SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

SFC
證監會

The **Securities** and **Futures Bill**

Published by

Securities and Futures Commission

12/F Edinburgh Tower

The Landmark

15 Queen's Road Central

Hong Kong

Tel : 2840-9222

Fax : 2521-7836

Email : enquiry@hksfc.org.hk

Website : http://www.hksfc.org.hk

Electronic Investor Resources Centre Website: http://www.hkeirc.org

ISBN 962-7470-50-3

Foreword

When I joined the Securities and Futures Commission on 1st October 1998, I inherited responsibility for an organisation whose mission and purpose was to protect the investors of Hong Kong. Today, that mission remains as true as it did then, but technology is having an increasing influence on how we seek to accomplish it.

The end of the Asian crisis coincided with a technological roller-coaster ride for global markets. The hi-tech bubble driven by the New Economy accelerated during 1999 and peaked in March this year. The subsequent fall brought back to earth those who dreamed of unprecedented wealth riding the Internet wave.

As I warned investors during that period, I believed that the exuberant investor interest in the hi-tech bubble reflected an overshooting of enthusiasm, which carried large risks. But the subsequent correction also signalled investor recognition that the New Economy will ultimately result in unprecedented global growth in e-commerce. Growth carries with it risks, and investors must have ready access to reliable information to make good judgements and investment decisions.

For Hong Kong, 1999 saw the beginning of a new chapter in its securities and futures markets. In March 1999, the Financial Secretary announced three new initiatives aimed at completely and radically revamping the framework behind these markets. The initiatives were:

- demutualisation of the stock and futures exchanges, their merger with related clearing houses, and the subsequent listing of the new holding company;

- enhancement of the financial technology infrastructure of the securities and futures industry; and

- modernisation of Hong Kong's securities legislation through a new composite Securities and Futures Bill.

And in November, the Growth Enterprise Market (GEM), which allows smaller, dynamic companies to seek access to market capital, was launched.

These measures were aimed at helping Hong Kong to maintain its place amongst the world's premier markets, and as the principal fund-raising centre for the Mainland of China.

In March this year, the first of the three new initiatives was implemented and the Hong Kong Stock Exchange and Futures Exchange were demutualised and Hong Kong Exchanges and Clearing Limited (HKEx) was created. HKEx was successfully listed in June.

The second initiative has already commenced. A dedicated Securities and Derivatives Network (SDNet) has been set up which electronically links members of the securities and futures community, enabling them to automate previously paper-based tasks. Financial Resources Rules Returns, for example, can now be submitted electronically through SDNet. And we are working with HKEx, the Government and market participants to implement a number of longer-term initiatives, including straight-through processing, scripless transactions and arrangements for a single clearing process.

In October this year, electronic applications for shares were accepted for the first time for the successful MTRC public offering. In the same month, AMS/3, the third-generation automatic matching system for the Stock Exchange was successfully introduced. AMS/3 is designed to enable Internet and wireless connections for online trading and to cope with the phenomenal rise in turnover that is expected from online trading.

What remains now is the enactment and implementation of the new Securities and Futures Bill, the legal cornerstone which will hold the new financial infrastructure together. This brochure is designed to give you a flavour of the main changes under the new statutory regime, and how they may affect you as a registered person or investor.

Andrew L.T. Sheng

Chairman, Securities and Futures Commission

December 2000

The Securities and Futures Bill What changes will it bring?

The Securities and Futures Bill is one of the most important Bills to be presented in Hong Kong in recent years. It consolidates ten different Ordinances into one comprehensive Bill and introduces a number of significant changes to the existing regulation of the securities and futures market in Hong Kong. Here, we explain some of these changes, and how they may affect you.

A new, streamlined licensing regime

What is the present position?

At present, intermediaries must apply to be registered for each type of activity in which they wish to engage. For example, anyone who wishes to deal in, and advise on, securities and futures contracts would need to apply for four separate registrations. This incurs additional costs for applicants, but does not help to address the increasing blurring of boundaries between different licensed activities which innovation in financial products has brought about.

What will change under the Bill?

There will be a universally applicable single licensing system, with one licence (and therefore one set of Financial Resources Rules returns each month and one annual return) which covers all of the regulated activities. The activities that could be covered under such a licence include:

- dealing in securities;
- dealing in futures contracts;
- trading in leveraged foreign exchange contracts;
- advising on securities;
- advising on futures contracts;
- advising on corporate finance;
- providing automated trading services;
- providing securities margin financing; and
- providing asset management services.

The new regime allows only corporations and their individual representatives to be licensed. This is an important change to deal with the problem that arises when the death of a licensed individual or partnership creates difficulties for the continuity of their business operations. Existing registered persons will be allowed two years to migrate to the new regime, following enactment of the Bill.

Since licensed entities will be corporations, the Bill strengthens the concept of "management liability", which places responsibility for the acts of a corporation on

those who are responsible for managing it. Any director who actively participates in, or supervises the regulated activities of a business, will be required to register with us as a "responsible officer".

Under the management liability concept, responsible officers will only be criminally liable for the culpable conduct or failures of their companies if they have "aided, abetted, counselled, procured, consented or connived in" such conduct or failures.

New, proportionate disciplinary sanctions

What is the present position?

At present, where we find that a registered person has engaged in improper conduct, we may impose a number of disciplinary sanctions. These sanctions include reprimands (which may be private or public), or suspension or revocation of registration. Such a limited range of sanctions is not flexible enough to cover all the circumstances that we may face. A reprimand may not be a sufficient deterrent for some offences, whilst a suspension or revocation can have serious consequences for a firm with many operations, with unintended consequences for its clients.

What will change under the Bill?

The Bill proposes to add to the sanctions that we may impose. We will be able to impose civil fines of up to HK$10 million, or three times the amount gained or loss avoided, whichever is higher, and to suspend or revoke a licence in respect of part of a person's business. This will allow us to more flexibly tailor a disciplinary sanction that is proportionate to the seriousness of the improper conduct.

Combating market misconduct

Market misconduct damages market integrity and, therefore, the interests of investors. There must be appropriate laws to combat such misconduct.

What is the present position?

Under the present law, market manipulation is a criminal offence. We must prove to the criminal standard of proof - beyond reasonable doubt - that market manipulation has taken place before we may secure a conviction. Sophisticated market practices have, however, made it increasingly difficult for us (as well as regulators around the world) to prove beyond reasonable doubt that market manipulation has taken place. Left unchanged, this would make it increasingly difficult for us to continue effectively to combat market manipulation.

By contrast, insider dealing is not a criminal offence under the present law. It is dealt with through civil proceedings before the Insider Dealing Tribunal. The Tribunal inquires into suspected insider dealing and makes decisions based on the civil standard of proof. It may impose a number of sanctions on those found to be responsible for insider dealing, including fines of up to three times the profit made or loss avoided.

The Tribunal is generally considered to be leading world markets in combating insider dealing.

What will change under the Bill?

The Bill proposes an alternative civil route to deal with all types of market misconduct; not just for insider dealing. This builds on the work of the Insider Dealing Tribunal by putting in place a new Market Misconduct Tribunal, which will be chaired on a full-time basis by a High Court Judge.

The Tribunal would handle cases of insider dealing, market manipulation and related abuses, and spreading false or misleading information, which have been referred to it by the Financial Secretary. It would decide cases on the civil standard of proof and have a range of civil sanctions at its disposal, including:

- ordering the disgorgement of profits made or loss avoided;
- disqualifying a person from being a director of a company or being involved in the management, liquidation or administration of a company for up to five years;
- issuing a "cold shoulder" order for a period of up to five years, so denying the person concerned access to market facilities for the effective period of the order;
- issuing a "cease and desist" order, non-compliance with which would be a contempt of court and punishable accordingly; or
- recommending to any relevant body the taking of disciplinary action against the person concerned under the rules of that body.

However, the criminal route would still remain an alternative in cases where there is sufficient evidence for a criminal prosecution and it is considered that prosecution is in the public's interest. Decisions about whether to prosecute will be made according to the Department of Justice's Prosecution Policy Guidelines.

If a decision is made to prosecute market misconduct instead of following the civil route, the penalties available on conviction will include:

- imprisonment for a period of up to 10 years; and
- a fine of up to HK$10 million,

as well as the sanctions that may be imposed under the civil regime.

Under the new regime, insider dealing will become a crime as well as being punishable civilly, and the sanctions available will be consistent with those available for other forms of market misconduct.

A person will not be tried in both the civil Market Misconduct Tribunal and the criminal courts for the same misconduct.

Redress through the civil courts

What is the present position?

For those who have suffered loss as a result of market misconduct, seeking redress through the civil courts may be difficult, even if they establish a cause of action in law against those responsible for the misconduct.

What will change under the Bill?

The Bill introduces a new statutory civil right of action for damages and other remedies against those found to be responsible for market misconduct. However, in order to succeed in such a claim, the person who has suffered loss will need to prove that the Tribunal's findings (or the criminal convictions concerned) are relevant to the claim. The court will also have to be satisfied that it is "fair, just and reasonable" that compensation should be paid in the circumstances of the case.

The Bill also introduces a statutory civil right of action for those who have suffered financial loss as a result of relying on any false or misleading public communication concerning securities or futures contracts which has been knowingly, recklessly or negligently disclosed to the public. Again, the court will have to be satisfied that it is "fair, just and reasonable" that compensation should be paid in the circumstances of the case.

It is recognised that certain persons (e.g. printers, live broadcasters or certain Internet service providers) may not be "culpable" even though, technically, they may have played a role in disseminating the information. To address this, the Bill includes a number of defences, including a defence for those acting in good faith as mere conduits of information if they have not altered the information they were given to disseminate.

Empowering investors to protect themselves

All investors should have equal and timely access to information about who may be in a position to exert control over a listed company.

What is the present position?

Anyone who has an interest in shares in a listed company of 10% or more of its issued voting share capital is required to disclose that interest within five days of acquiring or disposing of the interest. Directors and chief executive officers are required to disclose any acquisition or disposal of shares in companies in which they are directors and/or chief executive officers, irrespective of the percentage they hold.

What will change under the Bill?

The Bill tightens the existing disclosure of interests regime. Those who acquire, or dispose of, an interest in 5% or more of the issued voting share capital of a listed company will be required to disclose their acquisition or disposal and their new holding

to the Stock Exchange within three business days. This is stricter than the present legislation. Directors and chief executive officers remain required to disclose any acquisition or disposal of their company's shares, irrespective of percentage.

The disclosure requirements have also been extended to include interests in underlying securities held through certain derivative products (the existing legislation does not require all such interests to be disclosed).

We will publish standard forms for disclosure together with guidance in plain language on how these forms should be completed.

Investor compensation

What is the present position?

There are currently two compensation schemes - the Unified Exchange Compensation Fund and the Commodities Exchange Compensation Fund. Both rely in part on deposits paid by members of the exchanges and statutory transaction levies. The schemes provide a maximum level of compensation for each broker (HK$8 million per stockbroker and HK$2 million per futures broker).

What will change under the Bill?

The Bill proposes a new investor compensation regime to replace the existing schemes. The new regime will be based on a per investor compensation limit, as opposed to the present per broker limits. This will enable more transparency and allow investors to know precisely what level of compensation will be available to them should their intermediary fail.

The new regime will be administered by an independent Investor Compensation Company, which would be required to apply prudent principles to managing its funds – including the possibility of seeking insurance to minimise costs to the industry.

Facilitating market innovation

The existing regulatory regime was designed when stock and futures markets were physical meeting places where buyers and sellers came together to trade. Technology has now altered markets dramatically by enabling buyers and sellers to deal electronically.

What will change under the Bill?

Today, a market can consist of a number of computers connected together in a network, which allows those who are part of the network to trade through their computers. These new trading methods are described generally as "automated trading services" or "ATS", and they raise a number of important regulatory issues which are not adequately addressed in the present regime.

The Bill proposes a flexible and pragmatic approach to the regulation of ATS. In short, this approach requires a person seeking to provide ATS to seek approval from us. We

would then examine the specific characteristics and risks of the ATS to determine the regulatory approach best suited to it. The ATS may be more closely related to intermediaries' operations and therefore fall under the licensing regime, or it may more closely resemble a market and be better regulated as an exchange.

This approach should provide a flexible environment which facilitates the growth of ATS operations in Hong Kong while, at the same time, ensuring adequate investor protection.

Checks and balances: the SFC's accountability

We are ultimately responsible to the Government of the Hong Kong SAR, and to the public, for the performance of our functions. There should be certain checks and balances to reflect this accountability.

What is the present position?

At the moment, we are subject to a number of checks and balances. The non-executive directors provide a first level of oversight. In addition to this, we are subject to the scrutiny of the Ombudsman if there is a complaint in relation to our conduct.

With few exceptions, those who are the subject of a licensing or disciplinary decision by us may appeal to the Securities and Futures Appeals Panel against our decision. In addition to this, our administrative actions may be subject to judicial review by the court on the application of a person who believes he/she has been aggrieved by certain action that we have taken or failed to take.

We also report regularly to the Financial Secretary, through the Financial Services Bureau. Our accounts are scrutinised by the Bureau and tabled before the Legislative Council.

What will change under the Bill?

The Bill proposes replacing the existing part-time Securities and Futures Appeals Panel with an independent full-time Securities and Futures Appeals Tribunal. A much wider range of our decisions will be subject to appeal to the Tribunal. The Tribunal's job would be to review our decisions, which have been appealed to it (including almost all licensing-related and disciplinary decisions), and would be empowered to change our decisions if it considered appropriate. Any appeal against a decision must be made by the person against whom the decision was made, within twenty-one days of notice of the decision.

An additional element of accountability is the recent establishment (ahead of enactment of the Bill) of the independent, non-statutory Process Review Panel. We are subject to rigorous secrecy provisions because of the market sensitivity of our investigations and actions. Some may question whether we can avoid

accountability through these secrecy provisions. To allay such concerns in an accountable manner, the Process Review Panel has the power to review our procedures and audit our actions to ensure that we have followed our set procedures and given effect to due process. The Panel will report its findings to the Financial Secretary. However, it will not be required to publish the entirety of its conclusions because, like ourselves, it cannot generally disclose details of the precise steps that we have taken in the performance of our functions.

The Panel comprises prominent public persons appointed by the Chief Executive, together with a number of *ex officio* members.

We will continue to be subject to the Ombudsman's scrutiny and will continue to report regularly to the Financial Secretary.

How does this affect you?

This depends very much on whether you are an intermediary or an investor.

For intermediaries:

You will see that there are both benefits and obligations which arise from the new regime. We would encourage you to take a little time to familiarise yourself with the new obligations that the Bill introduces. We believe that the benefits outweigh the costs of the new obligations.

We are aware that you may need a little time to adjust to the new regime, and we will try to do everything that we can to make the transition as smooth as possible. We are happy to give guidance and assistance, wherever possible.

Our aim is to have a level playing field for all market participants, whether intermediaries or investors. We hope that the new regime will allow you to innovate and provide new and better services to your customers, so that you can play a part in helping to keep Hong Kong's financial markets at the cutting edge. In this regard, we also propose that all market professionals should be subject to continuous professional education, in much the same way as other professionals (e.g. lawyers and accountants). Better training will, we believe, lead to better standards which are observed more consistently and, ultimately, higher levels of investor confidence and trust in their intermediaries.

We will work closely with the industry to try and ensure that obligations, such as submission of regulatory information, are handled practically and efficiently and, where appropriate, using electronic methods.

For investors:

The Bill will bring a number of new ways to protect your interests and defend your rights. But you should not rest solely on these. You should and must do everything that you can to protect your own interests, because ultimately the decisions are for you to make and it is your savings that are at stake. We cannot prevent failures from occurring in the market. You should make your investment decisions in as informed a manner as possible. You should know what you are aiming to achieve with your investment, the type of products that are available and which of those products could help you to achieve your aim. And above all, you should know the potential risks involved with each product before you make your investment decision(s).

We can provide you with guidance as to things that you should look for before making an investment decision. We would

encourage you to visit our Electronic Investor Resources Centre website[1], as well as our main website[2]. We can also provide you with explanations for some of the terms used in the securities and futures industry. Our investor hotline (telephone number 2840 9333) can point you in the right direction for useful information, and we can help you to verify whether your intermediary is properly licensed. But we cannot make any of your decisions for you.

For some investors (mainly large shareholders and directors and chief executive officers of listed companies who hold shares or other securities in their companies), the Bill will bring changes to how and when you will need to disclose your holdings. You should take a little time to familiarise yourself with the new requirements. If in doubt, you should seek independent legal advice.

For both intermediaries and investors:

The Bill introduces a new level of transparency and accountability for us. Ultimately, we are here to serve you, and we are accountable for doing so. We will strive to be as transparent as possible within the confines of our obligation to maintain secrecy in the performance of our functions. If there is anything that you are not happy with, or if you have a suggestion for how we could improve our performance, we would encourage you to raise it with us. We would like to address issues through dialogue, wherever possible. Of course, where this is not possible and you believe that you have been aggrieved, a number of new avenues are open to you to pursue your case.

The Bill marks the beginning of a new chapter for us all. We look forward to working with you in partnership.

If you have any questions about the matters raised in this paper, please send them to: brochure_enquiries@hksfc.org.hk.

This paper is intended to be a brief overview of the Securities and Futures Bill, and it should not be relied on as legal advice. The Securities and Futures Bill is presently before the Legislative Council and changes may be made to it before it is enacted.

1 www.hkeirc.org

2 www.hksfc.org.hk