LETTERHEAD OF HONG KONG STOCKBROKERS ASSOCIATION LTD.

3rd August 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

We refer to our letter of 30 June, 2000, and the initial submission on the Securities and Futures Bill published in April, in which we indicated that we would make further submissions.

Our Second Submission has hence been compiled and sent to the Financial Services Bureau and the Securities & Futures Commission. Therefore, I attach a copy of the 2nd submission on the Bill as before, 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 second 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.

3 August 2000

Section 113

This section has been commented on under paragraph 2.6, example B, on p.12 and p.21 of the first submission.

It is suggested that the fine of 10,000,000 and imprisonment for 7 years for the offence is grossly excessive. Section 48, subsection (2) of the existing Securities Ordinance on the carrying on of an unlicensed business in dealing in securities provides as follows:

"Any person who knowingly acts in contravention of subsection (1) or (1A) shall be guilty of an offence and shall be liable on conviction to a fine of $50,000 and, in the case of a continuing offence, to a further fine of $500 for each day during which the offence continues."

It can be seen that the existing version of the offence under section 113 carries no punishment with imprisonment and the fine is $50,000. There is no particular reason that the a breach in the licensing of this business should be earmarked as an indictable offence attracting a penalty of ***imprisonment for 7 years*** *and the fine be* ***increased by 200 times*** *from today's tariff.*

Section 115

Subsection (6) provides that a licence granted under the section shall be subject to such *reasonable conditions* as the Commission may impose, and the Commission *may at any time,* by notice in writing served on the licensed corporation concerned, *amend or revoke* any such condition or *impose new* conditions.

It is observed that in this subsection, there is no indication as to what are the matters that the Commission has in mind upon which conditions have to be imposed, nor under what circumstances that conditions would have to be amended or added on *at any time. Since the validity of the licence depends on those conditions, it should not be a matter to be left entirely unascertainable and the process of its formulation opaque.* If this power of imposition of conditions is left as it is, it is suggested that there should be an avenue to appeal so that it can be independently assessed whether they are reasonable or not on the licensed corporation. And it should not be allowed to take almost instantaneous effect as provided in subsection (7) pending any application to appeal.

If one would compare this with the proviso under section 118 (7) regarding exempt persons, one can see that they are not receiving the same treatment. Subsection (7) of section 118 provides that the Commission shall not exercise its power under that section without consulting the Monetary Authority in advance.

Section 120

Subsection (7) provides that if a provisional licence is revoked or deemed to be revoked, the person shall return the licence to the Commission within 2 business days, failing which an offence is committed punishable by a fine of $200,000 and imprisonment for 6 months.

It is suggested that if the person whose licence is revoked is involved in any activity which is inconsistent with his status and against the law, let him be punished according to what he has committed. One cannot impute that the failure to return a licence in 2 days is an act with criminal intent. It is absolutely unnecessary to punish such an omission with imprisonment. A fine of say $5,000 would be a sufficient deterrent. We suggest subsection (8) be amended to this effect.

Comments made in paragraph 2.5 on p.10 of the first submission are relevant.

Section 122

This section provides for the situation where a licensed representative ceases to act for his principal. The principal shall notify the Commission of the cessation in 2 business days, and the person shall return his licence to the Commission within the same period.

It is suggested that the penalty of $200,000 and imprisonment for 6 months and a daily fine of $10,000 are uncalled-for and excessive. Comments made on the previous page under section 120 are similarly applicable.

Section 123

This section has been commented on under paragraph 2.2, example A, on p.6 of the first submission. It is suggested that a fine of $1,000,000 is by far too excessive and imprisonment uncalled-for. It should only result in a small fine, a warning or an endorsement on the licence of the corporation.

It is further observed that in this modern age, control by an executive director with his presence in Hong Kong can always be temporarily replaced by other means such as e-mails, on-line conferences or on-line computers with suitable softwares. If the Commission needs someone responsible to be able to respond in matters of urgency, it can provide that such executives should be able to respond by any means within 24 hours if they are away from Hong Kong.

Section 126(1)

"In considering whether a person is a fit and proper person for the purpose of any provision of this Ordinance, the Commission shall, in addition to any other matter that it may think relevant, but subject to section 129, have regard to —

(a) the financial status or solvency;
(b) the educational or other qualifications or experience having regard to the nature of the functions which, if the application is allowed, the person will perform;
(c) the ability to carry on the regulated activity competently, honestly and fairly; and
(d) the reputation, character, reliability and financial integrity,

of ..the person himself;"

In considering whether an applicant is fit and proper, it is suggested that the public would expect that the Commission to apply the same tests which are common to all applicants and the criteria upon which a decision is made are fair, objective (as oppose to subjective), predictable and transparent.

In subsection (1) above, the phrase "*in addition to any other matter that it may think relevant*" is at issue. It's true interpretation seems to suggest that anything may be relevant, *such as race, sex, religious belief, social circles, political affiliation, etc;* and the matter rests with the Commission entirely. *We consider that unless all these considerations are expressed in the law, there is little transparency in the process of licensing and a lot of uncertainty as to who may or may not qualify.*

Subsection (1)(b) should set out the exact minimum educational or other qualifications or period of experience expected by the Commission in each class of licence, so that it is fair and transparent for all to see.

Under subsection (1)*(c)*, the ability to carry on the regulated activity competently can only be assessed by reference to the educational and other qualifications mentioned in (1)(b) and does not require to be repeated unless it is to be separately examined by standardised examinations. *Whether an applicant will be honest and fair in the conduct of a business in future can never be foretold or determined objectively and any opinion on that can only be subjective and arbitrary, bearing no direct reference as to what may actually happen.*

Subsection (d) mentioned about reputation, character and reliability etc. which are concepts and values without any particular standards and any information on those conceptual qualities are more likely to be hearsay unless the source is known. It would for example, be more tangible if it is expressly provided that an applicant should provide two bankers' references on his previous commercial activities for, say, at least two years' duration prior to his application.

Section 53 of the Securities Ordinance, which deals with the refusal of registration of an applicant is much more specific. Matters *such as personal information, mental disorder, undischarged bankrupt, financial resources etc. are all specific matters which can be proved or disproved. We suggest this spirit be followed when deciding whether a person is fit and proper in the Ordinance.*

Section 141

Subsection (1) provides that the Commission may make rules requiring intermediaries and their associated entitles to treat and deal with securities received or held by them as client assets of the intermediaries and in such manner as specified in the rules.

Subsection (2)(h) states: "..require a person who becomes aware that he does not comply with any specified provision of the rules to notify the Commission of that fact and of any further information within the time specified in the rules;"

Subsection (5) provides that where a person fails to comply with any specified provisions of the rules that applies to him, the person and in the case of a licensed corporation or an associated entity, **each of its executive officers** commit an offence is liable to a fine and imprisonment for 2 years.

The spirit of our existing common law system is that one is allowed the freedom not to incriminate oneself. The breach of any rules is already an offence under subsection (5) and failing to report a breach within the time specified is another offence under subsection (2)(h). The arrangement of these provisions is exactly ***built on self-incrimination*** *and a direct contravention of the spirit of our existing legal system. We suggest that subsection (2)(h) and provisions of similar effects in the Bill should be removed.*

The question on strict criminal liability on executive officers of a corporation under paragraph 2.2 of the first submission is also relevant and the comments therein are not repeated here.

Subsection (2)(e) has been covered on page 24 of the first submission.

Section 142(2)

Section 142 provides that the Commission may make rules requiring licensed corporations and their associated entities to treat and deal with client money in such manner as is specified in the rules.

Subsection (2)(1) states: "...require a person who becomes aware that he does not comply with any specified provision of the rules to notify the Commission of that fact and of any further information, within the time specified in the rules;"

Subsection (5) provides that where a person fails to comply with any specified provisions of the rules that applies to him, the person and in the case of a licensed corporation or an associated entity, **each of its executive officers** commit an offence is liable to a fine and imprisonment for 2 years.

Section 84 of the existing Securities Ordinance provides for the keeping of clients' money in trusts accounts and subsection (7) states: "A person who (a) without reasonable excuse, contravenes any provision of this section shall be guilty of an offence and shall be liable on conviction to a fine of $10,000; or (b) with intent to defraud, ...to a fine of $50,000 and to imprisonment for 5 years."

On comparison with the existing law, one can notice that in the Securities Ordinance, the licensed person is given the benefit of a "reasonable excuse", whereas in the Bill, any contravention is strict and there is no place for any excuse no matter how reasonable and compelling. It is noted that existing contravention under section 84(7)(a) carries no term of imprisonment whereas in the Bill it is 2 years.

It is suggested that the spirit of the existing law be allowed to continue that ***any contravention which does not touch upon defraud should not attract punishment by imprisonment****. The fine would be appropriate if raised to, say,*

$25,000. Fines in the region of $100,000 to $200,000 would be entirely out of proportions for offences of a technical nature without any element of criminal intent to defraud.

The comments on self-incrimination under section 141 above are equally applicable here and not repeated. The question on strict criminal liability on executive officers of a corporation under paragraph 2.2 (p.6) of the first submission is applicable and the comments therein are not repeated here.

Section 146, 147

These sections provide that a licensed corporation shall commit an offence if it fails to give notice to the Commission within the time limits specified regarding the appointment, removal or replacement of auditors of the corporation, punishable by a fine of $200,000 and imprisonment for 1 year.

Section 87B of the existing Securities Ordinance on notification of change of auditors provides for a fine of $5,000 only for any contravention and there is no term of imprisonment imposed.

On the face of it, it seems that a licensed corporation should not worry itself too much about imprisonment, being a legal and not a real person. However, if one reads into section 367 (3) on the liabilities of officers of a corporation, one would not be so sure.

Section 367(3) states: "...where commission of an offence under this Ordinance (Bill) by a corporation is proved to have been ... attributable to any neglect on the part of, any officer of the corporation, or any person who was purporting to act in such capacity, that person, as well as the corporation, is guilty of the offence and is liable to be proceeded against and punished accordingly."

It is evident that if section 146 or section 147 is breached by reason of neglect of any officer of the corporation, which is more likely to be so rather than by intention, the corporation cannot be physically imprisoned, but an officer can, under section 367(3). Comments on the same section under paragraph 2.3, example B, on page 9 of the first submission regarding the general issue of criminal vicarious liability are also relevant here and not repeated. It is suggested that ***matters*** *of this nature,* ***not on a question of fraud, should not carry any provisions of imprisonment at all as they are in the existing law.***

Section 148

It provides for the notification to the Commission regarding the date on which the corporation's financial year ends, failure of which is an offence punishable by a fine and imprisonment for 4 months.

It is suggested that no term of imprisonment is necessary for this section. Comments under section 146, 147 above are applicable. So are the comments under paragraph 2.1, example D, on page 6 of the first submission.

Section 149

This has been touched upon under paragraph 2.2, example C, of the first submission (p.7). However, we would wish to add the following:

It is noted that under subsection (4), the Commission **may** extend the period within which the financial statements and other documents and the auditor's report are required to be submitted, **if** the Commission is satisfied that there are special reasons for granting the extension. *It seems to be a life-saving exit in a desperate situation but in reality, this subsection is more likely to be a virtual mirage to be turned "on" or "off" on criteria which cannot be controlled by a licensed person.*

If the non-compliance is due to an unavoidable over-workload of the auditor, which is rather common, would this be considered to be under the category of special reasons by the Commission? If the difficulties for meeting this provision are not anticipated until a week or two before the deadline, is it possible to expect the Commission to make a ruling in time on the application for extension? If the application is not responded in time or is rejected by the Commission, one would have committed an offence anyway on reaching the deadline and no amount of good faith on the applicant could alleviate the situation and exonerate officers of a corporation from criminal liability. ***It is suggested that criminal liability with terms of imprisonment is unjust, unnecessary and undesirable in this situation.***

Section 152(3)

Subsection (3) provides that if the Commission is of the opinion that the whole or any part of the costs and expenses of an auditor appointed by it under subsection (1) should be borne by any person or persons, being the licensed corporation whose accounts are being examined, the Commission may direct the person or persons to pay a specified amount, being the whole or a part of the costs and expenses, within the specified time and in the specified manner.

It is not clear how the opinion of the Commission is to be formed on the question of payment of costs and expenses and under what circumstances is a person liable for such costs. It is suggested that these circumstances should be expressly spelt out so that the Commission would have to exercise its discretion carefully and weigh the possibility of paying such costs itself if audit results do not show any adverse situations. If there is no better transparency in the process, this ***administrative power to order payment*** *would become a threatening punishment in the form of an unspecified fine in disguise.*

Section 153(1)

This section provides that the Commission may appoint an auditor to examine and audit either generally or in respect of any particular matter, the accounts and records of the licensed corporation and its associated entity in the event of an application in writing by a person who alleges that a licensed corporation or its associated entity has failed —

"(a) to account to the person for any client assets held on behalf of the person by the licensed corporation or the associated entity (as the case may be); or

(b) to act in accordance with instructions given by the person to the licensed corporation or the associated entity (as the case may be), and -

(i) has failed to account to the person for any profit that may have been secured or increased by the person had the instructions been followed; or

(ii) has failed to compensate the person for any loss that may have been avoided or reduced by the person had the instructions been followed,"

Subsection 153 (1)(a) is on similar line to the existing section 91(1) of the Securities Ordinance which reads; "On receipt of an application in writing from a person who alleges that a dealer has failed to account to him in respect of any money or securities held or received by that dealer for him or on his behalf, the Commission may, after first giving the dealer an opportunity to give an explanation of the failure, appoint in writing an auditor to examine, audit, and report, either generally or in relation to any particular matter, on the books, accounts, and records of, and securities held by, that deader."

There is little cause for objection to the existing Section 91 since it deals with client's money or securities held in trust. However, the concept behind subsection 153(1)(b) is entirely another matter. It deals with client instructions without any qualifications and could therefore, for all purposes and intent, be interpreted in a court of law to include market instructions.

Paragraph (1)(b) is to be objected to for its presumptions which, if put in practice, may prove unworkable and the effect of it will place the intermediaries into a most vulnerable position. The fault lies in the presumption that "instructions", including market instructions, can be taken literally to the letter and carried out accordingly to the satisfaction of a client. In a real-world market, this is not always the case. To illustrate, consider the following "instructions":

(a) Sell "X" if its price peaks in the afternoon.
(b) Stop loss if "X" falls more than 5% of yesterday's closing.
(c) Sell "X" at close of market, generally known as "m.o.c." (market on close)
(d) Buy "X" at "m.o.c."
(e) Buy at market price.
(f) Buy at whatever price at the time.

In situation (a), no broker can know if the price of a stock has actually peaked until the market has closed. Anyway, if the price indeed has peaked as the broker has judged, he can only sell it on a downturn and the price cannot be the best price.

In situation (b) the "stop loss" instructions can only be taken when the price has fallen through the 5% mark, but by the time the order is executed, the price could have fallen by 10%. A dissatisfied client would definitely, in good faith, claim that the broker has not followed his instructions.

In situations (c) and (d), it is understood that the market closes at 4:00 p.m. Taken literally, the order has to be executed within the 59th minute. However, one would run the risk of the transaction not being completed because of the lack of time

and confusion at the close and one would have a dissatisfied client. If, in order to be safe, a broker executes the order say 5 minutes before the close, at 3.55, prices might change dramatically at the last minute and one would have a dissatisfied client as well, depending on which way the market goes in later sessions.

In situation (e), a client would have noted the price of the stock at the time when the instructions were given. However, by the time the instructions were reduced into writing by his broker and to be keyed in for execution (at the end of a queue in a busy day), the price would have changed, sometimes by a remarkable amount. A client who feels aggrieved genuinely would complain in good faith that his instructions had not been followed.

Situation (f) is an extension of (e). A client might hear a rumour and notice a stock picking up in price rather steadily and gave instructions to buy at any price at the market, contemplating that prices might break away by 2% at the most on the day. However, if the price of the stock moved rapidly and repeated orders to buy were rendered redundant in a matter of seconds and had to be withdrawn before the issue of a new order and the price went up by 10% in a matter of minutes, a responsible broker would wish to check his instructions again before carrying them out. But if the price continued to shoot upwards while he is trying to contact his client, he would be accused of not following client's instructions. If a broker followed his instructions literally and executed the order after the price had gone up by 20% but then the price fell back to its previous level, a client would complain that in such a volatile situation, a responsible broker should have checked before execution. Either way, the broker was apparently at fault, and may be complained against, by a client in good faith.

The crux of the matter is, instructions are given in a set of circumstances known to a client. If circumstances changed dramatically, instructions can become obsolete and cannot be followed. If this is a statutory cause for complain leading to the Commission requiring an audit on the intermediary ***generally,*** *it would become a nuisance to the securities intermediaries and therefore would be taken advantage of by clients trying to settle a hard bargain against a broker. This tactic would further become a "no-lose" situation for a client to complain since subsection (5) states categorically:*

"A person shall not incur any liability, whether arising in contract, tort, defamation, equity or otherwise, in respect of anything done, or omitted to be done, by him in good faith in making an application under subsection (1)."

It is suggested that if a client feels aggrieved as a result of his broker's action or omission, it should be a matter for civil action or investigation by the Commission and not be resolved by the appointment of an auditor, which process tend to be cumbersome, time-consuming and not cost effective. Definitely, it is not a case for auditing ***generally*** *since the exercise is to determine the facts of one particular complain and nothing more.* ***We suggest that paragraphs 153(1)(b) and 153(5) be deleted altogether.*** *The matter in 153(1)(b) is not a proper subject to be tied up with that contained in 153(1)(a).*

Section 153(7)

This subsection provides for costs and expenses in respect of an auditor appointed under the section and comments on section 152(3) (p.4) are equally applicable here.

Section 155

Subsection (3) states that:

"A person who —

(a) without reasonable excuse, fails to comply with any requirement imposed on him (including the requirement to answer any question put to him) under this section ... or

(b) in purported compliance with a requirement imposed on him (including the requirement to answer any question put to him) under this section .... produces any accounts and records or gives an answer which he knows to be false or misleading in a *material* particular, or recklessly produces any accounts and records or gives an answer which is false or misleading in a *material* particular, .."

shall commit an offence punishable by a fine of $1,000,000 and imprisonment for 2 years.

It has been our common law right to remain silent when being accused and one is not forced to answer anything to incriminate oneself. The Basic Law provides that this right shall be maintained. Article 8 of the Basic Law states:

"The laws previously in force in Hong Kong, that is, the common law, rules of equity, ordinances, subordinate legislation and customary law shall be maintained, except for any that contravene this Law, and subject to any amendment by the legislature of the Hong Kong Special Administrative Region."

Article 39 of the Basic Law states (inter alia):

"The rights and freedoms enjoyed by Hong Kong residents shall not be restricted unless as prescribed by law."

It is therefore clear that the proviso in 155(3)(a) contravenes one of our basic rights in common law as provided by the Basic Law and the matter goes to the root of our freedom, to issues of criminal justice, which are much further and wider than the ambit of the Bill itself. ***We vouch for the deletion of paragraph (a) under subsection 155(3).***

For the same reason paragraph, (b) in subsection 155(3) is equally objectionable to the extent that one is obliged to comply with the requirement of giving an answer. It is the spirit of our law that one commits no criminal offence for anything one says in private except in specific cases such as statements made in public which constitute criminal libel in the law of defamation or statements made under oath in a court of law which amount to perjury. We do not suggest that ***an offence equivalent to perjury*** *in nature, with such heavy penalties,* ***be delegated to be***

determined by an undefined agent (under subsection (1)(g)), in an unknown process of questioning; and removed from our courts of law to places unascertained, *where questions might be asked of a licensed person.*

For reasons as explained, we suggest that the parts which relate to verbal questions and answers be deleted entirely from paragraph (b) in subsection 155(3).

Section 156

Subsection (3) has been commented on in paragraph 2.7, example B, on p.13 in the first submission.

The presumption of guilty intent contained in the existing section 96(2) of the Securities Ordinance seemed to have modelled from the amendments of the Companies Ordinance passed in 1972. However, with the introduction of the Human Rights Ordinance in 1992, it is suggested that presumption of this nature is no longer compatible with our existing Human Rights.

Section 157

This section has been commented on pp. 6, 7 in the first submission. It is worth mentioning at this stage that the particulars referred to in subsection (1)(b) as being prescribed by rules to be made by the Commission are not yet available for consultation and one therefore has no knowledge what might be required.

We would wish to further add here that under subsection (5), non-compliance with the provisions of this section with intent to defraud shall be punishable with a fine of $1,000,000 and imprisonment for 7 years. It follows that cases without any implication of defraud shall be covered by subsection (4).

It is suggested that since subsection (4) shall cover all cases ***not related to fraud*** *and which are possibly caused by a slip in the office routine or an oversight in the management, penalties by way of imprisonment is totally uncalled-for.* ***Making the offence under subsection (4) indictable is quite unnecessary.***

Subsection (6) has been previously discussed on p. 7 of the first submission. However, we would wish to add *that its spirit is against the notion that one should not be compelled by law to incriminate oneself. Subsection (6) requires giving notification to the Commission of any non-compliance to the section but provides for no respite for the offence committed*. Subsection (7) provides that failure to comply with subsection (6) shall be an offence punishable by imprisonment for 4 months. *This is an apparent breach of our existing rights under common law and our Human Rights. It is suggested that for reasons mentioned above,* ***subsections (6) and (7) should be deleted.***

Section 159

Subsection (3) states: "Rules made under this section may provide that any client contract entered into by an intermediary with its client otherwise than in compliance with any specified provisions of the rules that apply to it or its representative is, notwithstanding anything in the contract, unenforceable at the option of the client."

In view that the rules referred to are not available for comments, one does not know what the contents of these specified provisions are. However, if they contain a host of minor details which are of no material importance, *not affecting the essence of the contract,* ***this will enable a client to avoid a contract merely on a technicality created by this provision.*** *Thus****, fairness*** *in respect of the contract* ***is not balanced*** *between the intermediary and its client. It is suggested that this subsection be held in abeyance until the rules are published to support a more meaningful consultation.*

Section 161

This section provides that the Commission may make rules prohibiting securities dealers dealing in security options. Subsection (2) provides that the securities dealer and each of its executive officers shall be liable for a breach of these rules, an offence punishable by a fine of $200,000 and imprisonment for 2 years.

The issue of attaching criminal liability to a breach of the rules to be made by the Commission is commented on under paragraph 2.9 in the first submission and not repeated here. It is suggested that the offence should be limited to a fine of say $5,000 and should not classified as indictable.

Section 162

Subsection (1) provides that a licensed person shall not make unsolicited calls and during or as a result of which, trade or offer to trade in securities, futures etc. Subsection (4) provides that contravening subsection (1) is an offence punishable by a fine of $200,000 and imprisonment for 2 years.

Without any element of deception or intent to defraud, it is suggested that the offence should be limited to a fine and it is unnecessary to make it indictable. The offence should be limited to the person who defaults and not extended to the licensed person unless it is committed with his knowledge or consent etc.

Subsection (5) provides that if the person who received the unsolicited call subsequently entered into an agreement, he can rescind the same within 28 days after the date when he becomes aware of the contravention. *It is suggested that in such circumstances, 5 business days (equivalent to a week) would be ample time for the person to decide whether it is in his favour to rescind the trading. 28 days would just allow him to take advantage of 4 weeks of market development to make a profit if there is profit to be made and avoid a loss if it is subsequently not in his favour. We believe that the law only intends to be fair to a party aggrieved in this respect and not to guarantee an opportunity for him to make a profit out of somebody's contravention.*

The effect of subsection (1) seems to suggest that once an unsolicited call is made, its effect should last forever. *It is suggested that a time limit should be set to cut off its effect and 28 days would be sufficient.*

Section 163

Subsection (1) prohibits a licensed intermediary or a representative to represent that his abilities or qualifications have been endorsed by the Government or the Commission. *It is suggested that only the person who defaults should be liable for this offence unless it is proved that it is committed with the knowledge or consent of his principal. We suggest that the word "**knowingly**" be inserted in the second line of subsection (1) immediately before the word "permit" so that the offence is confined to parties with an intent to breach it.*

Section 166

This section has been commented on generally under p.3 of the first submission. It is suggested that the power and authority of the person authorised should be limited to specific cases under investigation and not for supervision in general.

This section seemed to have modelled with additions, from section 127 of the Securities Ordinance, which provides for an investigation by an inspector. Subsection (6) of that section provides that any person who without reasonable excuse contravenes any of the provisions shall be guilty of an offence punishable by a fine of $5,000. Subsection 166(13), however, provides that a person failing to comply with a requirement imposed on him by an authorised person under this section shall commit an offence punishable by a fine of $200,000 and imprisonment for 1 year.

*It is suggested that this penalty is **excessive** in that the fine has been increased **40 times** from the existing $5,000, plus an imprisonment for 1 year. The provisos in subsections (14) and (15) of section 166 further support this argument.*

Subsections (14) an (15) provide for the non-compliance of requirements as in subsection (13) but under different circumstances. Subsection (14) concerns purported compliance which is known to be false or misleading. Subsection (15) concerns non-compliance with intent to defraud. Both subsections carry heavier penalties than those prescribed under subsection (13). *It is clear that both subsections (14) and (15) cover cases of non-compliance with criminal intent. It therefore follows that subsection (13) is only intended for instances where there are no such intent. Hence it can be seen that the penalty prescribed therein is excessive.*

Section 169

Subsection 169(1) provides: "The person under investigation or a person whom the investigator has reasonable cause to believe or **suspect** has in his possession any record or document which contains, or which is likely to contain, information relevant to an investigation under section 168, or whom the investigator has reasonable cause

to believe or **suspect otherwise** has such information in his possession, shall" — (inter alia) produce any record or document specified..; an explanation or further particulars..; attend before the investigator at the time and place required..; and give to the investigator all assistance in connection with the investigation which he is reasonably able to give, including responding to any written question raised by the investigator.

The investigator has, under this section, very wide powers to investigate, examine a person under a statutory declaration and demand all his assistance in the course of an investigation. *It is suggested that in view of the powers conferred upon him, they should not be used in a "fishing expedition" and demand assistance from people who are unrelated to the subject matter of investigation. Therefore, these powers should be discretely used on persons whom he had sufficient reasons to believe to be so related. Mere suspicion is undesirable for such administrative powers to be exercised. We recommend that the words "suspect" and "or suspect otherwise" be deleted from subsection (1).*

Section 170, 171

Subsection 170 (2) provides that where a person is obliged to answer a question in an investigation, he may claim that the answer might tend to incriminate himself and the answer shall not be admissible in evidence against him in criminal proceedings other than those under section 171 or for perjury.

Section 171 provides for a number of offences under section 169, such as: failure to produce any record or document; failure to give an explanation; failure to attend before the investigator as required; failure to answer a question; failure to give all assistance; and failure to make a statutory declaration, all punishable by a fine of $200,000 and imprisonment for 1 year.

Under the existing section 127 of the Securities Ordinance, on the similar powers of an investigation by inspector, any person who without reasonable excuse contravenes any of the provision of the section shall be guilty of an offence and shall be liable on conviction to a fine of $5,000.

It is suggested that an increase of the fine to $20,000 would be more than sufficient and no term of imprisonment is necessary. This is considered particularly appropriate, in view of the fact that in cases where there is intent to mislead or to defraud, the offence is more heavily punished by a fine of $1,000,000 and imprisonment for 2 to 7 years.

Section 175

The phrase "in a legible form" appearing for a second time in line 2 under paragraph (a) seems to be an error.

Section 177

Subsection (4) provides that "where a person removes any record or document under this section, he shall as soon as reasonably practicable thereafter give a receipt for it..."

It is suggested that in the circumstances, it is not a matter of a "receipt" but an inventory detailing all the records or documents removed under the warrant, and it is suggested that such a list of inventory be provided at the same time on the premises on the removal of such records or documents.

Section 178

This section has been commented on under paragraph 2.7 of the first submission on p.14.

It is suggested that subsection (1) be amended to read as follows:
"A person commits an offence if he knowingly destroys, falsifies, conceals or otherwise disposes of, or causes or orders the destruction, falsification, concealment or disposal of, any record or document required to be produced under this Part."

This suggested amendment puts the element of intent in proper perspective in relation to the offence. An intent of guilt should not be presumed on the accused who is then required to disprove it in his defence.

Section 179

(1) In this Part, unless the context otherwise requires -
"misconduct", in relation to a person, means —

....

(c) an act or omission relating to the carrying on of any regulated activity for which a person is licensed or exempt 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.

It is suggested that the phrase "in the opinion of the Commission" be deleted. Similar provisions in Section 56 (5) of the Securities Ordinance has nothing to the effect that the determination of a misconduct lies solely in the opinion of the Commission.

Section 179 has been initially commented on in pp.14 and 15 of the first submission. *For reasons mentioned therein, it is suggested that neglect should not be a cause to make an officer of a corporation guilty vicariously for the misconduct committed by another person in the same corporation. We suggest that subsection (2) be either deleted or amended to exclude any element of neglect in the proviso.*

The phrase "a person involved in the management of the business" creates ***uncertainty*** *as to its interpretation. It is not clear, apart from the board of directors who would always be involved, how far and down to what level would a person be construed as involved in the management of the business.*

Section 180

The comments on this section previously made in pages 15 & 16 of the first submission are not repeated here.

For a licensed person to have his licence revoked or suspended, it is suggested that this should only occur when he has been found guilty of an offence or that he has breached a condition of his licence, which justifies a revocation or suspension. We do not suggest that these severe sanctions should rest solely and ***exclusively*** *on the* ***opinion*** *of the Commission that a certain person is not a fit and proper person to remain licensed. This is even more so when we consider that there is insufficient transparency in the process of finding whether a person is "fit and proper" under some of the various headings listed in section 126. Comments on page* ****3 **** *is referred.*

Subsection (2) provides that the Commission may separately or in addition to any power of revocation or suspension of licence, order the regulated person to pay (inter alia) a pecuniary penalty not exceeding $10,000,000. *It is suggested that the sanction of revocation or suspension of a licence is a penalty grave enough for discipline and an additional "fine" is unjustifiable, particularly one of such magnitude. If the person has committed a serious offence, he would have been punished according to that offence and there is no justification to penalise him twice either.*

The duplicity of roles played by the Commission in ordering a fine, previously mentioned, is not repeated here.

Subsection 180 (9) states:
"In this section —
"regulated person" means a person who is or at the relevant time was -

(a) a licensed person; or
(b) a responsible officer, **or** *a person involved in the management of the business,* of a licensed person; ..."

For a person to understand whether he is a "regulated person", *it is necessary to define "a person involved in the management of the business", without which definition, it is uncertain who or which class of people is being "regulated".* Section 179 (2) in respect of misconduct poses the same problem and has been commented on in page 14 of the first submission.

Section 181

Subsection 181 (1) provides for the revocation of a licence on the happening of certain events as listed (some seem to be related to bankruptcy of a person or winding

up of a corporation which pose no problem). Under paragraph (a), sub-paragraph (iv) needs attention, so is (v) under paragraph (b), in relation to a corporation. Both provide for revocation of licence on the following:

"the licensed person is convicted of an offence (other than an offence under any of the relevant provisions) in Hong Kong or elsewhere, which in the opinion of the Commission impugns the fitness and properness of the licensed person to remain licensed;"

*It would be clear and unambiguous if the offences or the nature of the offences or the gravity of the punishment of the offences, which would trigger-off a revocation of licence, are described. In its present form, one cannot even speculate into what offences may probably fall into this category which "**in the opinion of the Commission**" shall call for a revocation of licence.*

In passing, the word "properness" arouses some curiosity. In our limited knowledge, this word is seldom seen or referred to in the laws of Hong Kong and is, moreover, not found in ordinary dictionaries.

Regarding sub-paragraph (b)(iii):
"the licensed person enters into a compromise *or* scheme of arrangement with its creditor;", *it is not specified that this may be in relation to a winding-up procedure of a corporation. Because if it is not related to winding-up, an arrangement with creditors is in ordinary sense an entirely harmless event.*

Sub-paragraph (b) (vi) and (vii) state:

"(vi) *any* of the directors of the licensed person has been found by a court to be mentally incapacitated, or is detained in a mental hospital, under the Mental Health Ordinance (Cap. 136); or

(vii) *any* of the directors of the licensed person is convicted of an offence (other than an offence under any of the relevant provisions) in Hong Kong or elsewhere, which in the opinion of the Commission impugns the fitness and properness of the licensed person to remain licensed;"

It is suggested that the fact that one of the directors of a licensed corporation being found by a court to be mentally incapacitated should not result in the licence for the whole corporation to be revoked. The same applies to an offence committed by any one of the directors of the corporation in Hong Kong or elsewhere. The comments made on paragraph (a)(iv) above are equally applicable here. *A director's offence, whatever it may be, should only affect his own individual licence, and there is no link of culpability that the corporation should be vicariously liable and punished by a revocation of the corporation's licence for the personal offence of one of its directors.*

Subsection 181(4) provides that: "A licence shall be deemed to be suspended if —

(a) the licensed person fails to pay an annual fee to the Commission in accordance with section 133; or

(b) the licensed person fails to make an annual return to the Commission in accordance with section 133,

and subject to subsection (5), the suspension shall remain in force until such time as the Commission considers it appropriate that the licence should no longer be suspended and informs the licensed person to that effect by notice in writing."

This section, together with other related sections have been referred to in pages 5 and 12 of the first submission. It may well be an oversight of the corporation that an annual fee is not paid or an annual return not made in time. *However, it cannot be seen to be justifiable that this should result in an **automatic** and **immediate** suspension of a licence which would certainly cause an abrupt disruption to an on-going business, creating a multitude of unsolved problems and disputes among market participants as well as clients. It is believed that a warning to a fine or a late paying/filing fee would be sufficient for this purpose.*

The provisions of subsection (6) relating to the revocation or suspension of the licence for a responsible officer are similar to sub-paragraphs (1)(a)(iv) and (b)(v) above and similar comments would apply thereto.

Section 182

The duplicity of roles played by the Commission has been mentioned under subsection 182(1) in page 16 of the first submission.

Section 186(1)

"In reaching a decision under section 180(1) or (2), 181(1), (2) or (6) or 183(1), the Commission may have regard to any information or material in its possession which is relevant to the decision, regardless of how the information or material has come into its possession."

This seems to be a repetition of the phraseology used in section 125(2) plus an extension regarding the manner in which the Commission may come to be in possession of such information or material. *There is no objection to the Commission using information which is relevant and authentic but this information must not hide behind anonymity and be beyond challenge. In proving authenticity, it is believed that the Commission cannot avoid divulging the origin or source of the information in question. It is only **natural justice** that a person **accused should be able to test the authenticity** of any adverse information or material used against him otherwise it might be a decision on hearsay, rumours and slurs. It is suggested that this section should be amended to the effect that any information or material used by the Commission shall be disclosed to the person involved and subject to be challenged.*

Section 187(1)

This section provides for the situation where a licence is revoked or suspended, the Commission may order the person to transfer to his client records relating to client assets in such manner as specified, failing which an offence is committed, punishable by a fine and imprisonment for 2 years. (2)

*It is suggested that this provision should **not** be applied to a case under section 181 (4) where automatic suspension may deemed to be effective for the late paying of an annual fee or filing an annual return.*

Section 189

"(1) Subject to section 193, the Commission may be notice in writing —

(a) prohibit a licensed corporation from —

(i) entering into transactions of a specified description or other than of a specified circumstances or other than in specified circumstances, or entering into transactions to a specified extent or other than to a specified extent;

(ii) soliciting business from persons of a specified description or from persons other than a specified description;

(iii) carrying on business in a specified manner or other than in a specified manner;"

It is suggested that if a certain transaction or part of a transaction is objectionable to the Commission for whatever reason, it may invoke its power, subject to our comments to section 193, of imposing prohibition or requirement to that particular transaction *but certainly this power should not be so exercised as to restrict securities business in respect of a specified description of persons or business to be carried on in a specified manner. There is no indication as to what these "specified description" or "specified manner" will be. Would description of persons include race, colour, creed, political out-look, local, foreign, rich, poor etc.? These provisos need to be more specific to be seen to be fair, instead of being left as they are now.*

Section 192

"(1) Subject to section 193, the Commission may be notice in writing require a licensed corporation or *any other person* to transfer the *custody* of relevant property of a specified description (whether of the licensed corporation or the other person (as the case may be) to the Commission or to any person appointed in that behalf by the Commission."

It is not clear how this provision can be applied to "any other person", apart from the licensed corporation. In this section there is no definition of who "any other person" is going to be, and there seems to be no link between this "any other person" with the licensed corporation. Unless this problem is resolved, one cannot see how the Commission may extend its administrative sphere to any person not related to the licensed corporation in question.

The word "custody" in subsection (1) also causes some concern. Presumably, "relevant property" here would mean property as defined under section 188, which includes money, goods, choses in action and land, and easements, interest etc. arising out of the same.

So far as land itself is concerned, *custody is abstract and cannot be transferred. One can only transfer the custody of the title deeds of land, or if one*

wants to transfer ownership, one transfers the legal title by registration, but there is no transfer of custody of land as such.

As for choses in action, obligation, easements etc. there is no custody. *One can transfer the right in a chose in action in money or the right of easement in land but there is no custody of these intangible assets to be transferred.*

In passing, the definition of property in section 188 seems to have left out "securities" on purpose, the reason of which in unclear, since one would relate a licensed corporation more with securities than with land property.

Section 193

Subsection (1) provides that the Commission may impose a prohibition or certain requirements regarding a transaction by a licensed corporation if it appears to the Commission, under sub-paragraph (b), that the licensed corporation is not a fit and proper person (having regard, *among other matters,* to the matters specified in section 126) to remain licensed.

Firstly, it is noted that the fit and proper test as provided in section 126 is mainly conceptual upon which no hard and fast rule can be drawn. The comments on page 3 in the 2nd submission that the criteria require to be more certain, objective and transparent need not be repeated here. The position is made even more uncertain and unpredictable by the phrase "among other matters". There is no indication what the "other matters" will be.

Secondly, the subsection does not provide any link between the fitness of the licensed corporation to remain licensed and the prohibition in respect of a future transaction to be entered into or business to be carried out as provided in section 189. In order that the prohibition shall be operative, it is suggested that the transaction or business (as in section 189(1)) must be related to the cause that the licensed corporation is found to be unfit.

Sub-paragraph (e) provides: "the imposition of the prohibition or requirement is desirable in the interest of the investing public or in the public interest."

This sub-paragraph opens up the application of the section from specified situations from (a) through (d), to an entirely different category, a universal application under the heading of public interest and interest of the investing public. Unless these "public interests" are capable of being expressly defined and their basic considerations known, it would be impossible to anticipate when or under what circumstances the prohibition or requirement may or may not be imposed. In the circumstances, it is suggested that sub-paragraph (e) be deleted.

Section 195

Subsection (8) provides that if the Commission considers appropriate, a notice published in the Gazette may include a statement specifying the reasons for the imposition, withdrawal, substitution or variation (as the case may be).

A notice in the Gazette, publishing the imposition or a withdrawal of a prohibition is a matter of public notice and interest. It is therefore highly desirable that the public should be informed of the reasons behind such an exercise. It makes this administrative action appear to be more fair and transparent and helps the public to believe that nothing is withheld behind the scene.

It is suggested that reasons are always given for each and every case in such a notice. The word "may" in subsection (8) is recommended to be replaced by "shall" and the phrase "if the Commission considers appropriate" deleted.

Section 197

"(1) If —

(a) it appears to the Commission that it is desirable in the public interest that *a corporation* should be wound up and

(b) the corporation is of a class of corporation which the Court of First Instance has jurisdiction to wind up in specified circumstances under the Companies Ordinance (Cap 32),

the Commission may present a petition for it to be would up under that Ordinance on the ground that it is just and equitable that it should be so wound up."

It is suggested that one should not lose sight of the fact that the interest and jurisdiction of the Commission is related to securities and futures in this Bill and not to all corporations in Hong Kong. The term "a corporation" in subsection (1) should therefore, be amended to read "a licensed corporation or a listed corporation". Similarly, "corporation" appearing on the 2nd line of subsection (3)(a) should be amended accordingly.

Section 198(7)

"Where the Commission applies to the Court of First Instance for an order pursuant to subsection (1), it shall not be required, as a condition of the granting of an interim order under subsection (6), to give an undertaking as to damages."

It is suggested that it is a matter of natural justice and established practice that where an applicant is able to show to the court that granting an interim order as pleaded in his application, pending further hearing is justified, he is able and prepared to give an undertaking as to damages if he fails in the final hearing. If the Commission is fully confident of the cause of its application for a restraining or injunction order as provided under subsection 198(2), which is a serious event by any measure, it should have no objection to giving such an undertaking to the court. If, the Commission fails, however, in the final hearing, the Court is always at liberty to order damages against it in any event if appropriate and this is irrespective of whether an undertaking has been given or not.

Therefore, this provision only seems to give the impression that the Commission is prepared to proceed to an application of this nature regardless of its outcome in Court. We suggest that this subsection be deleted.

--to be continued--