

**Letterhead of HONG KONG STOCKBROKERS ASSOCIATION LTD.**

30th June 2000

Ms Leung Siu Kum  
Clerk to Bills Committee  
Legislative Council Secretariat  
The Legislative Council  
8 Jackson Road  
Hong Kong

Dear Ms Leung,

Re: Securities & Futures Bill

In response to the invitation by the Financial Services Bureau and the Securities & Futures Commission to comment on the Securities & Futures Bill published for general information in April this year, the Sub-committee of our Association spent two months' time to study and discuss the Bill. A submission contains our overview on the Bill and some comments on key issues and legal concepts is now prepared, there are also comments on individual sections of the Bill but due to shortage of time, this part is only partially finished. We undertake, however, to make further submissions as soon as they are compiled.

I attach a copy of the submission on the Bill, sent to the Financial Services Bureau and the Securities & Futures Commission, for your perusal. Should you have any comments, please do let me know.

Yours sincerely,

**Paul Fan**  
Chairman

Encl.

**SECURITIES AND FUTURES BILL**  
(Published for general information in April 2000)



A summary of initial comments on the Bill

by

**HONG KONG STOCKBROKERS ASSOCIATION**

in response to

The Consultation Document on the Securities and Futures Bill

issued by the Government of

The Hong Kong S.A.R.



30 June 2000

**SECURITIES AND FUTURES BILL**  
(Published for general information in April 2000)

-----  
A summary of initial comments on the Bill  
by  
**Hong Kong Stockbrokers Association**

in response to  
The Consultation Document on the Securities and Futures Bill  
issued by the Government of  
The Hong Kong S.A.R.  
-----

In response to the publication of the Bill and its Consultation Document in April this year, the Association, along with other market stakeholders, has been invited by the Financial Services Bureau and the SFC to give its views on the Bill. The Association wishes to submit its comments on the Bill, firstly with a broad overview. Secondly to outline other key issues of importance. Thirdly, specific comments with examples and lastly in parts in greater detail at different stages. This is necessary for reason that the Bill is voluminous and in order to read and understand the Bill, it has to be divided among a working committee. Hence it involves group discussions, collating opinions, as well as debating at committee level before adoption by members. This process would clearly take months to complete and therefore the Association can only offer what it can digest, namely in parts rather than in its entirety at the same moment of time.

**Part I: Comments in general**

On reading through the Bill, one has an overall impression that the spirit and the main theme of the proposed law only very remotely resembles what the Association was told to expect during meetings with senior officials of the S&F Commission. According to our recollections, we were assured at the time that the proposed Bill would be built mainly on three principles: (a) codify all existing statutory provisions governing the securities and futures industry, and in the process repealing ten existing ordinances; (b) that the interest of the investing public is to be well protected; and (c) to effectively monitor the operation of securities intermediaries on a sound financial basis. Criminal liability would only fall on defrauding clients' assets and failure in maintaining financial resources. The Association was, and still is, in total agreement to these principles and to the rationale that intentional breach of false submission of returns would result in criminal punishment.

However, in the theme of the present Bill, criminal culpability goes much further than the above understanding, to areas where one would not have imagined before, whether in the criminal law we know of or in the law of corporations. It can

extend to a normal day's routine of a corporation, executive or management oversights or negligence without any criminal intent, late paying of a fee, late notice of a change of auditors, examples of which will be later expounded in this paper. The culpability of directors and executive officers of a corporation is another area requiring detailed study. In some cases their penal liability goes to the extent to become strict or vicarious by statute and as such, one is practically devoid of a defence. This is a matter of grave concern for people holding such positions. If these penal measures become operative, they would certainly affect the attitude of the people working under them and encroach upon the harmonious and effective management culture which has made Hong Kong competitive and successful in the past.

The following points illustrate the Bill is unduly draconian and the penalties excessive:

- The effect of criminal culpability in respect of certain corporate executive oversights or negligence with no pecuniary advantage or criminal intent whatsoever will undermine the stability of corporate management, affect its normal operations and development.
- The imposition of criminal punishment for executive acts or omissions without any guilty intent on such a wide scale is opposite to the spirit of rule of law in Hong Kong and some of which may stand doubtful in the light of our existing Human Rights.
- To keep abreast with the present day fast-lane IT development, we have to attract technology and other experts of international level into top management. The prospect of being charged with criminal proceedings for the fault of somebody else's oversights on an executive job is not going to help Hong Kong find the elite we need.
- At present, some directors are licensed and they have direct executive responsibilities in the management of the corporation. Other directors not required to be licensed perform their duties as directors in general. If in future, as in the Bill, this distinction is to be blurred and respective responsibilities are to be merged and held vicariously in certain circumstances, not only executive directors find it onerous, non-executive directors would also find it highly disturbing.
- In the securities industry, one could easily understand that, apart from high quality management, sizable amounts of capital are a prerequisite. Entrepreneurs who commit themselves to this sort of capital would naturally want to be a director of the corporation. He would generally attend board meetings and decide on policy issues but may wish to leave management to professional people. In the spirit of the Bill, the penal culpability of such a director would by far exceed what he would happily accept as an investor in the industry. The consequences are apparent. Future investors will refrain from investing in Hong Kong while existing investors will either resign as directors or withdraw altogether. These circumstances, when they occur, will be profusely disadvantageous to the securities industry and also to Hong Kong as a world financial centre.

## **Key Issues of Importance**

### Rules and Codes for Business Conduct

Sections 159 and 160 provide for the Commission to make rules and guidelines. The two sections raise difficult questions of transparency and industry consultations. The Association is reluctant to see such carte blanche power being granted to the Commission without a check and balance of public consultation measure being introduced in the two sections.

### Compliance Costs

Effective regulation can help a market flourish by promoting investor confidence in the safety, honesty and basic fairness of the market. It can also stifle the market by operating with too heavy a hand.

The Association is concerned that the Commission has too expansive powers, which range from repeated requests of information from different departments/divisions of the Commission to unnecessary and sometimes intrusive questionnaires issued again by different departments/divisions of the Commission at different times. A more serious practical difficulty which arises is many of these requests and issue of questionnaires are not coordinated and in a manner and form specified by the Commission. These measures pose considerable compliance costs to the industry. The Association believes in today globalised market, it will be the system of regulation that is cost effective while remaining true to its ideal that will excel.

The scale and magnitude of these requests and questionnaires has gone too far and too much and impose considerable compliance cost to the industry. There is also a noticeable trend that the requests/questionnaires are repeated requests and at fixed period. It is clearly evident that the Commission has not adopted any cost/benefit analysis on such requests and questionnaires. The Association believes a provision will need to be introduced that any measure introduced by the Commission (whether it is requests/questionnaires or guidelines); a cost/benefit analysis need to be undertaken and that overall the proposed measure will not impose additional compliance cost on the intermediaries.

### Supervision

Section 166 deals with supervision of intermediaries and their associated entities. The effect of section 166 extends the Commission's supervision power to any other person, whether or not connected with the intermediary or the associated entity (as the case may be), whom the Commission has reasonable cause to believe has information relating to, or is in possession of, any record or document relating to business and transaction of the intermediary or its associated entity. Also the section gives the Commission a power to require any person to answer any question regarding any record or document of the intermediary or its associated entity.

While the Association favoured the Commission having such powers in the case of investigations, this power is not recommended to be given to the Intermediaries

Supervision Department. This view is taken because in the case of investigation, a threshold of reasonable cause to believe an offence may have been committed has occurred. In contrast, an inspection is of routine in nature and is merely a "fishing expedition". The result is that if such powers are given, inspections will be more investigatory in nature and intermediaries would not have the benefits of other checks and balances available under Division 3 of the Securities & Futures Bill.

**Part 2: Specific Comments with Examples**

(All sections refer to sections in the Bill unless otherwise stated)

**2.1 Introducing criminal elements to management omissions or acts**

We generally associate crime as a social wrong, the perpetrator of which had a dishonest intention or was reckless to the consequences of its commission, causing either damage to life or property or a breach of certain public policies, such as peace and order. We do not associate crime with commercial activities which are innocent and perfectly essential and beneficial to our society. *We do not equate crime with components of these commercial activities when some of them do go wrong by change of circumstances, mistake, oversight or negligence which are part of human nature.* When the consequences are of a contractual or tortious nature, with a party being aggrieved, the remedy is one of civil action for damages or other relieves.

However, in the present Bill, we have abundant examples to illustrate that such activities, no matter how trivial or routine in nature, can give rise to serious criminal punishments:

- **Example A**

Section 122

If a licensed representative ceases to act for his principal, the principal shall notify the Commission in 2 business days and the individual shall within the same time return the licence to the Commission. The breach of this is an offence punishable by a fine of \$200,000 and to imprisonment for 6 months.

- **Example B**

Section 130

A licensed person shall inform the Commission in any event not later than 7 days before an intended cessation. (s. 130(1))

Where a person becomes or ceases to be a director of an intermediary, both parties shall notify the Commission of the particulars of the director within 5 business days. (s. 130(4))

An executive officer of a licensed corporation shall report to the Commission of **any** persons's attempt to prevent him from his duties in regard to the regulated activity. (s. 130(5))

Any person who fails to comply, without reasonable excuse, commits an offence and is liable to a fine and imprisonment for 6 months. (s. 130(6))

*The criminal intent element is entirely absent in the above sub-sections.* And another question is: What is the test to be applied to determine which excuse is reasonable? Is it going to be subjective or objective? If it is objective, how can the accused know for certain he has a defence and therefore act in the manner which is expected of him.? In some cases, cessation of business is forced upon by circumstances, such as a major financial crisis, failure of banks or death of director and decision to cease the operation of the corporation may be instantaneous. Where does one have the luxury of a seven days' time span to act in the middle of a crisis?

S. 130(5) is a category of its own and shall be referred to later. However, it is sufficient here to say that an executive officer is an employee of the corporation. As such, his responsibilities are subject to control and variations by senior management or the board. Here the Bill seems to encourage employees to report their principals regarding decisions which may have the effect of restricting their responsibilities, with the possibility of imprisonment looming overhead if he does not do so.

- **Example C**

Sections 133, 181, 185, 113

Section 133 under the caption of Annual Fee simply mentions the paying of an annual fee and the filing of an annual return. One has to go to section 181(4) to know that if one fails to pay an annual fee, the law shall deem a licence to be suspended. Section 185 further provides that where a licence is deemed to be suspended under s. 181, the licensed person shall be deemed not to be licensed in respect of the regulated activity, in which case, under section 113, that person carrying on a business in a regulated activity without licence shall be punishable by a fine of \$10 Million and to imprisonment for 7 years.

*Do we really want a sentence of that magnitude to be traced through several sections, originating from the non payment of a fee, which can be a management oversight or misunderstanding? The enactment of a law should be written in such a way that it is fair, clear and unambiguous. We do not believe this spirit is exhibited here in the present example.*

- **Example D**

Sections 146, 147, 157

Section 146(3) provides that a licensed corporation shall notify the Commission of the appointment of an auditor within 5 business days, failing which it is liable to a fine and imprisonment for 1 year. The same penalty applies in the case where an auditor is removed or replaced, and the Commission is not notified within **one** business day. (s. 147)

If a licensed corporation fails to notify the Commission of the date on which its financial year ends within one month after it becomes licensed, the offence is punishable by a fine and imprisonment for 4 months.(s. 148)

An associate entity of an intermediary which becomes aware that it does not comply with giving certain notice to the Commission in 5 days, shall notify the latter in **one** business day of the fact. Section 157 (6)

*The sections cited here all relate to giving notice within a time frame, from a day to a month. Yet, if for whatever reason, one fails to meet them, one has committed a crime punishable by imprisonment. We do not believe that this truly reflects the spirit of the law we know of or we would hope to see. The playing-field may be level but equally treacherous to all.*

## 2.2 Creating strict criminal liability on officers of a corporation

- **Example A**

### Section 123

A licensed corporation shall not carry on its regulated activity unless there is **at all times** at least one responsible officer in Hong Kong. The breach of this is an offence for the corporation as well as **every** executive officer of it, punishable to a fine of \$1 Million and to imprisonment for 2 years. It also carries a daily fine of \$10,000.

This is easily breached if 2 such persons leave Hong Kong for a short trip to attend a conference or while one is on leave, the other dies or resigns, or when Hong Kong has a long Easter or Christmas public holidays and both responsible officers go on leave while the corporation may trade in securities overseas not having a holiday in that foreign land. Even during holidays in Hong Kong, it can be construed that a regulated activity is being carried on in the sense that clients assets are still being held, market data streams are still being received live from all over the world. Such activities cannot be avoided while the responsible officers are away.

*Every executive officer of the corporation, including the one who is rightfully away on leave and may not have any knowledge of the breach, commits the offence. The element of criminal intent is absent and there is no link of culpability.*

- **Example B**

### Section 139

This section provides for the maintenance of financial resources by a licensed corporation as required by the financial resources rules. *What is worth noting is the presumption that the corporation shall be regarded as being aware of a breach of the rules or requirements of the rules if **any** of its directors or employees is aware of it or should be aware of it.* (s. 139(4)). If the Commission is not notified in respect of this awareness, whether actual or presumed, on the **same** day, then the corporation and each of its executive officers commit an offence punishable by a fine of \$1 Million and imprisonment for 2 years.

*It is logically fallible to require someone to act on a presumed knowledge. Where knowledge is presumed, it is not actual. How can one expect a person to act*

*without actual knowledge of the circumstances under which he is supposed to act? Least of all, a corporation.*

If, for example, a junior staff is aware of such a breach late at 6 p.m. on a Friday afternoon but cannot be sure about it and therefore keeps the information to himself until Monday morning. *Under the presumption in (4), the corporation is regarded as being aware of the breach on Friday. Even if the Commission is notified on Monday, the offence has already been committed on Friday and **each** of the executive officers is culpable.*

- **Example C**

#### Section 149

This section provides for the preparation and submission of financial statements and auditors' report not later than 4 months after the end of a financial year. However, if one fails to comply, the licensed corporation and **each** of its executive officers commit an offence punishable by a fine and 1 year imprisonment. (5) If this failure is with intent to defraud, the penalty is a fine and imprisonment for 7 years. (6) This is understandable. *However, in the former case under (5), it is common experience that auditor's reports and financial statement are often delayed for various reasons. Is it necessary to criminalise management in this manner in respect of something which is not always within their control?*

- **Example D**

#### Section 157

An associated entity of an intermediary is required to notify the Commission of certain particulars and any change in them within 5 business days. Failing to comply *without any reasonable excuse* would make the associated entity and **each** of its executive officers guilty for an offence punishable by a fine and imprisonment for 2 years. (4) If that entity is aware of this breach, it shall notify the Commission within **one** business day (6), failing which, the associated entity and **each** of its executive officers commit an offence and each is liable to a fine and imprisonment for 4 months. (7)

One would not be able to know for certain, in an objective test, whether one's excuse is reasonable or not in the eyes of the Commission; and in practice the true answer will only rest in a court of law. Therefore, if you think your excuse is unreasonable, you comply with (6) but is definitely guilty under (4) by your own admission. If you think your excuse is reasonable, (but the Commission thinks otherwise), and comply with (6) you are guilty under (4) if you fail in court. If you think your excuse is reasonable, but in fact it is not and take no action, you will be guilty under both (4) and (6). *Therefore, the only option in this scenario when one wants to claim innocence is to prove that one's excuse is reasonable in a court of law. This is too onerous for a matter of this nature. The duty to file returns can normally rest on one officer. The law is not fair at all if **each and every** executive officer is liable for it, including those who are not in default. Under this category, we are definitely looking at a new situation and a novel idea of joint criminal liability in criminal law within the ambit of a corporation without any necessity of proof of guilty intent.*

## 2.3 Creating serious criminal vicarious liability on a corporation

### • Example A

#### Section 368

*This provision is a new device, unknown of in previous securities legislation in Hong Kong, to create a blanket vicarious liability for a corporation for acts, omissions or failures of its employees or agents. Because of its nature, it is worthy reproducing it here for easy reference.*

"For the purposes of this Ordinance, an act, omission or failure of a director, employee, agent or other person acting, or purporting to act, for or on behalf of a corporation within, or apparently within, the scope of his office or employment shall be deemed to be the act, omission or failure of the corporation as well as of the director, employee, agent or other person (as the case may be)."

*When liability of the corporation is so presumed by statute, a true interpretation of it will make the liability almost "absolute". Certain defences which might otherwise be open to the corporation are by the very nature of the presumption, excluded. Thus, under the present section, the corporation cannot escape criminal liability by establishing that:*

- (a) it had no knowledge of the matter complained of, or*
- (b) it had no dishonest intent, or*
- (c) the agent or "other person" has no authority to act for the corporation, or*
- (d) the employee was not acting within his authorized scope of employment, or*
- (e) the corporation has delegated the performance of a duty to a person of reasonable competence, and that the act, omission or failure was attributable to this person's fault alone.*

*None of the above defences which may otherwise be perfectly valid, whether alone or in combination, will be available to the corporation under a "blanket" presumption of liability. To illustrate, if a competent accounting clerk of a licensed corporation fraudulently appropriates money due to a client in a transaction beyond the scope of his duty, he would be criminally liable, whether under this Bill or the Theft Ordinance, but his principal, the corporation, would, by section 368, have also committed a criminal offence.*

The reasons for the recognition of the concept of vicarious liability in our civil law of torts may be various but the truth seems to be that it is simply a rule of rough justice, which ensures that a person injured by an employee, who is unlikely himself to have the means to satisfy the claim, may have recourse against the longer pocket of the employer. *However, when we move over to within the perimeter of criminal offence, is it prudent and justifiable for us to start experimenting vicarious liability by statute, by discarding even the most basic fundamental elements of crime: i.e. the principles of "mens rea" (criminal intent) and the "actus reus" (the act), and apportioning criminal liability by statute by arbitrary design with the possible consequence that out of any single oversight, error or default by an employee, heads will start to roll from bottom to top in a licensed corporation?*

- **Example B**

#### Section 367

*The arrangement of the Bill seems to show that, other than offences with "strict" liability on the executive officer, the test of criminal culpability of an officer of the corporation would be whether he has been negligent. This section provides that if the commission of an offence by a corporation has been aided, abetted, counseled, procured, induced, consented to, connived, or attributable to any **neglect** by any officer of the corporation, then the officer as well as the corporation is guilty of the offence.*

*The acts described by "aided, abetted, counseled, procured, induced, consented to, connived" are acts with intent and so far as offences are concerned, acts with criminal intent. An act of negligence is exactly the opposite. One is negligent because one has not put ones mind to it. It is an act (or rather omission) without any intent. The acts in the first category and negligence are mutually exclusive in the analysis of willful intent. Yet, the Bill has put **neglect** in the same category as **aiding and abetting, counseling, procuring, inducing, consenting etc.***

Therefore, an officer would be no less guilty in an offence if the part attributable to him is only **neglect** in management (e.g. the safe keeping of a password in a computer or a key to a drawer) than his actual participation in it, whether under his instigation or with his full knowledge and consent (e.g. in appropriating clients' money dishonestly). *Where is the fairness of our legal system if the law can be rightly interpreted in such a manner? Are we trying to forget the basics of criminal liability and depart from the concept of criminal intent? Do we really want to make negligence in the **management** of a corporation, a **crime**? These are fundamental questions which need to be seriously addressed to, not only in the Bill, but in a wider issue which goes to the root of the fairness of our legal system and criminal justice.*

## 2.4 Promoting disunity in management by encouraging reporting to Commission

- **Section 130(5)**

This section provides that an executive officer shall report to the Commission if any person prevents or **attempts** to prevent him from properly discharging his responsibilities in supervising the carrying on of the regulated activity. This duty is one which if breached will carry a criminal liability of a fine of \$25,000 and imprisonment for 6 months.

S. 130(5) is a category of its own. An executive officer is an employee of the corporation. As such, his responsibilities are subject to control and variations by senior management or the board. The Bill proposes to fix a duty on executive officers to report on their principals regarding decisions which may have the effect of restricting their responsibilities, or on colleagues who may not agree with them regarding how the operation should be supervised.

Here we are not only dealing with an act of prevention of an officer's supervisory duty but **attempts** of doing that, which may include a verbal intention privately communicated to the officer or discussions at a directors' meeting. *If the Commission is receiving reports on situations such as these, it is going to involve itself in inter-meddling with a corporation's internal management rows or disputes.* One must not forget that an executive officer is an officer of the corporation and his first duty and integrity is towards the latter. *Provided he is acting honestly and legally, his integrity should be unfettered. If the law imposes an additional duty on him, asking him to be a watchdog of the Commission, we are asking him to serve two masters at the same time, which is a task impossible for him to perform.*

Under this provision, the management of a corporation would not be the same again. The duties of an executive officer would be tailored to what is absolutely necessary so he is not supposed to report on anything which does not concern him. There will be more "Chinese walls" inside a corporation and segregation in management would be more favoured than harmony and unity. Where is that going to lead us to?

*Aiding and abetting a crime is a crime by itself in Hong Kong but failing to report one has not been.* Here, we are not even talking about a crime as such. Unless we go back in time and space to the era of "the Cultural Revolution" in China when children denounced parents, officials denounced superiors, students denounced teachers; and all were indulged in reporting to the authorities, not for the uphold of justice, but to save their own necks from being denounced. *Do we really want to envisage a commercial environment of this horrible nature? Is Hong Kong going to be a fore-runner in this law? If we are, we may be rushing into uncharted waters where angels fear to tread.*

## 2.5 Onerous time limits with consequential criminal punishment

*The Bill is abundant with examples of this category. It is considered that where time limits are necessary purely for administrative purposes, a warning or a fine is sufficient and there is absolutely no justification for expanding criminal punishment into areas where no dishonest behaviours are involved, especially on time limits.*

### • Example A

#### Section 120

If a representative fails to return a provisional licence which has been revoked within **2** business days, he shall commit an offence punishable by a fine of \$200,000 and imprisonment for 6 months.

- **Example B**

Section 122

If a licensed representative ceases to act for his principal, he and the principal shall return the licence and inform the Commission respectively in **2** business days, failing which an offence is committed punishable by a fine and 6 months imprisonment.

- **Example C**

Section 139 (6), (8)

Failure to notify the Commission of one's inability to maintain financial resources according to financial resources rules on the **same** day shall be an offence. Failure to comply with requirements of the same rules and notify the Commission within **one** business day shall be an offence. In both offences, the licensed corporation and **each** of its **executive officers** are punishable by imprisonment for a fine and 6 months.

- **Example D**

Section 147

If a licensed corporation fails to notify the Commission within **one** business day after it gives notice to its members of a motion either to remove or to replace an auditor before the expiration of his term of office, an offence is committed punishable by a fine and imprisonment for 1 year.

- **Example E**

Section 157

An associated entity shall notify the Commission if it becomes aware that it did not comply with certain requirement of notification of change of particulars, within **one** business day, failing which an offence is committed, whereupon **each** of its **executive officers** commits an offence punishable by a fine and imprisonment for 4 months.

## 2.6 Excessive criminal penalties

*It is our overall opinion that where the provisions of the Bill together with any rules, guidelines or regulations made under it are breached without any dishonest intentions, it should not result in criminal liabilities and penalties. Examples where criminal penalties are uncalled-for can readily be found in the Bill, some of which are cited here and others mentioned under other headings in this paper.*

- **Example A**

Section 144

Subsection (1)(a) provides that the Commission may make rules to provide for the keeping by the intermediaries of such accounts and records as are specified in the rules. Subsection (8) provides that where a person fails to comply with any specified

provision of the rules that applies to him, the person, and, in the case of an intermediary or an associated entity of an intermediary which is a corporation, each of its executive officers commit an offence and each is liable to a fine of \$200,000 and imprisonment for 2 years.

The keeping of accounts and records are invariably done by staff with knowledge and experience in this field in a corporation. In some corporations accounting is under the charge of staff who are professionally qualified. The necessity of delegation is obvious. It would be quite abnormal to find an executive director or officer in a corporation engaged in keeping accounts and entering records himself. *Under this section, if a rule is breached by a staff through carelessness, each and every executive officer of the corporation is criminally liable. The element of criminal intent is absolutely lacking in this example. In situations of this sort, an executive officer has no dishonest intent, nor did he commit the act himself. He should therefore never be held liable for a criminal offence vicariously.*

*In sections 139, 141, 142, 161 etc. where rules are made by the Commission, similar situations arise to hold executive officers of a corporation vicariously liable for criminal offences, our comments above apply as well.*

- **Example B**

Sections 19, 113, 133, 181, 185, 193(2)

Section 113 imposes a severe criminal liability for any person conducting a regulated activity without a licence, namely a fine of \$10,000,000 and imprisonment for 7 years. This can be understandable. What is more disturbing, however, is to impose this penalty for some breaches which are much more trivial in nature and which may be the result of some mistakes or oversight. Section 133 is the case in point. *When section 133 is breached by the late filing of an annual return or the late paying of an annual fee, one's licence is automatically deemed to be suspended under section 181(4) and section 185 further provides that the carrying on of any regulated activities shall be deemed unlicensed, whereupon the severe penalties of section 113 shall be invoked.* Furthermore, under section 193(2), the Commission may impose a prohibition on a corporation whose licence has been revoked or suspended, notwithstanding that an application for review has been made.

Compare section 113 with section 19. Section 19 provides that no person shall operate a stock or futures market unless he is recognized by the Commission. A person who contravenes this is liable to a fine of \$1,000,000 and to imprisonment for 2 years. *So, if punishment is commensurate with the crime, carrying on an unlicensed regulated activity would be about 10 (ten) times more serious than operating an unrecognized stock or futures market in terms of fine, or 3 1/2 times in terms of imprisonment. How can we rationalize the penalty in section 113 in this light?*

## 2.7 Presumption of faults and guilty intent

The concept of vicarious criminal liability on the corporation under section 368 is in itself a presumption of fault. *However, there are other instances in the Bill where fault or guilty intent is presumed on the part of the accused.*

- **Example A**

### Section 123(4)

Section 123 (2)(c) provides that there is at least one responsible officer of the licensed corporation in Hong Kong at all times. Subsection (4) provides that if this is contravened, the licensed corporation and **every** executive officer (i.e. responsible officer by definition under s. 112) commit an offence punishable by a fine of \$1,000,000 and imprisonment for 2 years.

*It is clear that the law is written in such a way that each and every executive officer is liable, including one who is not at fault or with any intention that this provision be breached.* To illustrate, if there are two executive officers in a licensed corporation and one is on annual leave for a month away from Hong Kong. The other one, on a business day, in an emergency has to leave Hong Kong on a short trip for a few hours, knowing fully that he is the only remaining executive officer in Hong Kong. *Under section 123, both are equally guilty.* We leave the question whether this provision is absolutely necessary for a moment, and proceed to consider the culpability of the officer who is on annual leave. His absence from Hong Kong is perfectly legitimate, he has had no intention of breaching this provision on leaving Hong Kong and he had no knowledge of the offence at all at the time when it happened. Yet he is guilty for the offence. *Have we departed from our fundamentals on crime and our sense of fairness in the application of our law and embarked on a new concept of "joint criminal culpability"?*

- **Example B**

### Section 156(3)

The section provides that a person commits an offence if, with intent, he deletes, destroys, mutilates, falsifies, conceals, alters or otherwise makes unavailable any account record or document concerning any matter relating to the business of a licensed corporation when an auditor is appointed by the Commission to carry out auditing work. (1) It is noted that words such as "**deletes**" and "**alters**" are quite neutral in certain circumstances as compared with words such as "destroys", "mutilates", "conceals" which may carry a sense of ill motives, while the word "**falsifies**" definitely describes a criminal act. If one falsifies, one has a criminal intent, but not necessarily so when one alters or deletes which can be perfectly innocent.

Therefore, it is unusual to find subsection (3) to provide that (whether guilty or innocent in the act), the accused person shall be **presumed to have done so with intent** to prevent, delay or obstruct the carrying out of the auditing work and punishable by a fine of \$1,000,000 and imprisonment for 7 years. *It has obviously*

become the burden of the accused to adduce evidence to the contrary before the presumption can be rebutted. **The phrase "with intent" in subsection (1) is completely circumvented by the presumption in subsection (3).** Each one of the acts described in (1), no matter how innocent, is presumed to have been done with criminal intent. This is contrasting to the established principle existing in our common law system that a person is presumed to be innocent unless proven guilty.

- **Example C**

#### Section 178

This section provides that a person commits an offence if he destroys, falsifies, conceals or otherwise disposes of any record or document required to be produced under that Part (IIIV), **unless** it is shown that at the relevant time he had no intention of concealing the facts capable of being disclosed by the same. The offence is punishable by a fine of \$1,000,000 and imprisonment for 2 years. In other words, *the accused is **presumed to have the intention of the concealment unless he can show he had no such intention.** It is always logically difficult to prove the negative and here the onus is shifted onto the accused. Similar to the example in the previous paragraph, this presumption is incompatible with the spirit of our existing legal system and our Human Rights.*

- **Example D**

#### Section 179(2)

The section provides that where any person is guilty of misconduct which occurred with the consent or connivance of, or was attributable to **any neglect** on the part of a responsible officer, or a **person involved in management**, then the latter is also regarded as guilty of the same misconduct.

*Here **neglect** is put in the same category as consent or connivance, a provision which totally disregards the element of intent in the mind of the person in question. Culpability may go to a responsible officer or a person involved in management. How do we pin-point an act of neglect in the management to a certain person in each and every case? Is there going to be a process of witch-hunting whenever that happens? The comments on section 367 are equally relevant here. (Please see Part 2, 2.3, Example B on p. 9)*

*All the four above examples exhibit a marked contrast to our existing common law principle which presumes a person is innocent until proven guilty. This right is further strengthened in statute by **Article 11 in the Human Rights Ordinance** which provides that "everyone charged with a criminal offence shall have the right to be presumed innocent until proved guilty according to law."*

*Therefore, any presumption of guilt, or fault is a violation of our human rights under the existing legal system. The presumption by law of a guilty intent or the presumption of a fault in an act which may be perfectly innocent is merely attempting to violate this right through the backdoor. We do not want to see that right breached for any **pretext of administrative necessity or convenience** in any circumstances, whether political or otherwise, least of all, commercial.*

- **Example A**

Sections 179, 180

In section 179(1), "misconduct" is defined as (a) a contravention of any of the relevant provisions; (b) a contravention of any of the terms and conditions of a licence; or (c) an act or omission relating to the carrying on of any regulated activity which, **in the opinion of the Commission**, is or is likely to be prejudicial to the interest of the investing public or to the public interest, and "guilty of misconduct" shall be construed accordingly.

*If a person has not contravened any of the provisions of law and any terms and conditions of a licence, he should not be guilty of anything. Here, under subsection (1) (c) he can be guilty of misconduct under public interest, if that is the opinion of the Commission.*

*The Commission, being the executive arm of the government, is already the investigator as well as prosecutor. In its opinion alone, if a person is not guilty of anything in law, he can be guilty of misconduct, so it is jury as well. In the sections that follow, it performs the part of a judge to pass penalty. Do we not have everything in one authority, **from prosecution to jury to judge?***

The Commission, not being a real person, cannot form an opinion by itself. Is there any means to know how the opinion of the Commission is formed? At what level are the people responsible for it and is there any mechanism for its formation? On what basis or principles is such an opinion formed? *All these principles and details should be made known to the public so we have some **transparency** in the Commission.*

Public interest and interest of the investing public may not always be the same. A substantial inflation in stock prices may be beneficial to the investing public but prejudicial to public interest. *Similarly, interest of one section of the investing public may be a disinterest in another section. Who is to be the judge of these and form an opinion?*

- **Example B**

Section 180(1) provides that if the Commission is of the opinion that a person is not a fit and proper person to be or to remain licensed or to be or remain a responsible officer, or a person in the management of a licensed corporation, the Commission may exercise the following powers:

(i) revoke or suspend his licence; (ii) revoke or suspend his approval as a responsible officer; (iii) publicly or privately reprimand him; (iv) prohibit the person from applying for a licensed or to be a responsible officer for such period as the Commission may specify.

Under subsection (2), the **Commission may also order** the person to pay a **pecuniary penalty of up to \$10 Million** or 3 times the amount of profit obtained.

*Thus the Commission (whoever acting on its behalf) may form its own opinion and pass penalty including the revocation of licence / approval and a heavy fine. This is another example where the Commission plays the role of prosecution, jury and judge at the same time, with a wide range of administrative sanctions in addition to its power to make a heavy fine without any ceiling.*

Under subsection (7), the Commission shall publish guidelines **to indicate** the manner in which to perform these functions. *This means that the guidelines only serve as **indications** to the manner of acting and nothing more. They shall not be binding on the Commission in law and any departure from them shall not make the Commission answerable. Subsection (8) seems to follow this line of thought to state that such guidelines are **not** subsidiary legislation.*

#### Section 182(1)

This section provides that the Commission shall not exercise its power to revoke a licence or order a fine etc., without first giving the person an opportunity of being heard.

*When the Commission plays the parts of prosecution, jury and judge at the same time, there is definitely a **conflict of interests**. How can it "hear" a case impartially as a jury and judge when it acts as the informant as well as prosecutor at the same time? This conflict in the **duplicity of roles** goes to the root of the matter and does not inspire confidence that justice will be done.*

- **Example C**

#### Section 193

Subsection 193(1)(e) empowers the Commission to impose a prohibition if it appears to the Commission that it is desirable to do so in the interest of the investing public or in the public interest.

*Issues such as: "how the interest of the investing public or public interest is to be assessed" can only become clearer if they are framed within certain principles, without which there is no reliable anticipation as to how they will be interpreted by the Commission.*

*The comments on the previous examples are equally applicable here. The Commission, in passing a prohibition, is playing all the roles from informant to "judge". How can justice be seen to be done in such circumstances? Even an application for review is of no avail. Subsection 193(2) provides that prohibition on a licence of a corporation may be imposed, **notwithstanding an application for review**.*

## 2.9 Where rules, regulations, conditions and discretion are not spelt out

It is obvious that no comments on the contents of the rules and regulations can be made when they are non-existent at present. However, one comment can be certain, in that it is a highly undesirable situation to pass a law of such importance. In our legal system the enactment of a statute law would aim to be fair, clear and unambiguous. Here, under this category, we are given a **blank subsidiary legislation**. *We do not know whether they will be clear or unambiguous but in its present form, one cannot honestly say that the provisions of the Bill are fair. One is looking at a void into the unknown.*

### • Example A

#### Section 120(1)

The Commission may in its absolute discretion grant to the applicant a provisional licence ...

#### Section 120(6)

The Commission may, having regard to the interests of the investing public and in its absolute discretion, revoke a provisional licence granted under subsection (1).

#### Section 121(4)

A licence (temporary) granted ... shall be subject to such reasonable conditions as the Commission may impose, ... who may amend or revoke any such condition or impose new conditions.

#### Section 129(4)

A modification or waiver granted... shall be subject to such reasonable conditions as the Commission may impose...

*In these examples, we do not know how the **absolute discretion** of the Commission is formulated and in the case of reasonable conditions we do not know the tests of "reasonableness". One cannot even enquire into a discretion if it is "**absolute**", not to mention challenging it. Is there sufficient transparency? Is this fairness?*

### • Example B

There are a multitude of areas where the Commission is empowered to make rules and regulations. The breach of these rules and regulations may result in serious criminal punishments for the licensed corporation as well as its officers. E.g.

Section 139(9): "The financial resources rules may provide that where a licensed corporation fails to comply with any specified provision of the financial resources rules that applies to it he licensed corporation and each of its executive officers commit an offence" punishable by a fine of \$500,000 and imprisonment for 2 years.

Section 141(5): "Rules made under this section may provide that where a person fails to comply with any specified provision of the rules that applies to him, the person and, in the case of an intermediary or an associated entity of an intermediary which is a corporation, **each of its executive officers** commit an offence" which is punishable by a fine of \$200,000 and imprisonment for 2 years.

*It is therefore obvious that a breach of any of these rules, though non-existent at this point of time, may result in terms of imprisonment which is no less serious than a breach of some of the provisions of the Bill itself. Is it not appropriate therefore, that one should have an opportunity to look at these rules before one can really form a more meaningful and complete opinion on the Bill itself?*

*The right of passing these rules, a host of subsidiary legislation, is left **unattended by the legislature** at the moment with the Bill in this form. This is not a small gap that can be overlooked and subsequently remedied but a whole city-gate wide open, through which four-horse chariots can drive. If the legislature is prepared to surrender its power of law-making to this extent, leaving a blank cheque with full signature, on which this Bill can be steered and implemented, we do not know if this is the beginning of a trend when the **administrative will merge with the legislative.***

The following are examples where the Commission may make rules:

- Section 138:

The Commission may, after consultation with the Financial Secretary, make rules requiring licensed corporation to maintain such financial resources as are specified in the rules.

- Section 141:

The Commission may make rules requiring intermediaries and their associated entities to treat and deal with securities received or held by them as client assets of the intermediaries in such manner as is specified in the rules.

- Section 142:

The Commission may make rules requiring licensed corporation and their associated entities to treat and deal with client money in such manner as is specified in the rules.

- Section 144:

The Commission may make rules to provide for the keeping by intermediaries of such accounts and records as are specified in the rules provide for the period for which, and the location at which, the accounts and records are to be kept before they may be destroyed.

- Section 145:

The Commission may make rules to provide for the preparation by intermediaries of such contract notes, receipts, statements of account etc.

- Section 159:

The Commission may make rules requiring intermediaries and their representatives to comply with such practices and standards...

- Section 161:

The Commission may make rules prohibiting securities dealers from transacting... an option to sell to or purchase from them... any securities...

In the examples mentioned on this page and the last, **all** the rules provide for a fine and a term of **imprisonment** of at least **2 years** for breaching the same, and in the case of a licensed corporation (except section 159), the corporation itself and **each** of **its executive officers** commit an offence and all are liable.

*Therefore, it is not suggested that these rules can be taken with levity. The breach of them even by accident, neglect or in error may result in criminal proceedings being brought against the **corporation** as well as **each and every executive officer**. Here, we are looking at a term of **imprisonment**, a matter of committing a **criminal offence**, a real prospect of losing one's **liberty**. Can they be taken as a matter of course? **We cannot contemplate that such rules and provisions can be considered by the legislature as of no important consequences to the entire industry of securities intermediaries to the extent that these rules can be allowed to appear in any form that they may eventually appear.***

*There is a school of thought that until all these rules and regulations that are to be made under the Bill are spelt out on the table, the Bill itself cannot be said to be entirely complete for consideration. We are very much inclined to vouch for this.*

- **Example C**

#### Section 129

"The Commission may grant a modification or waiver in respect of any condition specified in section 117 ..."

"...modification or waiver granted .. shall be subject to such reasonable conditions as the Commission may impose, and the Commission may at any time,... amend such modification or waiver, or amend or revoke any such condition or impose new conditions."

(4)

"The Commission shall not grant a modification or waiver under(3) unless it is satisfied that to do so will not prejudice the interests of the investing public." (7)

*In the interest of **fairness**, we believe that all intermediaries should be treated in the same manner under the law. If any provision or rule is proved to be impracticable, it should be changed so that each application is treated fairly in the same open manner. If the Commission is empowered to grant modifications or waivers in respect of a whole range of activities and rules mentioned in subsection 129 (1)(f) and impose such "reasonable" conditions as it may think fit, one cannot be certain how the provisions and rules may be waived or modified and subject to what conditions. This situation will take us to a place of **unpredictability**, somewhere between a **rule of law** and a **rule by administrative means**.*

### Part 3: Specific Comments on Sections of the Bill

#### Section 22

Subsection (6) provides for a fine for contravening an unspecified time limit in producing books, accounts, records etc. to the Commission but it contains an "escape clause" of "**reasonable excuse**". This clause is **not** to be found in the rest of the sections in the Bill which requires a licensed corporation to meet time limits in its obligations.

It is also observed that there is no term of imprisonment for breaching the time limit in (6) *whereas in similar situations in a licensed corporation they all carry terms of imprisonment.*

*The exchange company plays a crucial and central part in the securities industry and is supervised by the same Commission and works under the same Ordinance. The exchange company is now part of a public listed entity with profitearning as one of its objectives, only that it has a heavier responsibility towards public interests.*

*Is it not right that directors and officers responsible for its functions have a more **onerous** duty to the public at large than an ordinary corporation and therefore should be subject to stricter scrutiny rather than having more laxity? Why is there the rationale that the exchange company is above the law applicable to the rest of the licensed corporations governed by the Commission? There is obviously a marked double standard.*

#### Section 23 Immunity

This section provides that no liability shall be incurred by a recognized exchange company or any person acting for it including any of its directors or members of committee in respect of anything done or omitted to be done with reasonable care and in good faith.

Subsection (3) provides that any failure by a recognized exchange company to comply with its rules in relation to a matter does not prevent the matter from being treated as done according to the rules unless it **substantially** affect the rights of a person entitled to their compliance.

*Thus, when the exchange company fails to comply with its rules, there will be no consequences unless a party is substantially aggrieved. It and its officers are immuned from liabilities provided they can show that were in good faith and exercised reasonable care in anything done or omitted to be done. The test is one of reasonable care, the usual common law approach. It is worthwhile to note that this approach is not followed in the case of directors of a licensed corporation in the rest of the Bill. Where is the principle of **fair play**? What is substantial and what is not, cast uncertainty in the interpretation of this subsection.*

## Section 39

Similar comments to a recognized clearing house as to the exchange company under section 22.

## Section 40

Similar comments to a recognized clearing house as to the exchange company under section 23.

## Section 64

Similar comments to a recognized exchange controller as to the exchange company under section 23.

## Section 80

Similar comments to a recognized investor compensation company as to the exchange company under section 23.

## Section 112(1)

The term "executive officer" is defined as a "responsible officer" in a licensed corporation. Is there any real necessity to described the same person in two different terms?

## Section 112(2)

It is unclear what is included or excluded by the term "clerical duties".

## Section 113

The penalty in subsection (2)(a) is excessive as compared with that under section 19, particularly so, if one reads through Sections 133, 181(4), 185(1) which will lead to section 113. (Comments under 2.1, Example C are relevant)

## Sections 114(1), 119(1), 123(2)

A person shall require to be a licensed representative under these sections, in order to take part in a regulated activity for a corporation. If he is also an executive officer, he will also need to be approved as a responsible officer. *Therefore, there seems to be duplicity in registration for the same person.*

## Section 123(2)(c)

This subsection has been commented on earlier in Specific comments. Subsection (3) provides for the same requirement for an exempt person. However, under **Schedule 10, Part 2, section 24**, a licensed bank shall be **regarded as having**

**complied with subsection 123(3).** Subsection 123(3)(b): "there is at all times at least one such executive officer in Hong Kong." needs a **continued compliance**. How is it logically possible for it to be complied with at one point of time, namely the commencement of Part V of the proposed Ordinance?

Section 125(2)

"In considering an application referred to in subsection (1), the Commission may have regard to **any information in its possession** whether provided by the applicant or not."

*It is submitted that we need more transparency in knowing how the Commission shall arrive at a certain decision. If the information in its possession is **adverse** to the applicant, it is only fair that its contents and source are to be disclosed to the applicant so that a response can be heard. Any information hiding behind **anonymity** should be **disregarded** and not be taken into account in the Commission consideration of an application.*

Section 126(2)(a)(iv)

This subsection provides that the Commission may, in considering whether a person is a fit and proper person, take into account a decision made in respect of the person by any other authority or regulatory organization, whether in Hong Kong or elsewhere, which, in the Commission's opinion, perform a function similar to the functions of the Commission.

If that authority is elsewhere, we wish to know whether we have reciprocity in the law of that authority in accepting a decision of the Commission?

Section 126(2)(c):

"...whether the person has established **effective** internal control procedures and risk management systems to ensure his compliance with all applicable regulatory requirements..."

*Internal control procedures and risk management systems that can be seen are only words on paper. Their effectiveness can only be tested in motion or in a crisis. Platitude can be very reassuring but it may not work in a real-world situation. Any attempted assessment of a system on paper is only arbitrary and if the term "effective" cannot be quantified or measured, it will only be reduced to a matter of personal opinion. For the uncertainty that it carries, we suggest that the term "effective" be deleted.*

Section 128

Subsection (1) provides that a person shall not become a substantial shareholder of a licensed corporation unless he has been approved by the Commission.

Subsection (5) provides that approval shall be subject to such reasonable conditions as the Commission may impose upon the applicant, which can be amended revoked or added to. There is so much uncertainty as to what the conditions can be and what is considered to be reasonable.

*If an applicant satisfied the Commission as to the initial conditions but is unable to comply with the amended or new conditions, what shall be his position in respect of his shareholding and is there any redress for him?*

#### Section 129

This section has been commented on under paragraph 2.9, example C. *Alternatively, in the interest of fairness, we suggest* at the end of subsection (7) that "**or unfair to other intermediaries**" be added at the end of the sentence immediately after "the investing public" to make it read as follows:

"The Commission shall not grant a modification or waiver under subsection (3) unless it is satisfied that to do so will not prejudice the interests of the investing public **or unfair to other intermediaries.**"

#### Section 130

*We do not believe that any time limit on notifications to the Commission should be punished by imprisonment at all.* This is applicable from subsections (1) through (4). This section has been commented on under paragraph 2.1, example B. Subsection (5) has been commented on fully under paragraph 2.4.

#### Section 133

This section has been commented on under paragraph 2.1, example C.

#### Section 139

This section has been commented on under paragraph 2.2, example B.

## Section 140

*We believe that where a licensed corporation fails to comply with a condition imposed by the Commission on the licence, it should result in the suspension or revocation of the licence itself but not in a term of imprisonment.*

## Section 141

Under subsection (2)(e), The Commission may in the rules specify the circumstances in which securities to which the rules apply may, notwithstanding that they are subject to a lawful claim or lien, be dealt with by intermediaries or their associated entities.

*This is an undesirable situation. If the securities are subject to a lawful claim or lien, and the intermediaries have to comply with rules of the Commission to deal with them in a manner contrary to their lawful ownership, the intermediaries would be in fact breaching their lawful or contractual obligations.*

## Sections 144, 145

*The intermediary or the person directly responsible for the failure should be liable, but not each of the executive officers. This question of strict criminal liability on officers of a corporation has been commented on in paragraph 2.2.*

--to be continued--

For and on behalf of  
Hong Kong Stockbrokers Association

30 June 2000