



Regulatory Reform to meet the challenges of Globalisation

Securities and Futures Bill Banking (Amendment) Bill 2000

Need for Regulatory Reform

- The Bill consolidates and modernizes 10 existing Ordinances governing the securities and futures market
- Intensive consultation on the White Bill since early April : LegCo, market practitioners and professional bodies
- Consultation is fruitful :
 - Having grasped major concerns of the market, refinements are made to facilitate compliance
 - The market is now more familiar with the objectives of the reform and details of the provisions

Fruits of Consultation (I)

- The public supports the objectives and direction of reform, including the following
 1. Introducing a single licence, to streamline procedures; and raising the quality of intermediary service to enhance investor protection
 2. Establishing a Market Misconduct Tribunal to maintain a fair and orderly market
 3. Modernizing the disclosure regime for securities interests and upgrading the quality of disclosure to enhance market transparency
 4. Putting in place a flexible regulatory framework to keep pace with electronic trading technologies and facilitate market innovations

Fruits of Consultation (II)

- In view of market comments, refinements are made to the implementation details in relation to the licensing, market misconduct and disclosure regimes to facilitate compliance
- Major considerations for the refinements :
 1. Integrate into international norms and address local characteristics
 2. Strike a reasonable balance between protecting the investors and facilitating market development
 3. Streamline and remove unnecessary regulatory requirements
 4. Adequate checks and balances for regulatory powers
- These refinements will help address market concerns without affecting the overall effectiveness of the new regulatory regime

Improving the Regulation of Intermediaries

1. A single licence for intermediaries
2. Responsibility of senior management
3. Review of criminal penalty maxima
4. Level playing field between brokers and banks
5. Disciplinary sanctions
6. Protect clients' assets

1. Single Licence

- The market welcomes the proposal to replace multiple registrations with a single licence, which will simplify regulatory arrangements and reduce the burden on intermediaries
- With a single licence, an intermediary may conduct various types of business
 - The scope of products includes securities, futures and leverage foreign exchange contracts as well as corporate finance services
 - The nature of activities includes traditional and automated trading, giving investment advice, asset management, etc.
- Provide for a two-year transitional period

2. Management Responsibility (I)

- Every licensed corporation has to nominate at least two “responsible officers” to strengthen the internal controls of the corporation
- “Responsible officer” : a director who actively participates in or is responsible for directly supervising the regulated activity
- Remove the requirement that at least one “responsible officer” must be physically present in Hong Kong at all times

2. Management Responsibility (II)

- Refine the criminal liability provisions
 - If a licensed corporation breached the law and its management
 - (a) participated in, consented to or connived in the criminal acts of the corporation which they managed, or
 - (b) whose recklessness had allowed the corporation's criminal acts to occur,then the management may be held criminally liable for such acts
 - The onus of proof is on the prosecution

3. Review of Criminal Penalty (I)

- Under existing legislation, an intermediary would be held criminally liable if it commits a serious misconduct. The new licensing regime will retain these offences for deterring misconduct
- After considering market comments and without compromising effective regulation
 - Reduce the penalty maxima for certain offences (e.g. failure to inform SFC of the appointment of auditor within the specified period)
 - Remove custodial penalties for breaches of less serious administrative requirements (e.g. failure to return a revoked licence within the specified period)

3. Review of Criminal Penalty (II)

- Allow also conviction by indictment for a few serious offences to enhance the deterrent effect (e.g. breaches of the Financial Resources Rules)
- Extend statutory time limits for compliance with procedural licensing requirements from two to seven days

4. Level Playing Field (I)

- The Bill levels the playing field between the securities arm of banks and licensed securities corporations. It strikes a balance between protecting investors and minimising regulatory overlap
 - Vest in HKMA the same inspection power as SFC to allow HKMA to conduct effective front-line regulation of the securities arm of banks
 - SFC's regulatory standards (e.g. "Business Conduct" and "Fit and Proper test"), will equally apply to the securities arm of banks
 - If HKMA already has equivalent regulatory measures in place, SFC may grant modification or waiver for the securities arm of banks from specific regulatory requirements (e.g. requirements in financial resources, auditing, information reporting, etc.)

4. Level Playing Field (II)

- Simultaneously amend the Banking Ordinance to allow HKMA to conduct effective front-line regulation of the securities arm of banks
 - Employees of the securities arm of banks must be “fit and proper”. HKMA will maintain a register of these employees for public inspection
 - Introduce a “responsible officer” concept
 - Empower HKMA to reprimand publicly misconduct of the securities arm of banks
- HKMA will increase the manpower for regulating the securities arm of banks

5. 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 of licence to minimise adverse effects on third parties

6. Protect Clients' Assets

- Empower SFC to transfer the custody of assets from an intermediary to an appropriate custodian to avoid dissipation
- Basic Law requirement, thus additional safeguards over assets transferred
- Also extend certain regulatory controls to associated entities e.g. rules on handling of clients' assets

Combating Market Misconduct

1. Establishing a Market Misconduct Tribunal and expanding current criminal regime to deal with market misconduct
2. Providing investors with a private cause of action for seeking compensation
3. Facilitating SFC's inquiry into misconduct of listed corporations

1a. Establishing the Market Misconduct Tribunal (MMT) (I)

- The public generally supports the proposals to establish the MMT and to preserve and expand the current criminal route to deal with market misconduct
- Civil regime : MMT

Advantages

- ☞ allow evidence to be further developed during an inquiry
- ☞ accept a lower standard of proof

Limitations

- ☞ sanctions not heavy enough, hence insufficient deterrent

1a. Establishing the Market Misconduct Tribunal (MMT) (II)

➤ Criminal prosecution

Advantages

➤ Heavier penalty (maximum penalty \$10 million and 10 years' imprisonment) hence more effective deterrent

Limitations

➤ more difficult to prove up to criminal standard for commercial crimes

- The Bill will preserve both the civil and criminal regimes , as they complement each other and provide alternatives to the enforcement authorities. No person shall be subject to both civil proceedings before MMT and criminal prosecution for the same conduct

1b. Defining "Market Misconduct"

- Some market practitioners are concerned that the definition of "market misconduct" is too wide and the requisite mental element is unclear, and they believe that the burden of proof should be on the prosecution
- Refinements introduced
 - clearly define the 6 types of market misconduct, including "insider dealing"
 - strengthen the requisite mental element, including the addition of "intention" or "recklessness", etc.
 - clearly stipulate that the burden of proof is on the prosecution (except "wash sales" or "matched orders")

2. Private Cause of Action

The public welcome the establishment of a private cause of action for victims to sue another person for recovery of losses resulting from the latter's market misconduct

- compensation can only be claimed if it is fair, just and reasonable to do so
- allow the court to accept findings of the MMT or criminal convictions of market misconduct as evidence in a private action
- help strengthen the deterrent vs market misconduct

3. Inquiry into Misconduct of Listed Corporations

- SFC's existing power to inquire into listed corporations is limited. Assistance from the auditor of a listed corporation, its bankers and transaction counterparties can help verify the veracity of its documents
- Discussed with the accountancy profession on how the relevant provisions will be implemented for SFC to seek audit working papers from accountants. Adequate safeguards are built in to avoid "fishing expeditions"
- Welcome the accountancy profession's plan to prepare guidelines for its members. SFC has pledged to give assistance to the profession in preparing the guidelines

Enhancing Market Transparency

Timely and accurate disclosure of price sensitive information is important for enabling investors to make better informed decisions

1. Improving the disclosure of interests in securities

The market supports:

- lowering the initial shareholding disclosure threshold from 10% to 5%
- shortening the disclosure notification period from 5 days to 3 business days
- simplifying certain existing disclosure requirements

2. Creating civil liability for false disclosure to the market in order to improve the quality of information

1. Disclosure of Equity Derivatives

- Proposal to expand certain disclosure requirements to share interests held through derivatives
- Market practitioners have commented that if too detailed information is to be disclosed, it might expose their hedging strategies to competitors and hence expose themselves to the risk of being front run
- The Bill will compress the level of details to be disclosed (e.g. removing the need to disclose "exercise period" and "maturity date", etc), but preserve the essential aggregate data (e.g. total numbers of shares held)

2. False Disclosure to the Market

- The Bill provides that a person will be civilly liable for false disclosure to the public. This aims to improve the quality of public disclosure by listed corporations
- Refinements to take into account market comments
 - Added “mental element” : it needs to be proved that a person knowingly, recklessly or negligently discloses false information to the public
 - The person participated in or authorized the disclosure
 - The false information may affect market prices

Catering for Market Developments

1. Regulation of Automated Trading Services (ATS)
2. A new investor compensation scheme

1. Regulation of ATS

- The market accepts that a flexible approach should be adopted for the regulation of ATS to cater for new technology and facilitate market innovations
- Regulation depends on the nature of services provided by the ATS applicant
 - if similar to a dealer : to be regulated under the licensing regime
 - if similar to an exchange (e.g. providing matching services) : to be authorized as an exchange
- SFC will prepare guidelines on the regulation of ATS to assist the market in understanding its operation. SFC will engage the market in the drafting exercise

2. New Investor Compensation Scheme

- The Bill provides for a flexible regulatory framework for establishing a new investor compensation scheme
- SFC has commissioned a consultancy study and entered into discussion with the HKEx, with a view to putting forward detailed proposals for a compensation scheme for consultation with the market
- Detailed operation of the scheme, including the per investor compensation ceiling, will be set out in subsidiary legislation

Transparency and Accountability of SFC (I)

In addition to existing accountability arrangements, the Bill will

- provide for SFC's regulatory objectives
 - SFC needs to adhere to its objectives when exercising its powers
 - The public can assess the performance of SFC against these benchmarks
- establish the Securities and Futures Appeals Tribunal
 - Full-time basis, chaired by a Judge and assisted by 2 market practitioners
 - Independent operation
 - Power to confirm, amend and substitute around 60 types of SFC decisions

Transparency and Accountability of SFC (II)

- We have, through administrative arrangement, established the Process Review Panel (PRP) to ensure that SFC exercises its powers fairly and consistently
 - PRP operates independently, its members are equipped with professional knowledge and expertise
 - Audit the internal operations of SFC, including its investigative and disciplinary procedures
 - Submit independent reports to the Financial Secretary for publication
 - Already started operation

Looking Ahead

- To continue dialogues with the market, and listen to comments from the legislature and the public, with a view to striking a reasonable balance between investor protection and market development
- Enactment of new legislation and putting in place a new regulatory framework conducive to enhancing Hong Kong's competitiveness as an international financial centre



Thank You