CompliancePlus Consulting

Submission to Consultation Paper on Proposed Amendments to Enforcement-related Provisions of the Securities and Futures Ordinance

Josephine Chung

Director

CompliancePlus Consulting Limited

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For inquiries on this submission, please contact Josephine Chung at jchung@complianceplus.hk. CompliancePlus Consulting Limited understands and agrees that our name and/or submission may be published to the public.

Introduction

The Securities and Futures Commission (the "SFC") issued a Consultation Paper in June 2022 on the Proposed Amendments to Enforcement-related Provisions of SFO. In general, CompliancePlus supports the proposal as it could offer stronger protection of the interests of investors through more effective enforcement action. CompliancePlus is pleased to provide feedback on the Consultation Paper in details as below:

Question 1: Do you agree with: (i) the proposal to amend section 213 of the SFO to expand the basis on which the SFC may apply to the CFI for remedial and other orders after having exercised any of its powers under section 194 or 196 of the SFO against a regulated person, and; (ii) the proposed consequential amendments to section 213(1), (2), (7) and (11)? Please explain your view.

(i) CompliancePlus agrees with the proposal to amend s.213 of the SFO to expand the basis on which the SFC may apply to the CFI for remedial and other orders after having exercised any of its powers under s.194 or 196 of the SFO against a regulated person. Allowing the SFC to more easily seek one or more of the wide range of orders available under s.213 in relation to the rule-breaking individuals and/or firms is likely to increase the effectiveness of sanctions against them.

Under the current wordings of s.213, SFC cannot apply for the high court orders even when a regulated person has been found by the SFC through its disciplinary processes to be guilty of misconduct or to not be a fit and proper person to remain a regulated person under s.194 or 196 of the SFO, unless the conduct which gave rise to the SFC's finding also constituted a contravention of the "relevant provisions" (*c.f.* Schedule 1 of SFO), any notice or conditions. However, this definition does not include the SFC's codes and guidelines, including most notably the Code of Conduct. As a result, the SFC's current disciplinary powers in respect of breaches of its codes, guidelines and circulars are comparatively limited.

The proposed amendment of s.213 is needed to ensure the effectiveness of sanctions by SFC. At present, under s.194 and s.196, fines against licensed persons and registered institutions are capped at a maximum of HK$10 million or three times the profit gained or loss avoided. As for the non-financial disciplinary measures, the only penalties available to the SFC are focused on impacting a licensed

firm's ability to continue to be licensed. These measures are limited in effectiveness when dealing with individuals or firms that have no desire to continue to be licensed. Thus, on top of the proposed changes of s.213, we suggest the SFC to revisit the pecuniary penalty of HK$10 million under s.194 and s.196 to uphold the deterrent effect on misconducts.

A point to note is that given the implications of s.213(2) orders are so wide and CFI may direct steps to restore the parties to any transaction to the position in which they were before the transaction was entered into, the initial legislative intention of the provision may expect a higher threshold to apply for the order(s). SFC should take it into account and the wordings of the proposed amendment should be as flexible as possible. Moreover, SFC could also explore the possibilities to allow other stakeholders, such as liquidators, receivers, and creditors, to seek a CFI order under s.213. At the moment, CFI can only make injunctions and other orders under s.213 upon the application of the SFC. Victims involved in an alleged misconduct case have no means to initiate an application of s.213 order in the High Court. It results in potential loopholes should SFC takes no action or overlooks the misbehaviors of licensed persons or registered institutions. Therefore, CompliancePlus suggests the applicants of s.213 order not confining to the SFC but including other parties involved. The judges in CFI could act as a gate keeper to strike out groundless claims and SFC's disciplinary power would not be defeated.

(ii) CompliancePlus also agrees with the proposed consequential amendments to s.213(1), (2), (7) and (11). After the enactment of the proposed consequential amendments, breach of conduct cases would expose regulated firms to both SFC disciplinary action and, to an extreme, investor compensation orders that can be sought from CFI that may enhance their compliance awareness as well in the long run.

Question 2: Do you have any comments on the proposed consequential amendments to section 213(3A) in respect of OFCs? Please explain your view.

CompliancePlus agrees with the proposed consequential amendments to s.213(3A) in respect of OFCs. An open-ended fund company (OFC) is an investment fund established in corporate form with limited liability and variable share capital in Hong Kong. As the primary regulator, the SFC also processes registrations and oversees OFCs. The proposed consequential amendment enables the SFC to apply for orders under section 213 where it has exercised any of its powers under s.194(1),

194(2), 196(1) or 196(2) against a regulated person who is a director, investment manager, custodian or a sub-custodian of an OFC. It is in line with the purpose of the previous revisions to s.213.

On top of the OFCs, CompliancePlus suggests SFC should also consider exploring the scope of s.213 and adapting similar regulations on the limited partnership fund (LPF) structure introduced in Hong Kong in August 2020 that in essence are similar to OFC. It is expected that the inclusion of LPF in s.213 could offer more comprehensive protection to the interest of investors.

Question 3: Do you agree with the proposal to amend the exemption set out in section 103(3)(k) and the consequential amendments to section 103(3)(j)? Please explain your view.

CompliancePlus agrees with the proposal to amend the exemption set out in s.103(3)(k) and the consequential amendments to s.103(3)(j). We notice that the purpose of s.103(1) of the SFO is to protect the retail investors from exposing advertisements and other documents that are not authorized by the SFC, and s.103(3)(k) provides that the professional investors (PI) are exempted from this. However, following the CFA's judgement in *SFC v (1) Pacific Sun Advisors Limited and (2) Mantel, Andrew Pieter*, retail investors are placed in a vulnerable position because the court has expanded the scope of the PI exception and the effect of such is it increases the risk for retail investors to act upon the unauthorized advertisements. Therefore, to rectify this situation, we believe it is necessary to amend s.103(3)(k) so that it can align with the intended purpose of the ordinance and retail investors' interests are once again safeguarded.

Moreover, we are of the view that the CFA ruling is not in line with the legislative intent in the first place. If the CFA had adopted a more pragmatic approach, they would not have reached such decision.

In terms of the amendments to s.103(3)(j), since it is phrased identically to the PI exception, we agreed that it should be amended in the same way as s.103(3)(k) so as to avoid confusion.

Question 4: Do you agree with the proposal to expand the scope of insider dealing provisions of the SFO to cover insider dealing perpetrated in Hong Kong with respect to overseas-listed securities or their derivatives? Please explain your view.

CompliancePlus agrees with the proposal to expand the scope of insider dealing provisions of the SFO to cover insider dealing perpetrated in Hong Kong with respect to overseas-listed securities or their derivatives. The current insider dealing provisions of the SFO, i.e. section 270 and 291, are unable to deal with such type of insider dealing.

With the global trend of market convergence, cross-border insider dealing has occurred with increasing frequency. It is therefore an opportune time for the SFC to deliver a deterrent message by expanding the scope of insider dealing provisions of the SFO. While insider dealing involving overseas-listed securities or their derivatives does not have a direct impact on Hong Kong markets, it is essential to preserve the reputation of Hong Kong's financial industry as well as its status as an international financial centre.

With the proposed amendment, the SFC will be able to deal with insider dealing involving overseas-listed securities or their derivatives with the restoration order calculated on the basis of restoring aggrieved investors affected by the illicit trades to the position they were in prior to their involvement in the relevant transactions. This approach would better promote fairness, transparency and orderliness of the securities market and protect the investing public. In addition, the proposed amendment is in line with insider dealing provisions of other major common law jurisdictions and other market misconduct provisions of the SFO.

The accordingly added defences are fair to the securities market as well as the investing public.

Question 5: Do you agree with the proposal to expand the scope of insider dealing provisions of the SFO to cover insider dealing perpetrated outside of Hong Kong, if it involves any Hong Kong-listed securities or their derivatives? Please explain your view.

CompliancePlus agrees with the proposal to expand the scope of insider dealing provisions of the SFO to cover insider dealing perpetrated outside of Hong Kong, if it involves any Hong Kong-listed securities or their derivatives. The current civil and criminal regimes of the SFO do not expressly apply to such type of insider dealing.

Over the past few years, there has been an increase in the number of cases of insider dealing perpetrated outside Hong Kong in respect of Hong Kong-listed securities or their derivatives. It is therefore an opportune time for the SFC to formulate express provisions specifying the territorial scope of the existing insider dealing regimes. This will better promote fairness, transparency and orderliness of the securities market and protect the investing public.

The proposed amendment is in line with insider dealing provisions of other major common law jurisdictions and other market misconduct provisions of the SFO.

In addition, given that insider dealing perpetrated outside of Hong Kong is a remote market misconduct and offence, the SFC should consider what ancillary support to be equipped with, such as with which countries mutual legal assistance treaties should be signed and what provisions to be added on to exercise the enforcement power under the proposed amendments. After all, it is a matter of concern whether the proposed amendment can be effectively implemented.

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