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**Legislative Council**

LC Paper No. CB(1)1008/06-07

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**Panel on Financial Affairs**  
**Meeting on 2 March 2007**

**Background brief on**  
**major proposals of the Securities and Futures (Amendment) Bill 2007**

**Purpose**

This paper sets out the background of the Administration's proposal to amend the Securities and Futures Ordinance (SFO) (Cap. 571) to give statutory backing to major listing requirements, and summarizes the views and concerns on the subject expressed by members of the Panel on Financial Affairs (FA Panel).

**Background**

Listing Rules

2. At present, the Listing Rules are made and administered by the Hong Kong Exchanges and Clearing Limited (HKEx). The Rules are non-statutory and compliance with which by issuers is based on the contractual listing agreements between the HKEx and the issuers. The existing Listing Rules contain detailed requirements relating to, among other things, the following matters:

- (a) criteria for initial and continuing listing;
- (b) disclosure in listing documents;
- (c) disclosure in periodic reports by listed issuers;
- (d) disclosure of price sensitive or material events and information;
- (e) duties of directors and advisers of listed issuers;
- (f) trading by directors of a listed issuer in its securities;
- (g) certain categories of transactions, etc.; and

- (h) certain corporate activities of listed issuers, including secondary issues and placements, rights issues, and granting of share options.

### Past consultation

3. In the wake of the Penny Stocks Incident<sup>1</sup> on 26 July 2002, the Financial Secretary (FS) announced on 31 July 2002 the appointment of a Panel of Inquiry on the Penny Stocks Incident (PIPSI) to look into the circumstances surrounding the incident. In its report submitted to FS on 9 September 2002, one of PIPSI's recommendations was that the Government should review the three-tier regulatory structure of the securities and futures markets relating to listing matters (i.e. the Government, the Securities and Future Commission (SFC), and HKEx), with a view to increasing the effectiveness, efficiency, clarity, fairness and credibility of the regulatory system.

4. FS accepted PIPSI's recommendation and announced on 26 September 2002 the appointment of the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure (the Expert Group) to take forward the recommendation. The Expert Group submitted its report to FS on 21 March 2003 and one of its key recommendations was to give statutory backing to major listing requirements.

5. At its meeting on 13 June 2003, the FA Panel discussed with representatives of the Expert Group, SFC, HKEx and the Administration on the Expert Group's report and the Administration's plan to issue a public consultation paper on regulation of listing matters in the third quarter of 2003. Subsequently, the Consultation Paper on Proposals to Enhance the Regulation of Listing was published on 3 October 2003 to seek public views on a number of issues for the better regulation of listing. These included the legal status of certain fundamental requirements in the Listing Rules, the manner of their enforcement, and the roles of SFC, as the statutory regulator, and HKEx, as the market operator, in performing the listing functions.

6. On 26 March 2004, the Administration released the Consultation Conclusions on Proposals to Enhance the Regulation of Listing (the Consultation Conclusions) and briefed the FA Panel on 2 April 2004 on the proposed way forward. On account of the public support received, the Consultation Conclusions recommended codifying in the statute the more important listing requirements, i.e. financial reporting and other periodic disclosure, disclosure of

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<sup>1</sup> On 25 July 2002, HKEx released a "Consultation Paper on Amendments to the Listing Rules Relating to Initial Listing and Continuing Listing Criteria and Cancellation of Listing Procedures". HKEx proposed, among other things, that shares of listed companies should be consolidated if their trading prices fell below HK\$0.50 (penny stocks). Delisting would follow, after certain procedures and with recourse to appeal, if the companies concerned failed to consolidate their shares. On 26 July 2002, 577 (76%) of the 761 stocks on the Main Board suffered a loss. The total market capitalization of the stocks with a quoted closing price of HK\$0.50 or lower fell by HK\$10.9 billion (US\$1.4 billion), roughly equivalent to 10% of the market capitalization of these stocks and about 0.3% of the total market capitalization of the Main Board.

price-sensitive information and shareholders' approval for notifiable transactions; and making breaches of the statutory listing requirements a new type of market misconduct under SFO.

7. To facilitate further consideration of the aforesaid proposals, the Administration and SFC issued consultation papers in parallel on 7 January 2005<sup>2</sup> to gauge the views of the public and the market. The consultation period ended in March 2005.

8. The FA Panel was consulted at its meeting on 4 April 2005 on the Administration's proposals to amend SFO to give statutory backing to major listing requirements having regard to the views received during the public consultation. In its paper provided to the Panel, the Administration stated that the majority of submissions received supported the amendments to Parts IX, XIII and XIV of SFO proposed by the Administration which aimed to :

- (a) provide that SFC may make rules to prescribe listing requirements and ongoing obligations of listed corporations under section 36 of SFO;
- (b) extend the market misconduct regime in Parts XIII and XIV of SFO to cover breaches of the statutory listing rules made by SFC;
- (c) empower the Market Misconduct Tribunal (MMT)<sup>3</sup> to impose, in addition to existing sanctions such as disqualification orders and disgorgement orders, new civil sanctions, namely public reprimands and civil fines, on the primary targets, i.e. issuers, directors and officers<sup>4</sup>, for breaches of the statutory listing rules made by SFC; and
- (d) empower SFC to impose civil sanctions, namely public reprimands, disqualification orders and disgorgement orders, on the primary targets for breaches of the statutory listing rules made by SFC under the amended Part IX of SFO.

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<sup>2</sup> The "Consultation Paper on the Proposed Amendments to the Securities and Futures Ordinance to Give Statutory Backing to Major Listing Requirements" and "A Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules (the Rules)" were issued by the Administration and SFC respectively on 7 January 2005 to invite public views on the proposed amendments to SFO and the proposed Rules to be made under the amended SFO.

<sup>3</sup> The Market Misconduct Tribunal established under Part XIII of the SFO is an independent full-time body chaired by a Judge to deal with a range of market misconduct through civil proceedings and sanctions. Its scope covers, in addition to insider dealing, false trading, price rigging, disclosure of information about prohibited transactions, disclosure of false or misleading information including transactions and stock market manipulation, etc. It can impose by order a range of civil sanctions on a person identified as having engaged in market misconduct.

<sup>4</sup> Due to human rights concern, officers will not be subject to civil fines to be imposed by MMT.

## **Major views and concerns expressed by members of the Panel on Financial Affairs**

9. The FA Panel has followed closely the developments in the proposal to give statutory backing to major listing requirements at the meetings held on 13 June 2003, 2 April 2004 and 4 April 2005. Members concurred that it was important for Hong Kong to enhance regulation of listing matters with a view to increasing the protection for investors, upgrading market quality, and reinforcing Hong Kong's position as an international financial centre. While supporting in principle the Administration's proposal aimed at achieving the aforesaid objectives, some members have raised the following views and concerns for the Administration's consideration :

- (a) It was pointed out that there was overlap and confusion in the roles and functions of SFC and HKEx in the current listing regime. The Administration was urged to clarify the roles and functions of the two parties before providing SFC with new regulatory powers in regulating listing matters.
- (b) It was necessary to ensure a clear division of responsibilities between SFC and HKEx in administering the listing functions in future so as to avoid possible regulatory overlaps and gaps. As it was proposed to empower SFC and MMT to impose civil sanctions for breaches of the statutory listing rules, members were particularly concerned about the need to safeguard against "double jeopardy" on a person for the same breach committed.
- (c) In view of the new regulatory responsibilities proposed to be conferred on SFC, there were concerns over the expansion in SFC's power and the additional cost, if any, for undertaking the new function of enforcing the statutory listing rules. Members highlighted the need to strengthen the checks and balances on the regulatory powers of SFC and the cost-effectiveness in its deployment of resources in performing its role. In this connection, the Administration was requested to make reference to the regimes adopted by overseas jurisdictions in imposing checks and balances on the powers of regulatory bodies comparable to SFC, including mechanisms for reviews/appeals on the regulatory decisions relating to listing.
- (d) On the proposal of empowering SFC to impose direct sanctions on issuers, directors and corporate officers for breaches of the statutory listing requirements relating to information disclosure, there should be a limit on the period within which these relevant persons should be held liable for corporate disclosure. Consideration should also be given to providing appropriate exemption for independent non-executive directors because they

were not closely involved in day-to-day decision making and management of the company.

- (e) On the question of whether SFC should also be empowered to impose civil fines on issuers and directors for breaches of statutory listing rules, members noted that the Administration had not yet taken a stance on the matter as more than half of the submissions received in response to the consultation papers issued in January 2005 did not support such a proposal. Some members saw merits in the proposal as it would provide the necessary regulatory tool to SFC to impose a medium level of sanction in between reprimands and disqualifications. Some members however considered that the need for the proposed fine-imposing power should preferably be reviewed at a later stage given SFC's relatively short history. There was also the concern that the proposal might turn SFC into the police, the prosecutor and the judge.

### **Recent developments**

10. The Administration has indicated that it has refined the proposals in response to market comments and plans to introduce the Securities and Futures (Amendment) Bill 2007 into the Legislative Council within the current legislative session. The Administration has proposed a new legislative approach as outlined in paragraphs 7 to 10 of its paper for the Panel (CB(1)1007/06-07(07)) and will brief the FA Panel at the meeting on 2 March 2007.

### **References**

11. A list of relevant papers is in the **Appendix**.

Council Business Division  
Legislative Council Secretariat  
28 February 2007

## List of relevant papers

Committee	Paper	LC Paper No.
Meeting of Panel on Financial Affairs (FA Panel) on 13 June 2003	<ul style="list-style-type: none"> <li>✧ Report by the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure  <a href="http://www.legco.gov.hk/yr02-03/english/papers/fa/papers/fa-1199-e-scan.pdf">http://www.legco.gov.hk/yr02-03/english/papers/fa/papers/fa-1199-e-scan.pdf</a></li> <li>✧ Administration's paper on "Proposed Framework for Consultation on the Regulation of Listing Matters"  <a href="http://www.legco.gov.hk/yr02-03/english/papers/fa/papers/fa0613cb1-1908-3e.pdf">http://www.legco.gov.hk/yr02-03/english/papers/fa/papers/fa0613cb1-1908-3e.pdf</a></li> <li>✧ Minutes of the FA Panel meeting on 13 June 2003  <a href="http://www.legco.gov.hk/yr02-03/english/papers/fa/minutes/fa020613.pdf">http://www.legco.gov.hk/yr02-03/english/papers/fa/minutes/fa020613.pdf</a></li> </ul>	<p>CB(1)1199/02-03</p> <p>CB(1)1908/02-03(03)</p> <p>CB(1)2543/02-03</p>
Meeting of FA Panel on 2 April 2004	<ul style="list-style-type: none"> <li>✧ Consultation Paper on Proposal to Enhance the Regulation of Listing  <a href="http://www.legco.gov.hk/yr02-03/english/papers/fa/papers/fa1015-2545-e-scan.pdf">http://www.legco.gov.hk/yr02-03/english/papers/fa/papers/fa1015-2545-e-scan.pdf</a></li> <li>✧ Administration's paper on "Consultation Conclusions on Proposals to Enhance the Regulation of Listing" (with the Consultation Conclusions)  <a href="http://www.legco.gov.hk/yr03-04/english/papers/fa/papers/fa0402cb1-1393-3e.pdf">http://www.legco.gov.hk/yr03-04/english/papers/fa/papers/fa0402cb1-1393-3e.pdf</a></li> <li>✧ Minutes of the FA Panel meeting on 2 April 2004  <a href="http://www.legco.gov.hk/yr03-04/english/papers/fa/minutes/fa040402.pdf">http://www.legco.gov.hk/yr03-04/english/papers/fa/minutes/fa040402.pdf</a></li> </ul>	<p>CB(1)2545/02-03</p> <p>CB(1)1393/03-04(03)</p> <p>CB(1)2084/03-04</p>
Meeting of FA Panel on 4 April 2005	<ul style="list-style-type: none"> <li>✧ Consultation papers on: <ul style="list-style-type: none"> <li>(a) Proposed Amendments to the Securities and Futures Ordinance to</li> </ul> </li> </ul>	CB(1)6670/04-05

	<p>Give Statutory Banking to Major Listing Requirements (published by the Administration); and</p> <p>(b) Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules (published by SFC).</p> <p><a href="http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/facb1-670e.pdf">http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/facb1-670e.pdf</a></p> <p>✧ Administration's paper on "Securities and Futures (Amendment) (No.2) Bill 2005 - Proposals to Give Statutory Backing to Major Listing Requirements"</p> <p><a href="http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/fa0404cb1-1160-4e.pdf">http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/fa0404cb1-1160-4e.pdf</a></p> <p>✧ Submission dated 31 March 2005 from the Securities and Futures Commission</p> <p><a href="http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/fa0404cb1-1200-1e.pdf">http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/fa0404cb1-1200-1e.pdf</a></p> <p>✧ Background Brief on proposal to give statutory backing to major listing requirements</p> <p><a href="http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/fa0404cb1-1160-5e.pdf">http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/fa0404cb1-1160-5e.pdf</a></p> <p>✧ Information on practices in overseas jurisdictions provided by the Administration after the meeting</p> <p><a href="http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/fa0404cb1-1463-1-e.pdf">http://www.legco.gov.hk/yr04-05/english/papers/fa/papers/fa0404cb1-1463-1-e.pdf</a></p> <p>✧ Minutes of the FA Panel meeting on 4 April 2005</p> <p><a href="http://www.legco.gov.hk/yr04-05/english/papers/fa/minutes/fa050404.pdf">http://www.legco.gov.hk/yr04-05/english/papers/fa/minutes/fa050404.pdf</a></p>	<p>CB(1)1160/04-05(04)</p> <p>CB(1)1200/04-05(01)</p> <p>CB(1)1160/04-05(05)</p> <p>CB(1)1463/04-05(01)</p> <p>CB(1)1677/04-05</p>
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