not disclosed

Proposal:

- Extend provisions requiring disclosure of interests in shares held through derivatives



4c. Reducing the Compliance Burden

- ❖ Remove requirement to disclose details of registered shareholder
- ❖ Exempt substantial shareholders from disclosing small changes in their interest (at every 1% point above 5%)



4d. Large Position Reporting

Disclosure of large-volume transactions important for cross-market surveillance and management of systemic risks

- ❖ Bringing Hong Kong in line with International standards
- ❖ Comments from market and the absence of international consensus, thus
 - ↪ drop the original proposal for registering professional investors



5. Empowering the Investors

- a. Private cause of action against market misconduct
- b. Civil liability for false disclosure to market



5a. Private Cause of Action vs Market Misconduct

Assisting investors in private action

- ❖ findings of MMT and criminal convictions for market misconduct admissible as evidence of market misconduct in private action
- ❖ augments the MMT regime for protection of investors



5b. Civil liability for false disclosure to market

- ❖ Persons disclosing false information to the market to be held liable to pay compensation to others who suffer loss as a result of reliance
 - Bill strikes a balance - while creating statutory cause of action, also provides that victim must demonstrate that it is “fair, just and reasonable” to ask for compensation
 - suitable defence for innocent parties acting in good faith, including the media



6. Responsive to new market needs

- a. Regulation of automated trading services
- b. Flexibility in defining regulated activities and products
- c. Allowing SFC to intervene in litigation between third parties



6a. Automated Trading Services

- ❖ ATS operate in different modes
 - some operate like a dealer
 - others like a trading facility, providing order matching and settlement services
- ❖ Need for a flexible regulatory framework to protect investors w/o stifling innovation
- ❖ May be regulated as a licensee or an exchange, depending on the characteristics of each ATS



6b. Third Party Intervention

- ❖ To enable SFC to intervene in civil proceedings between third parties to provide its regulatory perspective and expert opinion
- ❖ Safeguards:
 - intervention must be in public interest
 - parties to the litigation may challenge the intervention
 - court to decide whether and the terms on which SFC may intervene



New Checks and Balances

- ❖ To bring Hongkong's regulatory regime in line with international standards, some new powers are necessary. Many of these powers, however, are given to and exercised by the courts, not the SFC, e.g.,
 - ↪ civil sanctions for market misconduct (by MMT)
 - ↪ criminal route for fraud and market misconduct (by the Criminal Courts)
 - ↪ statutory private action (exercised by private litigants in the civil courts)
 - ↪ intervention in proceedings (ultimately decided by court)
 - ↪ transfer of custody of assets (SFC to seek court direction)



New Checks and Balances (Con't)

- ❖ New powers given to SFC are in fact very modest:
 - ↳ access to audit working papers and counter party records
 - ↳ civil fines for disciplinary sanctions on intermediaries
- ❖ These new powers will be subject to enhanced accountability and transparency measures
 - ↳ Securities and Futures Appeals Tribunal (SFAT)
 - ↳ Process Review Panel (PRP)



1. Securities and Futures Appeals Tribunal

- ❖ confirm, vary or substitute a wide range of SFC decisions (eg. even reprimands may be appealed)
- ❖ operate on an independent, full time basis
- ❖ appointed by CE: High Court Judge as Chairman, assisted by 2 market practitioners



2. Process Review Panel

An administrative independent PRP to ensure proper exercise of powers by SFC

- ❖ to review SFC's compliance with its internal processes, including investigative processes
- ❖ to prepare independent reports to FS



Hongkong's Position as an International Financial Center

- ❖ The new proposals are essential to maintaining market integrity
- ❖ Market integrity, once lost, will be difficult to restore
- ❖ The SFC's mission is to maintain and promote the integrity and confidence of the market. In this endeavor, we look to the industry for support and partnership