

**Consumer Council**  
**Submission to Legislative Council Subcommittee on the**  
**Securities and Futures Bill**

**INTRODUCTION**

1. The Consumer Council is pleased to provide a submission to the LegCo Subcommittee on the Securities and Futures Bill, prior to finalizing its submission to the Government on the Consultation Document, by the due date of 30 June 2000.

2. In this paper, the Council has directed its response to issues in the proposed legislation that directly address consumer protection and competitiveness in the securities and futures markets. The Issues are:

- Market Misconduct
- Civil Liability for Engaging in Market Misconduct
- Private Right of Action
- Investor Compensation
- False Public Statements / Fraudulent and Deceptive Conduct
- Protecting Clients Assets from Dissipation
- Management Responsibility
- Access to Audit Working Papers

3. There are also two other issues that the Council would like to take this opportunity to raise for consideration:

- Minimum Brokerage Commission Rule
- Possible Future Entry of Competing Local Securities and Futures Markets

**COUNCIL RESPONSE TO THE CONSULTATION PROPOSALS**

***Market Misconduct***

4. In a previous submission in September 1998<sup>1</sup>, the Council recommended the setting up of a Market Manipulation Tribunal (MMT) to counter the destabilizing effects of manipulation and other unfair practices in financial markets. The Council is pleased to note the Government has taken up this suggestion, and offers its full support to the initiative.

5. In previously addressing the issue of market misconduct, the Council made the point that the conduct of exchanges in other jurisdictions, such as the US and UK are monitored by competition authorities, administering general

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<sup>1</sup> The Council has previously provided two separate submissions to the Government in relation to reform of the securities and futures markets, in September 1998 and August 1999.

competition law, to ensure that members do not restrict or distort competition in relevant markets.

6. A suggestion was made that in the absence of a general competition law in Hong Kong, a code of conduct covering such issues could be included within the definition of market misconduct. It appears from the current composite Bill that the definition of market misconduct does not include provisions that would address anti-competitive conduct. For example, provisions that prohibit price fixing, bid rigging, anti-competitive vertical restraints or abuse of a dominant position.

7. Whilst welcoming the moves taken by the Government in the creation of the MMT and the creation of prohibitions against various forms of market manipulation, the Council repeats its suggestion that prohibitions against licensees engaging in anti-competitive conduct, unless specifically exempted by the Securities and Futures Commission (SFC), should also be included within the definition of prohibited market conduct.

#### ***Civil Liability for Engaging in Market Misconduct***

8. The Council previously submitted that prohibited conduct examined by the MMT should be tested under the civil, rather than criminal onus of proof. The Council welcomes the move by the Government to establish civil liability for engaging in market misconduct, while also leaving in place criminal sanctions to be applied.

#### ***Private Right of Action***

9. The Council also welcomes the establishment of a right for private parties to seek compensation from relevant persons who have been found in breach of the market misconduct provisions and the dissemination of false information. In particular, it supports the provisions that allow for a determination by the MMT to be admissible in evidence for the purpose of proving that market misconduct or dissemination of false information has taken place when a private right of action for compensation is made.

10. As a means of strengthening the practical implementation of this assistance to investors, the Council suggests that the SFC should explore the means by which small investors are to be informed and empowered with regard to their rights in the new environment. While the Council will continue to maintain an active interest in this area, and provide advice and information where and when it can through its information activities, the creation of a more focused investor support group, with adequate resources would be a welcome initiative by the SFC. In the absence of an established investor association, that could provide a voluntary self-support mechanism, the SFC could take on a role of providing such an investor support service. The services to be provided could extend from informing relevant investors of when a contravention of relevant prohibitions has been proven against a party and that investors might be eligible

for compensation, providing administrative assistance on making claims, and possibly some financial assistance in worthwhile cases.

11. The Council believes that as more and more Hong Kong citizens are investing in the stock market, and relying on such investments to secure their retirement and long-term income plans, the above initiatives are vital to protect the interests and ensure the confidence of the investing public. This is particularly the case for small investors who might lack the sophistication and appropriate financial and information resources to protect their interests.

### ***Investor Compensation***

12. The Consultation Document raises the issue of establishing a new and independent entity called the Investor Compensation Company, to deal with investor compensation matters.

13. In the interests of the investing public it is important that the company be independent and include both industry and public interest representatives. The Council supports the setting up of this company.

14. It is also proposed in the new compensation scheme that a 'per investor level' of compensation be provided for retail investors. Without knowing a per investor compensation limit, nor the scope of compensation, the Council is not in a position to provide comments such as whether investors would be generally better off under the proposed per investor compensation limit. Nevertheless, the Council would like to stress that the new per investor compensation arrangement should not reduce the overall level of protection available under the existing per broker compensation arrangement.

15. With regards to what limit should be set on the amount of compensation payable to a claimant, the question arises as to whether investors should bear a share of any loss and whether 100% cover should be provided for a claimant. A scheme that provides full compensation of course could give 100% protection to investors and promote market confidence. However, this 100% compensation could act to investors' detriment in allowing firms to take unacceptable risks in the knowledge that the compensation scheme will protect an individual from loss. It would also act to increase the costs of participation in the scheme which would be passed on to consumers.

16. The concept of a tapering method (i.e. a percentage met in full and further percentages met to a lesser amount) of setting compensation limits could be considered. Under the existing Investors Compensation Scheme in the UK<sup>2</sup>, a 100% compensation cover is provided for the first £30,000 and 90% of the

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<sup>2</sup> UK is undergoing a major reform for its financial markets. Under the Financial Services and Markets Bill, it is proposed that a single compensation scheme should be set up to deal with claims in the event of the default of a firm authorised by the FSA. This new compensation arrangement is expected to come into operation once the new legislation comes into force. The new scheme will provide a single point of access to consumers.

next £20,000, with a maximum amount of £48,000 of an eligible claim. The combined effect of setting a limit and an element of co-insurance, as found in the UK scheme, could act as an incentive for consumers to take care of where they place their money or with whom they do business. It also reflects the principle that investors should take some responsibility for their decisions. However, this builds on the assumption that investors' awareness of compensation arrangements is high and that it is a factor to which investors attach significance when making investment decisions. Other EU states are either providing investor protection to at least 90% coverage, or setting a payment limit per failure. Countries such as Canada, Japan and US, provide a 100% cover (i.e. no co-insurance) with a maximum limit set for compensation.

17. In view of the above circumstances, the Council supports the Government putting a limit on the compensation amount. While it is acknowledged that the level of compensation will be prescribed by the Chief Executive in Council, and discussion has been carried out between the SFC and the HKEx on the new investor compensation proposals, the Council would urge the Government to undertake a separate public consultation on the matter of investor compensation before a final decision is made.

#### ***False Public Statements / Fraudulent and Deceptive Conduct***

18. Clause 200 of the Bill provides for a claim for damages where a person has suffered pecuniary loss as result of relying on any public communication (relating to securities or futures contracts) which is false or misleading. The intention is to ensure that persons, who might not fall within the SFC's purview are made responsible for issuing misleading public communications and that they exercise due diligence and care.

19. The proposed provision, and another such as Clause 292 that re-enacts the existing offences of fraudulent and deceptive conduct, is a welcome addition to the legislative safeguards that will be in place to protect investors. In this regard, the Council fully supports the provision.

20. The Council would also wish to take the opportunity to point out to the Government that the primary issue of false representations and misleading conduct is principally the same as existing general provisions in the Trade Descriptions Ordinance that prohibit false trade descriptions, false marks and misstatements. However, this legislation currently only applies to the sale of goods, and not services.

21. The Council is of the view that if the Government considers the issue of misleading and deceptive conduct in relation to the securities and futures services to be important, the same concern should apply to other services marketed in the economy. It should not be confined to the provision of securities or futures services. Accordingly, the Government should give some thought to introducing general legislative provisions that prohibit misleading and deceptive conduct in relation to all services (and goods) regardless of the economic sector.

### ***Protecting Clients Assets from Dissipation***

22. As a measure to protect client's assets from dissipation, the Bill empowers the SFC to require brokers to transfer custody of their client's property to an appropriate custodian. The Council welcomes the initiative by the SFC in protecting client assets.

### ***Management Responsibility***

23. The proposed Bill requires that a 'responsible officer' who is responsible for directly supervising the conduct of the regulated activities of the licensed corporation, must obtain an approval from the SFC. The Bill also brings in the 'management liability' concept in that both the 'responsible officer' of a licensed corporation and the corporation itself, are liable for breaches by the corporation of certain fundamental regulatory requirements.

24. The Council believes that persons in management at a senior level should be held responsible and accountable for their actions and omissions and, where appropriate, for breaches by the corporation. Holding a 'responsible officer' liable for a corporation's breaches, not only provides adequate and appropriate controls on management side, but also ensures such persons responsible for making decision exercise due care and diligence, thereby providing better investor protection. The Council fully supports this initiative by the Government.

### ***Access to Audit Working Papers***

25. Under the existing SFC Ordinance, the SFC has the power to conduct preliminary inspections of the records and documents of listed companies. However, as noted in the Consultation Paper:

- the SFC does not have the power to supplement or verify information obtained from records or documents produced by a listed company or its group of companies; and
- this often prevents the SFC from ascertaining the real nature of a company's transactions as recorded in its own books and documents.

The proposed Bill rectifies this loophole by enabling SFC to seek records and documents from third parties such as companies' auditors. The Council is of the view that this power will provide an added safeguard to the investing public as such access would assist the SFC to effectively and efficiently fulfil its inquiry function. Accordingly, the Council fully supports this proposal.

## OTHER MATTERS

### *Minimum Brokerage Commission Rule*

26. In a previous submission, the Council made a suggestion that in regard to the perceived globalization of securities and futures markets, the liberalization of minimum brokerage commission rules would be necessary to enhance the competitiveness of Hong Kong brokers.

27. The matter is not covered in the current Consultation Document. However, it is understood that the Government has plans to remove the minimum scale by 2002. In face of competition from other jurisdictions and the fact that deregulation will, as far as the Council is aware, be occurring in Singapore and Taiwan before that date, Hong Kong should consider bringing deregulation forward.

### *Possible Future Entry of Competing Local Securities and Futures Markets*

28. Under the composite Bill, only SEHK, HKEx and any other companies of which HKEx is the controller, may, with recognition by the SFC, operate securities and futures markets in Hong Kong. This means the monopoly status currently enjoyed by the exchange will remain.

29. Notwithstanding the Government's decision on the monopoly status for a securities and futures exchange in Hong Kong, the Council suggests that the issue should be kept open and the circumstances on which the Government's decision was made should be available for re-examination at a later date.

Consumer Council  
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