

Hong Kong Securities Institute

"The Securities and Futures Bill, 2000"

Speech by

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**5th September, 2000
SFC Multi-function Room**

HKSI Chairman Dr. Bill Kwok,
Distinguished Guests,
Ladies and Gentlemen,

1. I am very grateful for the opportunity this afternoon to say a few words about the new Composite Bill which is central to the development of our securities and futures market.
2. As you all know, the public consultation period on the Bill ended on June 30, but we have continued to receive many late submissions. I am sure that many of you are eager to know the outcome of the exercise and what the next step will be towards the full implementation of the Bill.
3. My intention this evening is to paint in broad strokes the development of the Composite Bill to the present day and to focus on how we will move forward on the public comments.

4 As the assessment of the public consultation comments is a joint exercise with the Financial Services Bureau and is still on-going, I do not intend to go into the details. Let me concentrate on the key principles we have followed in respect of the Bill:

Firstly, the whole purpose of the Bill is to ensure the regulatory framework delivers a level playing field in our market which is comparable to other major markets. As an international financial centre, we cannot afford to have a securities law that is not compatible with the New Economy and global financial markets. Thus, when we say international best practice, it does not mean that our regulatory framework will be the best in the world – it means that we are on a par with generally accepted regulatory practices in other major markets.

Secondly, this Bill has been carefully crafted taking into consideration the views of the market practitioners. It aims to be a practical law that achieves the objective of having an open, transparent, fair and efficient securities and futures market in Hong Kong.

Background

5. Two years ago, in my inaugural speech as the new Chairman of the Securities and Futures Commission, I said that one of my first priorities was to ensure that the securities regulatory framework will fit and facilitate Hong Kong's continuing status as a modern, efficient and competitive international financial centre. I strongly believe that this framework is strategically important as markets are moving towards those financial centres that are most transparent, liquid, efficient, competitive, firm and fair in terms of both financial infrastructure and regulation.

6. The regulatory framework we want to have in place is set out in the new Securities and Futures Bill, 2000. This Bill is the culmination of nearly 10 years of work, most of which was concentrated in the last 24 months to

bring our legislation up to a standard on par with major changes in regulatory practices in other major markets. The United Kingdom has just passed the Financial Services and Markets Act, 2000; the United States has made major changes in their securities and banking legislation, removing the Glass-Steagal restrictions between both markets; and Australia has dramatically upgraded its securities and corporate legislation.

7. In this context, the Composite Bill aims to create a world class regulatory regime which not only protects the investor but also benefits market users and intermediaries. It is designed to accommodate new regulatory, legal and policy issues and the rapid advance of technology seen in the last few years.

8. The Bill has been drafted to bridge US regulatory best practice and that in the United Kingdom and Australia. This is not necessarily easy because the UK and Australian frameworks share common law origins with Hong Kong, whilst the US regulatory framework relies to a great extent on codified law supplemented by vigorous private class actions. But we have to accept the fact that the major markets are driving regulatory change and we have to match such changes.

9. My own philosophy is that once you have a regulatory framework which instils:

- Public confidence and trust
- Market integrity and fairness
- A level playing field in competition
- Transparency and disclosure

then you will have a strong foundation with which to facilitate a growing securities and futures market.

10. You may have read in the newspapers that there has been one or two amendments made to the Composite Bill. Actually it may be more accurate to say that we have made one or two hundred amendments. But the principal features of the Bill remain basically unchanged.

11. First, the listing rules and the Take-over Code remain basically codes, and have not been given statutory backing, as they have been under US and Mainland securities law. We have retained this non statutory regime because the present system works quite well. We see no need to change for the sake of changing.

12. Second, we have retained in the Bill the innovation of spelling out the objectives of the SFC. The six objectives are:

- to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
- to promote the understanding by the public of the operation and functioning of the securities and futures industry;
- to secure the appropriate degree of protection for members of the public investing in or holding financial products;
- to minimise crime and misconduct in the securities and futures industry;
- to reduce systemic risks in the securities and futures industry; and
- to assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.

13. I wholeheartedly endorse these regulatory objectives as they give the public a yardstick against which to measure the Commission's performance.

14. I particularly welcome the objective to promote understanding by the public of the operation and functioning of the securities and futures industry. This gives us a mandate to enhance transparency and to improve investor education, an important task in a world of rapid change, increasing complexity and volatility of securities markets.

15. These objectives provide the framework within which the SFC must make its decisions. I am particularly pleased that the market and the industry have given us most helpful and constructive comments, criticisms and suggestions. The feedback we received was vital in helping us to strike a balance between the objectives of protecting the investor, maintaining a transparent and level playing field, helping the market raise capital and not standing in the way of financial innovation and change.

16. I want to say a big thank you to the whole spectrum of market participants - large international houses, financial institutions, professional bodies, trade associations, small to medium sized brokerage firms, the consumer council and individuals. They have spared no effort to give us helpful, practical and insightful ideas on how to improve both policy and technical aspects of the Bill. Working closely with the Department of Justice and the Financial Services Bureau, we will try to incorporate into the Bill as much as possible of this input within the tight deadline that we have been given.

17. Overall, I am pleased to report that there is a general consensus that the new Bill plays an essential role in helping to realise our shared common vision which is to promote Hong Kong as a major international financial centre and to make it the leading one in Asia.

18. By their very nature, many of the submissions overlap, and some reflect differences of interpretation of the Bill. We will work to ensure that the Blue Bill reflects as many of these comments and suggestions as possible. But realistically, not all views will be adopted.

Improvements to the Bill

19. I would now like to take you through some of the more significant highlights in the Composite Bill.

20. The new Bill provides for, amongst other things:

- The regulatory objectives of the SFC
- The definition of the scope of regulated activities
- Rules governing the new single license regime
- Powers of the SFC to authorise, regulate, investigate and discipline licensed intermediaries
- Regulations to deal with market misconduct (a term which includes forms of market manipulation, dissemination of false or misleading information and insider dealing) -
 - Through the creation of dual civil and criminal routes to prosecute market misconduct, with the civil proceedings before a new Market Misconduct Tribunal under the full time chairmanship of a judge, we will have laws which better discourage and punish market misconduct which hurts investors and can damage the credibility of the market as a whole.

- The effect of the dual regimes is supplemented by a new civil right of action for those who suffer loss, but made flexible by the SFC's power to make rules to create safe-harbours for legitimate conduct.
- Rules governing the disclosure of interests these will increase transparency in dealings in interests in shares of listed companies. Investors will therefore have more complete and comprehensive information.
- Arrangements for investor compensation
- Creation of the Securities and Futures Appeals Tribunal and Process Review Panel
 - in addition to scrutiny by the Ombudsman and being liable to judicial review of our actions, these bodies serve as additional check and balance measures on the Commission's decisions and activities.

21. In the time given, I cannot cover all the ground here. But let me focus on a few key points.

Disclosure of Interests

22. There has been concern expressed by market participants over the proposal to extend the disclosure of interests requirements to include purely cash settled derivatives. Our intention here is simply that in the interests of market transparency, all positions held through derivatives must be disclosed.

23. It would be very misleading if some interests in shares must be disclosed while significant derivative activities are undisclosed. This is why we feel that disclosure is necessary to give a complete picture.

24. On the other hand, we recognise that we do not wish to impose excessively burdensome reporting requirements on the market. The level of detail to be disclosed should therefore be appropriate, meaningful and fair.

25. We are now working with the market experts to minimise the burden of disclosure. Possible new solutions to address this problem include reducing the amount of information that must be disclosed, improved standard forms and enabling the electronic filing of returns. I am confident that we will reach a practical and effective compromise.

(ii) Market Misconduct

26. As mentioned earlier, one of our fundamental statutory objectives is to minimise crime and misconduct in the securities and futures industry.

27. Addressing market misconduct goes to the very heart of protecting investors and maintaining market integrity. Our goals are to better protect investors, minimize misconduct and ensure that our markets are more transparent than competing markets. I am pleased to say that overall there has been general support in trying to ensure that Hong Kong's laws are better adapted to combating market misconduct. No one likes to deal with market misconduct but it has to be done.

28. We have not tried to re-invent the wheel. We have spelt out the types of market misconduct in the Bill. Where necessary, we have adapted the tried and tested Australian regulatory model to suit our needs. The Australian market misconduct regime has been tested in the Australian courts for close to 20 years and is modelled on pre-existing US law. By adopting these standards, we will strengthen the regulatory oversight of our

securities and futures market and create laws that give clear guidance as to what conduct is lawful and what is unlawful.

29. There were some differences of opinion on the scope of certain provisions. As a result of our consultation with market players, we have redrafted some of these provisions to clarify their scope to reassure the market as to what will and will not be caught.

30. For example, under the revised provisions, it states in very clear terms that the general standard for the mental element (or, mens rea) for market manipulation offences under the Bill is one of "intention" or "recklessness".

31. Some provisions have also been fine tuned so that the onus of proving market misconduct will now generally rest with the prosecution, except in respect of conduct which is so remarkable that it demands explanation (for example, trades in which there is no change in beneficial ownership).

32. We believe that the revised provisions strike a reasonable balance between certainty and effectiveness that will serve Hong Kong's market well and better protect our investors.

(iii) Penalties and Management Responsibility

33. There have been various press comments that the penalties proposed under the new Bill impose too heavy a burden on management. I believe the most obvious disparities in penalties have already been eliminated.

34. But I should explain our regulatory approach. This is based on the principle that senior members of management, who are the 'responsible officers' under the new Bill, should be responsible for the management of their firms and for ensuring that their firms comply with regulatory requirements.

35. There is no doubt that responsible management inside firms will have more impact on the firms' compliance culture, and the way in which the firms' employees treat their customers, more so than any number of outside regulators.

36. However, there are cases where the management of an institution is itself uninterested in good practice, and is engaged in fraudulent activities. In other cases that we have seen, senior managers distance themselves from the actions of their sales forces, brokers, traders and intermediaries without taking responsibility or corrective action.

37. When this happens, it is the investors who have placed their money, assets, confidence and trust in these firms who stand to lose.

38. The legal consequences for financial firms who fail to comply with the law are potentially very serious and have a detrimental effect on their reputation.

39. Management should, therefore, have a strong determination to avoid such consequences. In addition, the SFC is prepared to exert as much regulatory pressure as is necessary to ensure that management responsibilities are taken seriously.

40. As the regulator, we need to reinforce good practice and within-firm responsibility for compliance by making those in charge responsible. If we are successful in instilling this compliance culture within the industry, then we are that much closer to achieving market confidence and integrity.

41. But we are not insensitive to the feedback from market players. We have concluded that a workable compromise can be reached in the following ways:

- We have revised the relevant clause to provide that management liability will now be based on actual fault and participation.

We are saying that if any manager who was not involved in the perpetration of the offence, did not aid, abet, counsel or induce the person who committed the offence and was not grossly careless in the discharge of his or her management duties, then that manager is not liable. There is fairness and justice in this arrangement, wouldn't you agree?

- You will also be pleased to know that we now have a revised scale of penalties, which are consistently proportionate to the offence.

Under the revised regime, penalties for purely administrative offences will be less severe. Serious offences such as those involving fraud will, logically, attract a more severe penalty.

The scale of penalties originally imposed under the draft Bill is actually based on current law. These have been reviewed in an effort to achieve the delicate balance of imposing a penalty of sufficient severity to discourage further breaches but not of such severity as to put the licensed person out of business. All the Bill of Rights issues and checks and balances against arbitrary imposition of penalties have been taken into consideration in the drafting.

Conclusion

42. In summary, I would like to say that the SFC has, in close consultation with market players and the Government, reached a positive and pragmatic compromise in response to the feedback from the consultation exercise.

43. We have taken an approach that, we believe, strikes a good balance in providing sufficient flexibility for market innovation and at the same time increases investor protection, increases accountability of responsible officers and improves regulation in areas which are currently deficient.

44. It is useful to remind ourselves that the SFC's priority must be, first and foremost, to protect the investor. The draft Bill seeks to do just that. In the process however, it is neither possible nor feasible to accommodate the wishes of all parties concerned. As we all know, all market participants have conflicting interests. We can never hope to please everyone.

45. As I indicated two years ago, I would consider myself doing a reasonable job, if participants from both sides criticize our proposals equally vehemently. Then the balance would be about right.

46. The law is for the legislature to decide and for the SFC, in conjunction with the other regulatory bodies to enforce. The SFC will continue to implement the law without fear or favour, fully subject to judicial review, appeals to the new Securities and Futures Appeal Tribunal and all the checks and balances that we have built into the system. The proposed Process Review Panel is an innovation that extends the internal checks and balances way in advance of other market regulators.

47. Contrary to some views, the SFC is not out there to pick on innocent persons who happen to break the law. It is there to protect the interests of investors and to ensure that our market is transparent, efficient and relatively free of market misconduct.

48. The proof of the pudding is in the eating. And we are content to be judged on our impartiality, professionalism and performance. And we will be accountable.

49. I give you my personal assurance, and the assurance of my colleagues, that we aim to regulate firmly, fairly and with as light a touch as possible. We do not judge our success by how many we prosecute. Rather we judge ourselves by how much the investor feels that our market is as transparent, as fair and as free of misconduct as possible. We all have a stake in our market and we will work closely with the market participants to ensure that we achieve the objectives of this new Bill.

50. I want to thank everyone who has worked so hard to give us their frank views. I wish also to thank our colleagues in the SFC, Financial Services Bureau, the Department of Justice and other regulatory bodies who have worked day and night to bring this Bill to fruition.

51. I am confident that the Blue Bill that goes to LegCo in November will be a landmark Bill that will help maintain Hong Kong's international financial status in the securities and futures market in the years to come.

Thank You.