For discussion on
8 May 2001

Paper No. 12/01

Bills Committee on
Securities and Futures Bill and Banking (Amendment) Bill 2000

Securities and Futures Bill
Parts XIII and XIV and Schedule 8 - Market Misconduct

INTRODUCTION

This paper outlines the provisions in Parts XIII and XIV of and Schedule 8 to the Securities and Futures Bill ("SF Bill") and the policy intention behind them. The provisions are principally concerned with defining and dealing with "market misconduct"[1], and seek to –

(a) establish the Market Misconduct Tribunal ("MMT"), and detail its composition and procedures and its powers to inquire into and punish market misconduct on a civil basis;

(b) create dual civil and criminal regimes for dealing with market misconduct;

(c) create a comprehensive right of civil action for those who suffer pecuniary loss owing to market misconduct; and

(d) create a number of criminal offences targeted at various acts of fraud, deception or misrepresentation involving securities, futures contracts or leveraged foreign exchange trading.

2. A table comparing the provisions contained in Parts XIII and XIV of the Bill with existing law is at **Annex 1**.

DUAL CIVIL AND CRIMINAL REGIMES TO DEAL WITH MARKET MISCONDUCT

3. The existing regulatory regime is inconsistent and inadequate in dealing with market misconduct and needs to be improved.

---

[1] Market misconduct here refers to the types of conduct which will be subject to civil proceedings within the jurisdiction of the Market Misconduct Tribunal under Part XIII, and which are also criminal offences under Part XIV. For the purposes of Part XIII, "market misconduct" includes insider dealing, false trading, price rigging, stock market manipulation, disclosing information about prohibited transactions in securities or futures contracts, and disclosing false or misleading information about securities or futures contracts inducing transactions in those products.

4. At present, insider dealing is a civil wrong defined in the Securities (Insider Dealing) Ordinance (Cap. 395) ("S(ID)O"). Under the S(ID)O, the Insider Dealing Tribunal ("IDT") inquires into cases of suspected insider dealing referred to it by the Financial Secretary. Civil procedures are adopted, and a high civil standard of proof is applied. The IDT is not bound by the civil or criminal laws of evidence. At the end of an inquiry, the IDT makes a report of its findings and may punish anyone it finds to have engaged in insider dealing with a variety of orders, as follows –

(a) to prohibit a person from being involved in the management of any named corporations for up to 5 years;

(b) to pay to the Government an amount up to that of the profit made or loss avoided as a result of the insider dealing; and

(c) to pay a penalty of an amount up to three times the profit made or loss avoided as a result of the insider dealing.

5. All other forms of market misconduct are, on the other hand, criminal offences under the Securities Ordinance (Cap. 333) ("SO") and the Commodities Trading Ordinance (Cap. 250) ("CTO"). The offences cover -

(a) false markets and trading;

(b) restrictions on fixing prices for securities; and

(c) false or misleading statements.

6. In addition, the SO and the CTO criminalize fraud and the employment of fraudulent or deceptive devices, offences which are more in the nature of a one-on-one fraud or deception, rather than conduct which affects the market for securities or futures contracts as a whole.

7. These offences are limited and have proven inadequate in effectively dealing with all forms of misconduct that are prejudicial to the interests of the investing public and the public interests, and in particular, different forms of market manipulation.

8. The criminal standard of proof (i.e. beyond reasonable doubt) and the restrictive rules of criminal evidence have inhibited successful criminal prosecutions in some instances of market manipulation. To date, there have been 10 successful prosecutions for market manipulation out of 12 cases brought. The maximum penalties under the SO and the CTO for similar offences are inconsistent and inadequate. For the 10 successful cases, the court has imposed suspended sentences in two instances, and the average fine of the other eight cases imposed has been only $40,000.

9. The civil regime for dealing with insider dealing under the IDT has been relatively successful, for the following reasons –

(a) obligation to answer questions put by the investigator which may later be used as evidence against the person before the IDT;

(b) absence of the right to silence before the Tribunal;

(c) use of a standard of proof below the criminal standard;

(d) the fact that the IDT is not bound by the formal rules of evidence and may consider any evidence it considers relevant and probative;

(e) the fact that a judge of the Court of First Instance sits with 2 lay persons who are experts; and

(f) the IDT's ability to impose a range of heavy financial penalties.

10. We therefore propose the establishment of a tribunal modelled on the IDT to be called the MMT that would have jurisdiction to inquire into and punish all forms of market misconduct, including insider dealing, and to make similar orders to those available to the IDT.

11. In the course of developing this proposal, the Government has been advised that the jurisprudence developing before the European Court of Human Rights involving human rights protections similar to those under the Basic Law and the Hong Kong Bill of Rights Ordinance cautions that pecuniary fine orders could, in certain cases, be "criminal" for human rights purposes. In light of such advice, the Government has decided that, while the original imperatives behind the creation of the MMT remain, a more prudent way forward would be not to pursue the original proposal to give the MMT the power to impose pecuniary fine orders, but to build in a series of effective civil measures to protect investors.

12. The consequence of the market misconduct regime being held to be "criminal" for human rights purposes would be that procedural criminal safeguards would have to be incorporated in order to comply with the right to the presumption of innocence, the right to remain silent and the right against self-incrimination guaranteed under Articles 10 and 11 of the HKBOR and Article 14 of the ICCPR. One option would be for the MMT to adopt a criminal standard of proof and that statements obtained under compulsion of law during investigation which may incriminate a person would no longer be admissible as evidence against the person concerned in proceedings before the MMT and that the person could no longer be compelled to give self-incriminating evidence before the Tribunal.

13. However, the success of the IDT has been primarily due to the absence of the right to silence and its ability to consider compelled self-incriminating statements gathered during SFC investigations. The incorporation of procedural criminal safeguards into the market misconduct proceedings, despite the retention of heavy financial penalties as a sanction, would therefore render the MMT little or no more effective than criminal prosecution in deterring and punishing market misconduct, and would not better protect investors.

14. To bolster the punishment and therefore deterrent effect of the proposed civil regime, the Bill will add two additional elements to the market misconduct regime.

15. First, the existing criminal regime will be expanded. The Government would not underestimate the difficulties of criminal prosecution for complex white-collar crime like market misconduct. However, sanctions such as heavy financial penalties and imprisonment have a strong deterrent and punitive effect. To ensure that this is the case, the maximum criminal sanctions will be increased to 10 years' imprisonment and/or fines of $10 million.

16. Secondly, the Bill will make it procedurally easier for those who suffer pecuniary loss as a result of market misconduct to bring a civil action. The Bill will make the findings of the MMT in relation to market misconduct admissible evidence in civil proceedings (see paragraph 59 below). This will in turn enhance the deterrent effect of the proposed regime.

MARKET MISCONDUCT TRIBUNAL

Establishment and jurisdiction

17. Divisions 2 and 3 of Part XIII and Schedule 8 describe the composition, procedures and powers of the proposed Market Misconduct Tribunal (MMT).

18. The MMT's composition, procedures and powers will largely emulate those of the existing IDT in relation to insider dealing. The MMT will have three notable differences from the IDT-

(a) the MMT's jurisdiction will be broadened to cover other forms of market misconduct in addition to insider dealing;

(b) a wider range of civil sanctions will be available to the MMT when compared with the IDT; and

(c) the role of the Presenting Officer (presently the counsel assisting the IDT) will change so that he becomes independent of the MMT.

19. The MMT will be comprised of a chairman, to be appointed by the Chief Executive ("CE"), who must be a judge[2] and two other members who cannot be public officers with the chairman presiding. Schedule 8 sets out provisions governing the composition of the MMT and the procedures it is to follow. These cover the appointment of members and temporary members, the procedures for

[2] "[J]udge" is defined in clause 237(1) to mean a judge or deputy judge of the Court of First Instance, a former Justice of Appeal of the Court of Appeal, or a former judge or a former deputy judge of the Court of First Instance.

hearings and powers to direct attendance at preliminary conferences and to make consent orders.

20. Initial reports of suspected market misconduct will be made by the SFC following an SFC investigation under clauses 175 and 176. The SFC may refer such a report to the Financial Secretary to consider the institution of civil proceedings before the MMT or to the Secretary for Justice to consider the institution of criminal proceedings. The SFC will also have the residual capacity to institute in its own name summary criminal proceedings for less serious criminal market misconduct offences. It is expressly provided that the powers of the Secretary for Justice in respect of the prosecution of criminal offences under the Basic Law are not affected (clause 376(3)).

21. The decision as to whether to take criminal proceedings in relation to suspected market misconduct will be made by the Secretary for Justice in accordance with the Department of Justice's Prosecution Policy. When the SFC decides to prosecute summarily less serious market misconduct before a magistrate, it will also make the decision in accordance with that Policy. Under the Prosecution Policy, criminal proceedings will be initiated where there is sufficient evidence that a criminal offence has been committed by an identifiable person, that there is a reasonable prospect of a conviction, and it is in the public interest to bring a prosecution.

22. The Financial Secretary will institute proceedings before the MMT whether or not following a report of suspected market misconduct by the SFC or following a referral from the Secretary for Justice, by giving the chairman a written statement containing details of what provisions of Part XIII will have allegedly been breached by a person, together with sufficient brief particulars to disclose reasonable information concerning the nature and essential elements of the market misconduct alleged.

23. The Secretary for Justice will also appoint a Presenting Officer who will be a legal officer, solicitor or counsel, and one or more persons to assist the Presenting Officer. The Presenting Officer's role will be to put the case against the parties before the MMT.

Proceedings of the MMT

24. The principal function of the MMT will be to decide whether market misconduct has taken place, and if so, to identify the person or persons who engaged in it. The MMT will also determine whether a profit was secured or increased or loss avoided or reduced as a result of the market misconduct and calculate the amount thereof (clause 244). It will also determine the sanctions to be imposed and ancillary orders, such as costs and witness expenses, to be made.

25. The MMT will only be able to identify someone as having engaged in market misconduct if they have been granted a reasonable opportunity to be heard. The MMT will make its findings to the civil standard of proof. In relation to contempt it will apply the same standard of proof as the Court of First Instance. The MMT will sit in public unless the Tribunal decides that, in the interests of justice, all or part of a sitting will be held in private.

26. Like the IDT, the MMT as a civil tribunal will have powers to receive any evidence, whether or not admissible in civil or criminal proceedings, to compel the giving of evidence including testimony on oath or affirmation, to prohibit the publication of information about evidence the MMT receives or any part of any MMT proceedings conducted in private and to govern its own procedure and make ancillary orders (clause 245). The MMT will also be empowered to stay its own proceedings on such grounds and subject to such conditions it thinks fit having regard to the interests of justice. Failure to comply with MMT orders, disruption or interference with proceedings, threatening or obstructing witnesses, MMT members or the Presenting Officer, without reasonable excuse will be a crime. Like the IDT, the MMT will also have the power, on its own motion or on the application of the Presenting Officer, to direct the SFC to investigate further and to receive any further evidence so obtained.

27. Clause 247 prescribes the use of evidence given in MMT proceedings. Such evidence will be admissible for any civil or criminal proceedings under Part XIII, civil proceedings arising out of the giving of evidence in MMT criminal proceedings and proceedings in respect of false evidence given in or for the purposes of MMT proceedings. The admissibility of such evidence in any other proceedings will be determined according to the normal rules of admissibility applicable to those proceedings. This is consistent with the intention of permitting the MMT to rely on any evidence whether or not it would be admissible in civil or criminal proceedings and in particular with allowing it to consider compelled self-incriminating evidence. We have been advised that the above provisions do not contravene the bill of rights provisions of the Basic Law relating to the privilege against self-incrimination.

28. At the end of MMT proceedings, the MMT will have to make a written report of its findings which includes -

(a) its determination of whether market misconduct has been engaged in, identification of who engaged in that market misconduct, and the amount of profit that was secured or increased, or loss reduced or avoided as a result and its reasons for so finding; and

(b) any sanctions to be imposed under clause 249 or 250 (see paragraph 30 below) and its reasons for imposing such sanctions.

29. The MMT will be required to give a copy of its report to the Financial Secretary first and then, unless the MMT sat in private for all or part of its proceedings, to the public. If the MMT will have sat in private for all or part of its proceedings, the Financial Secretary may decide, if in the public interest, to publish all or part of the MMT's report or make it available to a particular person or body in the manner he directs.

Civil sanctions available to the MMT

30. At the end of proceedings, the MMT will be able to impose the following sanctions on those persons it identifies as having engaged in market misconduct (clause 249) -

(a) an order that the person must not, without the leave of the Court of First Instance, be involved in the management of a listed corporation or any other specified corporation (for example, as a director, liquidator, or receiver or manager of the corporation's property or business) for a period of up to 5 years ("disqualification orders");

(b) an order that the person must not, without the leave of the Court of First Instance, in Hong Kong, directly or indirectly in any way trade in financial products which the SFC regulates, for a period of up to five years ("cold shoulder orders");

(c) an order that the person must not again engage in any specified form of market misconduct ("cease and desist orders");

(d) an order that the person pay to the Government an amount not greater than any profit secured or increased or loss avoided or reduced by that person as a result of the market misconduct ("disgorgement orders");

(e) an order that the person pay to the Government an amount the Tribunal considers appropriate for the Government's expenses in relation or incidental to the proceedings and any investigation of his conduct or affairs carried out for the purposes of the proceedings ("Government costs orders");

(f) an order that the person pay to the SFC such amount as the Tribunal considers appropriate for the SFC's expenses in relation or incidental to any investigation of his conduct or affairs before the MMT proceedings or in relation or incidental to the proceedings ("SFC costs orders"); and

(g) an order that any body which may take disciplinary action against the person as one of its members be recommended to take disciplinary action against him or her ("disciplinary referral orders").

31. Disgorgement orders, disqualification orders and Government costs orders are all modelled on orders which the IDT may presently impose in relation to insider dealing (sections 23(1)(a) and (b) and 27 of the S(ID)O). SFC costs

orders are a logical extension of the existing IDT power to order an insider dealer to pay the Government's inquiry and investigatory costs, and the power of a court to order a person convicted of a crime following an SFC criminal investigation to pay to the SFC the SFC's investigatory costs (section 33(15)(a) of the Securities and Futures Commission Ordinance). Cold shoulder orders[3], cease and desist orders[3] and disciplinary referral orders are all new orders which the Government has selected carefully for their credibility as sanctions and compatibility with human rights law.

32. Clause 270, which is derived from section 13 of S(ID)O, will impose a duty on an officer of a corporation to take all reasonable precautions to ensure that proper safeguards exist to prevent the corporation of which he or she is an officer from acting in any way which would result in the corporation engaging in market misconduct. The MMT will also be able to impose any specified orders on any person who is an officer of a corporation which the MMT identifies as having engaged in market misconduct if the corporation's market misconduct was directly or indirectly attributable to a breach by that officer of the duty imposed on them under clause 270 (clause 250(1)). Clause 250(1) builds on the existing section 24 of the S(ID)O. Orders made under clauses 249 and 250 are registerable in the Court of First Instance, whereupon they become for all purposes orders of the Court of First Instance.

33. Failure to comply with a disqualification, cold shoulder or cease and desist order will be a criminal offence punishable by a maximum $1 million fine and/or 2 years' imprisonment.

34. To avoid a person being subject to civil proceedings before the MMT under Part XIII and subject to criminal prosecution under Part XIV in relation to the same conduct, clause 274 will clearly provide that a person who has been subject to criminal proceedings under Part XIV may not be subject to MMT proceedings under clause 244 in relation to the same conduct if those criminal proceedings are still pending or no further criminal proceedings could be brought against that person under Part XIV in relation to the same conduct. Clause 298 will provide the same for Part XIV.

35. The MMT will be given the power to punish conduct that amounts to contempt of the Tribunal as if the MMT were the Court of First Instance. The Bill

---

[3] "Cold shoulder orders" are modelled on orders that the Takeovers and Mergers Panel may impose under rule 12.2(e) of the Introduction to the Hong Kong Codes on Takeovers and Mergers and Share Repurchases, and has imposed on those who breach those Codes or a ruling made under those Codes. They amount to a prohibition on dealing in Hong Kong in financial products regulated by the SFC and we believe are a fitting punishment for those found to have engaged in market misconduct.

[3] "Cease and desist orders" are modelled on orders that the US SEC may impose in administrative proceedings for breach of the US securities laws. A person subject to an SEC cease and desist order must not continue to breach identified US securities laws or breach such laws again. Breach of an SEC cease and desist order is punishable as a criminal offence or through contempt proceedings.

will protect a person from the "double jeopardy" of being subject to punishment for contempt and criminal prosecution for the same conduct.

36. The Secretary for Justice or a person who is identified by the MMT as having engaged in market misconduct will be able to appeal a finding or determination of the MMT to the Court of Appeal on a point of law or, with the leave of the Court of Appeal, on a question of fact. A person in relation to whom the MMT imposes a sanction under clause 249(1) or 250(1) or makes a costs order under clause 252 will be able to appeal that order to the Court of Appeal.

MARKET MISCONDUCT

37. In the following paragraphs, we outline the major elements of the provisions dealing with the six forms of market misconduct. Apart from insider dealing, the other five forms of market misconduct are modeled upon the well established provisions in the Australian Corporations Law. The Australian Corporations Law carries with it a body of case law which may provide for courts in Hong Kong a convenient guide for interpreting these new provisions in the Bill.

Insider dealing

38. Part XIII and Part XIV contain civil and criminal provisions, respectively, prohibiting insider dealing.

39. The insider dealing provisions are based on the existing provisions in sections 9-12 of the S(ID)O and their supporting definitions in sections 2 and 4-8 of that Ordinance. Clauses 261-264 in Part XIII and clauses 283-286 in Part XIV repeat the substance of the existing insider dealing provisions with some rewording. The most significant change is that insider dealing will also become a crime for the first time in Hong Kong under Part XIV.

40. The other major changes to the insider dealing provisions are made to close gaps in existing definitions. Those changes are -

(a) the insider dealing provisions will in future apply to dealing not only in securities that are issued and listed, but also to unissued and/or unlisted securities in certain circumstances (clauses 237(2) and 277(2) definitions of "listed securities");

(b) the insider dealing provisions will in future apply to inside information not only about the relevant corporation but also information about a shareholder or officer of the corporation or about the listed securities of the corporation or their derivatives, matters which may also impact upon the price of the listed securities (see definitions of "relevant information" under clauses 237(2) and 277(2)); and

(c) a person who holds or has an interest in 5% or more of the voting capital of a corporation will be regarded as a substantial shareholder for the purposes of the insider dealing provisions, consistent with the changes to the regime for disclosure of interests in the capital of a listed corporation in Part XV (clauses 239(3) and 279(3)).

False trading

41. Clauses 265 and 287 will prohibit four different types of false trading, under the civil and criminal regimes respectively.

(i) "False appearance of active trading"

42. Clauses 265(1) and 287(1) will prohibit a person, in Hong Kong or elsewhere, intentionally or recklessly creating, causing to be created or doing anything likely to create, a false or misleading appearance of active trading in, or with respect to the market for or price of, securities or futures contracts traded on a recognised market or by means of automated trading services ("ATS") authorized under clause 95. Clauses 265(2) and 287(2) will prohibit similar conduct but by a person in Hong Kong whose conduct affects securities or futures contracts traded on a relevant overseas market.

43. This approach of prohibiting manipulative conduct whether in Hong Kong or overseas which affects securities or futures traded on an exchange or by means of authorized ATS in Hong Kong, and conduct by a person in Hong Kong which affects exchanges outside Hong Kong, will be adopted throughout the market manipulation provisions. It is intended to better protect Hong Kong investors and markets, and enable Hong Kong to play its part in prohibiting cross-border market misconduct which affects increasingly globalized markets internationally. The US, UK and most of the Australian market misconduct laws adopt a similar approach. There is a growing international consensus that such laws are necessary to better regulate globalizing markets. To prevent this approach from resulting in outlawing conduct in Hong Kong that has an effect on securities or futures contracts traded on a market outside Hong Kong when that conduct would not be illegal in the place outside Hong Kong, the prosecution must prove that the conduct is also a crime in that place.

(ii) "Creating/maintaining artificial price"

44. Clauses 265(3) and 287(3) will prohibit a person, in Hong Kong or elsewhere, being involved, directly or indirectly, in one or more transactions with the intention that, or being reckless as to whether, the transaction or transactions has or have or are likely to have, the effect of creating an artificial price, or maintaining at a level that is artificial a price, for securities or futures traded on a relevant recognised market or by means of authorized ATS. Clauses 265(4) and 287(4) will prohibit the same conduct but by a person in Hong Kong which affects

securities or futures contracts traded on a relevant overseas market. The transaction or transactions concerned need not be in securities or futures contracts so these provisions prohibit a range of conduct that can occur off a market that will affect prices on a securities or futures market, most importantly cross-market manipulation and cornering.

(iii) "Wash sales" and "matched orders"

45. Clauses 265(5) and 287(5) will prohibit two types of conduct -

(a) "wash sales"[5]; and
(b) "matched orders"[6].

46. Under these provisions, the prosecution will only have to prove that a person has engaged in wash sales or matched orders. Under clauses 265(6) and 287(7), a person who has engaged in wash sales or matched orders will have a defence if they prove, on the balance of probabilities, that none of the purposes for which they engaged in the wash sale or matched orders was to create a false or misleading appearance with respect to active trading in securities or with respect to the market or price for them.

47. The onus of proving an innocent mental element will be imposed on the defendant who has been proved to have engaged in wash sales and matched orders. With wash sales and matched orders, the person who has engaged in such activity is the person best placed to explain if he engaged in that behaviour for only legitimate reasons. He will only have to do this on the balance of probabilities. We therefore believe that it is reasonable, in these limited circumstances, to require the defendant to explain the reasons for their conduct.

Price rigging

48. Clauses 266 and 288 will prohibit price rigging. The clauses will prohibit two types of conduct -

(a) prohibiting a person, in Hong Kong or elsewhere, from engaging in a wash sale of securities which has the effect of maintaining, increasing, reducing, stabilizing or causing fluctuations in the price of securities traded on a relevant recognised market or by means of authorized

---

[5] "Wash sales" are transactions in which a person buys or sells securities without a change of beneficial ownership in the transaction. Clauses 242(7) and 282(7) define a transaction as involving no change in beneficial ownership if a person, or his associate, who had a beneficial interest in the securities before the transaction, has a beneficial interest in the securities after the transaction. That is, a person basically sells securities to, or buys them, from himself.

[6] "Matched orders" are transactions in which a person offers to sell securities at a price that is substantially the same as the price at which he has made or proposes to make, or he knows an associate of his has made or proposes to make, an offer to buy substantially the same number of securities and vice versa.

ATS. There will be a defence to such conduct identical to that for wash sales and matched orders in the false trading provisions; and

(b) prohibiting a person, in Hong Kong or elsewhere, from engaging in any fictitious or artificial transaction or device with the intention that, or being reckless as to whether, it has the effect of maintaining, increasing, reducing, stabilizing or causing fluctuations in, the price of securities or futures contracts traded on a relevant recognised market or by means of authorized ATS.

49. The two clauses will also prohibit the same conduct by a person in Hong Kong which affects securities or futures contracts traded on a relevant overseas market.

Stock market manipulation

50. Clauses 269 and 291 will prohibit stock market manipulation. A person, in Hong Kong or elsewhere, will be prohibited from engaging directly or indirectly in two or more transactions in securities of a corporation that by themselves or in conjunction with other transactions -

(a) increase or are likely to increase the price of securities traded on a relevant recognised market or by means of authorized ATS with the intention of inducing another person to buy or subscribe for, or to refrain from selling, securities issued by that corporation or a related corporation;

(b) reduce or likely to reduce the price of securities traded on a relevant recognized market or by means of authorized ATS with the intention of inducing another person to sell, or refrain from buying, securities issued by that corporation or a related corporation; or

(c) maintain or stabilize or are likely to maintain or stabilize the price of securities traded on a relevant recognized market or by means of authorized ATS with the intention of inducing another person to sell, buy or subscribe for, or to refrain from selling, buying or subscribing for, securities issued by that corporation or a related corporation.

51. The two clauses also prohibit the same conduct by a person in Hong Kong which affects securities or futures contracts traded on a relevant overseas market.

Disclosure of false or misleading information about securities or futures contracts

52. Clauses 268 and 290 will prohibit the disclosure of false or misleading information about securities or futures contracts that is likely to induce investment decisions or have a material price effect. The price of securities and futures contracts is a reflection of information about their underlying value. For this reason, false or misleading information about securities or futures contracts which is important enough to affect their price or induce investment decisions in relation to them can be very damaging to investors and markets.

53. Accordingly, a person, in Hong Kong or elsewhere, will be prohibited from disclosing, circulating or disseminating, or being concerned in the disclosure, circulation or dissemination of information that is likely to induce the sale, purchase or subscription of securities or dealing in futures contracts in Hong Kong or likely to maintain, reduce, increase or stabilize the price of securities or futures contracts in Hong Kong if -

(a) the information is false or misleading in a material fact or through the omission of a material fact; and

(b) the person knows, or is reckless or negligent as to whether, the information is false or misleading in a material fact or through the omission of a material fact.

54. Defences will be available for those who may passively disseminate false or misleading information owing to the nature, or an aspect, of their business, which involves disseminating information received from others and who are not in a position to check the accuracy of that information. These defences will be for -

(a) a person who operates a "conduit" style business of issuing or reproducing information given to him by others where the information is wholly devised by another person typically a customer (clauses 268(2) and 290(3)). This defence is intended for printers, publishers and the like;

(b) a person who operates a business the normal conduct of which involves re-transmission of, or electronically allowing access to, third party information (clauses 268(3) and 290(4)). This defence is intended for those who operate internet websites that provide access to third party information; and

(c) a person who is a broadcaster who broadcasts live information that he did not modify and in accordance the terms of his broadcasting licence or any relevant code of practice or guidelines issued under the relevant Hong Kong laws (clauses 268(4) and 290(5)).

Disclosure of information about prohibited transactions

55. Clauses 267 and 289 will prohibit the disclosure of information about transactions being conducted in breach of the relevant market misconduct provisions in Part XIII or Part XIV. They will prohibit the disclosure of information concerning the effect on the price of the securities of a corporation or futures contracts by a transaction in breach of the market manipulation provisions in Part XIII or Part XIV relating to the securities of that corporation or a related corporation or futures contracts (respectively) if the person disclosing the information or an associate of his has directly or indirectly entered into the prohibited transaction or has received or expects to receive a benefit as a result of the disclosure.

56. The purpose of the provisions is to stop a person who is involved in market misconduct, or his associates or those he has recruited for reward, from spreading information that the price of a security or futures contract is going to be affected by market misconduct.

57. The provisions depart from the Australian provisions on which they are based, in that defences are added for those who, acting in good faith, spread the information about a prohibited transaction for reward. The defences are intended to cover journalists or investment and research analysts who innocently report the market misconduct and its likely price effect and who may innocently receive a benefit for such conduct (e.g. as part of their normal employment).

ASSISTING LITIGANTS IN A PRIVATE RIGHT OF ACTION

58. Clauses 272 and 296 create rights of civil action for any person who suffers pecuniary loss as a result of market misconduct. In addition, clause 296 creates a right of civil action for those who suffer pecuniary loss as a result of conduct in breach of the criminal offences created in clauses 292-294 (see paragraphs 63 - 65 below.)

59. Under clause 272 a person who has committed a relevant act in relation to market misconduct or, under clause 296, contravened a market misconduct provision or committed one of the offences in clauses 292-294, will be liable to pay damages to any other person for pecuniary loss they have suffered as a result of the market misconduct, whether the loss arises from having entered into a transaction or dealing at a price affected by the market misconduct or otherwise. A limiting factor exists in that damages will only be payable if it is fair, just and reasonable in the circumstances. This is intended to reproduce the tortious common law test of when a duty of care arises in cases of pure economic loss. Findings of the MMT in relation to the Part XIII market misconduct provisions will be admissible in evidence in a private civil action. The courts will be able to impose injunctions in addition to or in substitution for damages. The private rights

of action will not affect, limit or diminish other rights of action under statute or at common law.

"SAFE HARBOUR" RULES TO PROTECT LEGITIMATE MARKET PRACTICES

60. The line between legitimate and illegitimate conduct in the securities and futures markets may, in some circumstances, be very fine. Further, business practices in those markets change very rapidly in response to changes in technology, competition and commercial innovation. Given that it is difficult to include statutory provisions flexible enough to anticipate all the conduct which should be legitimate while still outlawing all the conduct which is not, it is useful to provide some flexibility to modify the law relatively quickly to adapt to changing business and market conditions and to afford certainty to market practitioners as to what is, and what is not, acceptable conduct.

61. It is not uncommon for securities and futures regulators to be given the power to modify the laws they administer by subsidiary legislation. For example, the US SEC and Commodity Futures Trading Commission ("CFTC") both have extensive powers to modify the laws they administer through rules they make.

62. Under clauses 273 and 297 the SFC will be able to make rules which will create exceptions to the market misconduct civil and criminal provisions ("safe harbour" rules). When the SFC wishes to make such rules, it will have to release the draft rules to the public to invite submissions. Once the SFC has consulted the public, it will, after consulting the Financial Secretary, be able to modify the rules taking into account any public submissions it has received. Like other subsidiary legislation, these rules will be subject to the usual vetting of the legislature.

OTHER OFFENCES PROVIDED FOR IN PART XIV

63. Division 4 of Part XIV will create a number of offences relating to -

(a) acts of fraud or deception involving securities, futures contracts or leveraged foreign exchange trading (clause 292);

(b) false or misleading information relating to leveraged foreign exchange contracts (clause 293), in the same manner as clauses 268 and 290 apply to securities or futures contracts; and

(c) "bucketing" or falsely representing that a futures contract has been executed or arranged on another persons' behalf on a recognized futures market or through an authorized ATS provider (clause 294).

64. These offences have not been dealt with in the same manner as conduct designated as market misconduct nor subject to dual civil and criminal regimes as they usually occur in one-on-one circumstances and are less likely to have an effect on the market as a whole.

65. In particular, clause 294 will prohibit the practice known as "bucketing"[7]. It will prohibit a person from representing that he has facilitated or arranged a dealing in futures contracts on another person's behalf on a recognized futures exchange or authorized ATS when he has not done so. Similar conduct will be prohibited where the misrepresentation is that a futures contract, or an instrument substantially resembling a futures contract will be executed in accordance with the rules of a futures market outside Hong Kong. A defence will be provided if a person can prove that he acted in good faith and did not know and could not reasonably have known that the futures contract or other instrument had not been dealt with in the manner represented.

RESPONSE TO MARKET COMMENTS

66. The following paragraphs summarize our response to the major comments received during the consultation.

67. We received comments from the Bar Association that the ability of the MMT to impose three times profit or loss financial penalties should be kept (as in the case of the IDT) as this has proven very effective. The Association considers that the proposed civil sanctions are ineffective and it is difficult to secure a criminal conviction. As explained in paragraph 11 above, the Government considers it prudent not to pursue the proposal to give the MMT the power to impose pecuniary fine orders. The criminal provisions are necessary deterrents and the maximum penalties thereunder are increased to a fine of up to $10 million and 10 years' imprisonment. They will be used where sufficient evidence exists, where there is a reasonable prospect of a conviction and the public interest favours criminal prosecution. We believe that the expanded criminal regime, coupled with the civil MMT regime and its wide range of civil sanctions, and the provision of a private cause of action to victims of market misconduct to claim damages from the person who has engaged in market misconduct, will provide a comprehensive and effective framework to combat market misconduct.

---

[7] Bucketing typically involves a person representing that they will execute futures contracts or purported futures contracts on a recognized exchange or similar market when instead the person acts as counterparty and takes the risk of the futures contract himself, pooling the risk of that futures contract together with the risk he assumes from any other contracts he enters into with other clients. This means that clients of the bucket shop are deceived into believing that they are receiving the protection of dealing with an exchange clearing house and subject to stringent trading rules when in fact they are dealing with a party who directly assumes great financial risks. Bucket shops are usually outright fraudulent schemes but at the very least involve serious misrepresentations and expose clients to far higher risks of losing their investment.

68. A group of investment bankers queried if the market misconduct provisions would outlaw legitimate conduct such as post-public offering price stabilization, index arbitrage, program trading, etc. During the consultation, we have engaged the market participants to consider in detail the effect of the draft provisions on legitimate market activities. The market misconduct provisions (other than insider dealing) in the Bill are modelled on similar provisions in the Australian Corporations Law which do not prohibit legitimate market activities such as arbitrage and program trading in Australia. In response to market comments, we have also clarified the mental element of the provisions to make it clearer that they will in appropriate cases only apply to intentional or reckless conduct that distorts the market. In addition, as stated in paragraph 62 above, SFC will consult the market on "safe harbour" rules to permit, for example, price stabilization following an initial public offering, which may otherwise be prohibited by the market misconduct provisions.

69. We also received comments from the same group of investment bankers that the White Bill provision concerning disclosure of false or misleading information that may induce transactions in securities or futures contracts, or have an effect on the price of either, would impose a strict liability provision with a reverse onus defence and was too harsh. In response to market comments, we have clarified the relevant provisions to require proof of knowledge that the information is false or misleading, or recklessness or negligence as to whether it is so. The onus of proof of all the elements of the provisions has been placed on the prosecution. We believe that imposing a duty to take reasonable care is not unreasonable with respect to disclosure of false or misleading information. False and misleading information is very damaging to financial markets and those disclosing information should take reasonable steps to ensure that information they disclose is true and not misleading.

70. Some banks suggested that the insider dealing provisions should be amended to allow pledgees/mortgagees (such as banks) of shares in a listed corporation to sell those shares in accordance with the security arrangement, if the pledgor/mortgagor or a related company defaults, even though the default may not be public knowledge. Our view is that a bank which sell shares in a listed corporation before information about a default is generally known to the market is dealing while in possession of relevant information and would constitute insider dealing (whether under the S(ID)O or under Parts XIII and XIV of the Bill). We do not agree that a bank should be made an exception.

71. There are also comments that the market misconduct provisions overlap. In fact, there are only six specified types of market misconduct. The provisions are drafted to identify and apply to specific conduct which is unlawful. This approach will help market participants understand what conduct is lawful and what is unlawful. The US and Australia also have overlapping market misconduct provisions. The alternative is to have a few vague provisions covering lots of different sorts of conduct, but this will make the law uncertain and should not be

adopted. In the light of market comments, we have streamlined and merged the provisions concerning instances of market misconduct concerning securities and futures contracts.

72. In response to market participants' concerns, we have amended the provisions on "stock market manipulation" provisions to apply only to two or more transactions carried out with a manipulative intention.

73. One on-line broker commented that the disclosing provisions on "false or misleading information to induce transactions" would chill the supply through the internet of information that benefits investors as a website operator who provides access to information from a third party site will not be able to check continuously to see if the information so available is false or misleading. We note the broker's concern and have added a specific defence to these provisions to protect a person who merely re-transmits (such as through hyper-links) on his websites information provided by third parties.

74. There are also comments that a defendant should not have to prove that a wash sale or matched order were engaged in for innocent purposes. Wash sales and matched orders are common manipulative devices with relatively few innocent explanations. As trading in financial products does not on its face disclose the intention with which it is engaged in, proving a manipulative intention to a high standard of proof is very difficult. If a defendant has a legitimate reason for a wash sale or matched orders, he will be in the best position to give evidence about it. The provisions only require that a person establish that their purposes were innocent on the lower standard of "balance of probabilities".

75. In response to the comments from the Legislative Council Subcommittee on the Securities and Futures Bill scrutinizing the White Bill during the last session, we have extended the civil sanctions available to the MMT to the criminal regime, where appropriate, to better protect investors and market participants. They include orders to prohibit the convicted from being a director of a listed corporation, or dealing in any securities or futures contracts.

INTERNATIONAL COMPARISON

76. A summary of the market misconduct regimes in the UK, US and Australia is at **Annex 2**.

Securities and Futures Commission
Financial Services Bureau
4 May 2001

Securities and Futures Bill
Parts XIIII and XIV and Schedule 8

Comparison Table

Legend:

ACL = Corporations Law (Australia)
FSMA = Financial Services and Markets Act 2000 (UK)
CTO = Commodities Trading Ordinance (Cap. 250)
LFETO = Leveraged Foreign Exchange Trading Ordinance (Cap. 451)
SFCO = Securities and Futures Commission Ordinance (Cap. 24)
SIDO = Securities (Insider Dealing) Ordinance (Cap. 395)
SO = Securities Ordinance (Cap. 333)

Note:

Provisions which are in substance identical in both Parts XIII and XIV are dealt with together

Clause	Contents	Derivation	Notes
	Parts XIII and XIV Division 1 – Interpretation		
237 & 277	Interpretation of Part XIII & Part XIV (respectively)	s2 S(ID)O	The definitions generally repeat the substance of existing law or are necessary for the operation of the new provisions.
238 & 278	Interest in securities (insider dealing) (Part XIII)/ Interest in securities (insider dealing offences) (Part XIV)	s2(5) S(ID)O	Clauses 238 and 278 re-enact existing law.
239 & 279	Connected with a corporation (insider dealing) (Part XIII)/ Connected with a corporation (insider dealing offence) (Part XIV)	s4 S(ID)O	Clauses 239 and 279 essentially re-enact existing law, save that the percentage of share capital that amounts to "substantial shareholder" is reduced from the existing 10% to 5% in clauses 239(3) and 279(3).

Clause	Contents	Derivation	Notes
240 & 280	Connected with a corporation – possession of relevant information in a privileged capacity (insider dealing) (Part XIII)/ Connected with a corporation – possession of relevant information in a privileged capacity (insider dealing offence) (Part XIV)	s5 S(ID)O	Clauses 240 and 280 are based on existing law.
241 & 281	Dealing in listed securities or their derivatives (insider dealing) (Part XIII)/ Dealing in listed securities or their derivatives (insider dealing offence) (Part XIV)	s6 S(ID)O	Clauses 241 and 281 reflect existing law.
242 & 282	Interest in securities and beneficial ownership, etc. (market misconduct other than insider dealing) (Part XIII)/ Interest in securities and beneficial ownership, etc. (market misconduct offences other than insider dealing offence) (Part XIV)	ss5 and 135(4) SO	Clauses 242 and 282 are essentially based on existing law, save that references to options in clauses 242(1) and 282(1) are new. Clause 242(7) and 282 (7) are based on s135(4) of SO.
	Part XIII Division 2 – Market Misconduct Tribunal		
243 (Part XIII only)	Market Misconduct Tribunal	New; influenced by s15 S(ID)O	New
244 (Part XIII only)	Market misconduct proceedings	New; influenced by s16 S(ID)O	New. Clauses 244 (1) and (2) largely reflect existing law on the Insider Dealing Tribunal ("IDT").
245 (Part XIII only)	Powers of Tribunal	ss17 & 20 S(ID)O	Clause 245 is based on existing law governing the powers of the IDT and creating offences for contempt and non-compliance with its orders. The penalty provided for these offences in clause 245(3) is higher than those provided for in S(ID)O.

Clause	Contents	Derivation	Notes
246 (Part XIII only)	Further powers of Tribunal concerning evidence	ss18 & 20 S(ID)O	Clause 246 essentially re-enacts ss18 and 20 of S(ID)O. Again, the penalty provided for in clause 246(7) is higher than in existing law.
247 (Part XIII only)	Use of evidence received for purposes of market misconduct proceedings	s19 S(ID)O	Clause 247 reflects s19 S(ID)O, save that clause 247(3) which expands on the use of evidence in criminal or civil proceedings, is new.
248 (Part XIII only)	Privileged information	s21(1)(a) S(ID)O	Clause 248 re-enacts existing law.
249 (Part XIII only)	Orders, etc. of Tribunal	New; ss23, 27 and 30 S(ID)O	Clause 249 partly follows ss23 & 27 S(ID)O. Clauses 249(1)(b),(c),(f) and (g) set out new orders that can be made by the MMT. Clause 249(2) which enables the MMT to take into account a persons previous conduct when making orders is new. Clause 240(9) sets out the penalty for non-compliance with an MMT order, which is higher than the equivalent penalty set out in s30 S(ID)O.
250 (Part XIII only)	Further orders in respect of officers of corporation	New; s24 S(ID)O	Clauses 250(1) and (3) reflect s24 of S(ID)O. Clauses 250(2), (4) to (9) are new, reflecting the provisions in clauses 249(2), (4) to (9) in relation to officers.
251 (Part XIII only)	Interest on moneys payable under section 249 or 250	New	New
252 (Part XIII only)	Costs	s26A S(ID)O	Clause 252 essentially re-enacts existing law.
253 (Part XIII only)	Contempt dealt with by Tribunal	New	New
254 (Part XIII only)	Report of Tribunal	s22 S(ID)O	Clause 254 largely follows existing law.
255 (Part XIII only)	Form and proof of orders of Tribunal	s28 S(ID)O	Clause 255 reflects existing law relating to the IDT.
256 (Part XIII only)	Orders of Tribunal may be registered in Court of First Instance	s29 S(ID)O	Clause 256 reflects existing law relating to the IDT.

Clause	Contents	Derivation	Notes
	Part XIII Division 3 – Appeals, etc.		
257 (Part XIII only)	Appeal to Court of Appeal	s31 S(ID)O	Clause 257 largely re-enacts existing law with minor modifications
258 (Part XIII only)	Powers of Court of Appeal on appeal	s32 S(ID)O	Clause 258 largely re-enacts existing law. Clause 258(2)(a) is new, which specifies the Court of Appeal's power to confirm, vary or set aside the order.
259 (Part XIII only)	No stay of execution on appeal	s33 S(ID)O	Clause 259 follows existing law.
260 (Part XIII only)	Rules by Chief Justice	s36 S(ID)O	Clause 260 on the whole follows existing law relating to the IDT.
	Part XIII Division 4 and Part XIV Division 2 – Insider dealing		
261 & 283	Insider dealing (Part XIII)/ Offence of insider dealing (Part XIV)	s9 S(ID)O	Clauses 261 and 283 essentially re-enact existing law.
262 & 284	Insider dealing – certain persons not to be regarded as having engaged in market misconduct (Part XIII)/ Insider dealing offence - general defences (Part XIV)	s10 S(ID)O	Clauses 262 and 284 largely reflects and elaborates on existing law. Clauses 262(4)(c)&(d) and (5)(a) and 284(4)(c)&(d) and (5)(a) add new elements to the defences for insider dealing and clauses 262(7) and 284(7) provide for a new defence.
263 & 285	Insider dealing – certain trustees and personal representatives not to be regarded as having engaged in market misconduct (Part XIII)/ Insider dealing offence - defences for certain trustees and personal representatives (Part XIV)	s11 S(ID)O	Clauses 263 and 285 re-enact existing law.

Clause	Contents	Derivation	Notes
264 & 286	Insider dealing – certain persons exercising right to subscribe for or acquire securities or derivatives not to be regarded as having engaged in market misconduct (Part XIII)/ Insider dealing offence - defences for certain persons exercising right to subscribe for or acquire securities or derivatives *Part XIII Division 5 – Other market misconduct/Part XIV Division 3 – Other market misconduct offences*	s12 S(ID)O	Clauses 264 and 286 largely re-enact existing law.
265 & 287	False trading (Part XIII)/Offence of false trading (Part XIV)	s135(1)&(2) SO, s62 CTO, ss998, 1259 &1260 ACL;	Clauses 265 and 287 elaborate on existing law and are modelled on ss998, 1259 &1260 ACL. The inclusion of recklessness as a mental element for the misconduct or offence of false trading is new. Clauses 265(5) and 287(5) which elaborate on the types of conduct that are regarded as false trading are modelled on s998(5) of ACL. The defence to certain types of false trading (clauses 265(5)(a), (b) and (c)) set out in clauses 265(6) and 287(7) is modelled on s998(6) of ACL.
266 & 288	Price rigging (Part XIII)/Offence of price rigging (Part XIV)	s135(3) SO, ss998 &1260 ACL;	Clauses 266 and 288 elaborate on existing law. The types of transactions that amount to price rigging and the defence of price rigging in clauses 266 and 288 are modelled on s998 of ACL. Clauses 266(1)(b) & (2)(b) and 288(1)(b) & (2)(b) on artificial transactions are modelled on s1260(2) of ACL. Clauses 266(4) and 288(5) are modelled on s998(8) of ACL.
267 & 289	Disclosure of information about prohibited transactions (Part XIII)/Offence of disclosure of information about prohibited transactions (Part XIV)	s135(5) SO; ss1001 &1263 ACL;	Clauses 267 and 289 elaborate on existing law, and are modelled on ss 1001 & 1263 of ACL. The defence provisions in clauses 267(2) and 289(3) are new.

Clause	Contents	Derivation	Notes
268 & 290	Disclosure of false or misleading information inducing transactions (Part XIII)/Offence of disclosure of false or misleading information inducing transactions (Part XIV)	s138 SO, s64 CTO, ss999 & 1261 ACL	Clauses 268 and 290 elaborate on existing law. Clauses 268(1) and 290(1) are modelled on ss999 and 1261 of ACL. The required mental elements set out in clauses 268(1)(ii) and 290(1)(ii) are new. Clauses 268(2) to (5) and 290(3) to (6) that set out the defences and the definition of "issue" are also new.
269 & 291	Stock market manipulation (Part XIII)/Offence of stock market manipulation (Part XIV)	s137 SO and ACL s997	Clauses 269 and 291 elaborate on existing law and are modelled on s997 of ACL.
	Part XIII Division 6 – Miscellaneous/Part XIV Division 5 – Miscellaneous		
270 (Part XIII only)	Duty of officers of corporations	s13 S(ID)O	Clause 270 is based on existing law relating to insider dealing.
271 (Part XIII only)	Transactions constituting market misconduct not void or voidable	s14 S(ID)O	Clause 271 largely re-enacts existing law relating to insider dealing.
295 (Part XIV only)	Penalties	s139 SO, s65 CTO; New	Rationalize existing law. Civil sanctions from Part XIII included where appropriate.
272 & 296	Civil liability for market misconduct (Part XIII)/Civil liability for contravention of this Part (Part XIV)	New	Influenced by s141 SO, s40 CO, s150 FSMA
273 & 297	Transactions not to constitute market misconduct (Part XIII)/Transactions not to constitute offences (Part XIV)	New	Influenced by s137 SO
274 & 298	No further proceedings after Part XIV criminal proceedings (Part XIII)/No further proceedings after Part XIII market misconduct proceedings	New	New
275 (Part XIII only)	Market misconduct regarded as contravention of provisions of this Part	New	New
276 (Part XIII only)	No retrospective application	New	Influenced by s3 S(ID)O.

Clause	Contents	Derivation	Notes
	Part XIV Division 4 – Other offences		
292 (Part XIV only)	Offence involving fraudulent or deceptive devices, etc. in transactions in securities, futures contracts or leveraged foreign exchange trading	s136 SO, s63 CTO, s40 LFETO	Clause 292 re-enacts existing law. Sub-clause (3) defining "a transaction" is new.
293 (Part XIV only)	Offence of disclosure of false or misleading information inducing others to enter into leveraged foreign exchange contracts	s40 LFETO, influenced by s138 SO, s64 CTO and ss999 &1261 ACL	Clause 293 elaborates on existing law and is modelled on ss999 and 1261 of ACL. The mental elements set out in clause 293(1)(b) are new. Clauses 293(3) to (6) that set out the defences and the definition of "issue" are also new.
294 (Part XIV only)	Offence of falsely representing dealings in futures contracts on behalf of others, etc.	New	Influenced by s1258 ACL
	Schedule 8 – Market Misconduct Tribunal	New	Influenced by s15 and the Schedule to S(ID)O and ss 18, 20 and 21 of SFCO.

INTERNATIONAL COMPARISON

All major developed jurisdictions, particularly those sharing common law legal systems and developed financial markets, have laws which broadly outlaw insider dealing, various forms of market manipulation and the disclosure of false or misleading information concerning securities and futures contracts. However, precise comparisons between the provisions in the laws of different jurisdictions may not be meaningful as the overall framework for outlawing market misconduct are not the same. We outline below the overall position in the US, UK and Australia.

United States

2. The US has dual civil and criminal regimes for market misconduct. The US Securities and Exchange Commission ("SEC") enforces the US securities laws through a mixture of civil and administrative action. The US Department of Justice may take criminal action for an intentional or reckless breach of those laws. Further, liberal US civil procedural laws such as the ease of bringing a class action and the legality of contingency fees encourages private individuals and firms to take civil action which supplements the enforcement of the law by government agencies.

3. The US securities law broadly outlaw various forms of market manipulation, insider dealing, the disclosure of false and misleading information concerning securities and circulating information that the price of a security will be affected by conduct intended to affect the price of that security[1]. The US law is very complex and fleshed out in both SEC rules and case law. The full extent of US law requires careful explanation by a US qualified specialist securities lawyer. However, the substance of the provisions outlawing market manipulation is largely reflected in the Australian law from which the proposed provisions in the SF Bill are drawn.

4. The US SEC has at its disposal a range of civil remedies for conduct that in Hong Kong would amount to market misconduct. The SEC may commence administrative proceedings to obtain a cease and desist order[2], order an accounting for or disgorgement of profit[3], apply to court for civil penalties of up to US$100,000 per violation per day for an individual and up to US$500,000 per violation per day for a corporation[4]. Intentional and reckless violations of the US securities laws are criminal offences prosecutable by the US Department of Justice[5]. The SEC may bring civil proceedings even though the US Department of Justice is bringing or has brought

---

1 Section 9(a)(1), (2), (3) and (5), 10(b) and 15(c) and (2) SEA and the extensive rules made thereunder and section 17(a) of the Securities Act.

2 Section 21C SEA.

3 Section 21C(e) SEA.

4 Section 21(d)(3) and 21B SEA.

5 Section 32 SEA.

criminal charges, although the courts may stay such civil action pending resolution of the criminal proceedings. US laws also contain extensive provision for private causes of action.

United Kingdom

5. The UK currently has a limited range of criminal offences governing insider dealing, market manipulation and the disclosure of false or misleading information concerning financial product[6]. However, the UK is now in the process of introducing a radically different system that is expected to commence later this year.

6. Under the reforms that the Financial Services and Markets Act 2000 ("FSMA") will bring, the UK will create dual civil and criminal regimes to deal with conduct that in Hong Kong will be termed market misconduct. The existing criminal offences will remain. The insider dealing provisions in Part V of the Criminal Justice Act 1993 will remain unchanged. The existing market manipulation and false and misleading offences in the Financial Services Act 1986 will be re-enacted with only minor changes in the FSMA[7]. The UK market manipulation and false and misleading information offences are similar to the present limited Hong Kong offences in section 135 of the SO and section 3 of the Protection of Investors Ordinance (Cap. 335) (which will be re-enacted in clause 106 of the Bill) respectively.

7. However, these limited criminal offences in the UK are being supplemented by quite a radical civil regime. Under Part VIII of the FSMA, the Financial Services Authority ("FSA") may draft a code which will describe the conduct that amounts to "market abuse"[8]. Market abuse is defined to be conduct which basically amounts to insider dealing or market manipulation or which would, or would be likely to, distort the market in investments of the kind in question[9]. Whether conduct is market abuse is determined by reference to whether a regular market user would regard it as such. The conduct must be such that a regular market user would regard it as a failure by the person concerned to observe the standard of behaviour reasonably expected of a person in that person's position in the market[10]. The FSA's code may describe conduct that the FSA thinks amounts to market abuse, describe conduct that the FSA thinks does not amount to market abuse and detail factors which in the FSA's opinion should be taken into account in determining whether or not behaviour amounts to market abuse. The fact that behaviour conforms with a description of conduct in the code that does not amount to market abuse is a strict defence to being fined or otherwise being punished for market abuse. Otherwise, the

---

6 Part V of the Criminal Justice Act 1993 (UK) (insider dealing) and section 47 of the Financial Services Act 1986 (UK).

7 Section 397 FSMA.

8 Section 119 FSMA.

9 Section 118 FSMA.

10 Section 118(1)(c) FSMA.

code may be relied on so far as it indicates whether or not certain behavious should be taken to be market abuse[11].

8. The FSA may change the code at any time[12]. The FSA must consult the public with a draft code. It must also release its consideration of public submissions on a draft code[13].

9. The FSA will be able to fine those who engage, or require or encourage others to engage, in market abuse unlimited amounts or publish a statement that they have engaged in market abuse[14]. But, if the FSA is of the opinion that a person had reasonable grounds for believing that their conduct did not amount to market abuse or that the person took all reasonable precautions and exercised all reasonable due diligence to avoid engaging in market abuse, the FSA cannot fine or otherwise punish that person[15]. A person whose behaviour conforms with a rule made by the FSA to the effect that their behaviour does not amount to market abuse is also not guilty of market abuse[16]. At present, there is only a draft code available. Much of the conduct described in the draft code in substance mirrors that outlawed by the market misconduct provisions in the SF Bill.

10. With regard to the conduct of investigations, no evidence relating to the statement made to an investigator by a person in compliance with an information requirement may be adduced and no question relating to it may be asked by or on behalf of the prosecution or the FSA in criminal proceedings (other than perjury or making of false statements) or in proceedings of market abuse against that person.

11. Before imposing a penalty for market abuse, the FSA will have to issue a warning notice setting out the grounds why they believe the person has engaged in market abuse and the proposed punishment[17]. They must then consider representations made in response to the warning notice. If having considered the person's representations, the FSA is still minded to punish the person they must give him a decision notice which gives details of the penalty to be imposed and the reasons for it[18]. A person who wants to challenge an FSA decision to punish that person for market abuse may refer the matter to the Financial Services and Markets Tribunal ("FSMT")[19]. The powers of the FSMT are similar to those of the SFAT proposed in Part XI of the Bill[20]. The FSMT was described in the discussion paper no. 10/01.

---

11 Section 122 FSMA.

12 Section 119 FSMA.

13 Section 121 FSMA.

14 Section 123 FSMA.

15 Section 123 FSMA.

16 Section 118(8) FSMA.

17 Section 126 FSMA.

18 Section 127 FSMA.

19 Section 127(4) FSMA.

20 Part IX FSMA.

12. There are no private rights of action under the FSMA in the same context as in Parts XIII and XIV of the SF Bill. The FSA however will be able to apply to court seeking an order that a person who has engaged, or encouraged or required another person to engage, in market abuse pay restitution to the FSA. The FSA must then hold the money to pay to those who have suffered loss as a result of the market abuse[21]. The FSA may also apply to court for injunctions and other orders in relation to market abuse or apprehended market abuse[22]. While making such an application, the FSA may apply to court for an order that a person who has engaged, or encouraged or required another to engage, in market abuse be fined[23]. Lastly, the FSA may itself order that a person pay restitution[24]. It must give a warning notice before doing so, consider representations and give a notice of its decision[25].

13. The FSA may also criminally prosecute offences under the FMSA and insider dealing offences under the Criminal Justice Act 1993[26]. The FSA will decide to prosecute criminally or institute market abuse proceedings by reference to a prosecution policy very similar to the one the Secretary for Justice uses in Hong Kong. The UK's new system gives an enormous amount of power to the FSA even with the checks and balances in place.

Australia

14. Australia's market misconduct provisions are contained in the Corporations Law (referred to as "ACL" in this paper). Australia has an extensive system of criminal offences dealing with various forms of market manipulation, disclosure of false and misleading information about securities and futures contracts and disclosure of information about transactions in securities or futures contracts that are made illegal by the other offence provisions[27]. These provisions are largely similar in respect of securities and futures contracts. These provisions were drafted in the 1970s and 1980s and were originally intended to be a statutory distillation of equivalent US securities and futures laws found in US statutes, SEC regulations and the US federal case law interpreting the US laws and SEC regulations. The Australian market manipulation, false and misleading information and disclosure of information about illegal transaction laws have been used as a model for the provisions in Part XIII and XIV of the SF Bill. The Australian Securities and Investments Commission ("ASIC") may take civil action in the courts for a variety of orders to remedy the effects of market manipulation and the other forms of market misconduct described in

---

21 Section 383 FSMA.

22 Section 381 FSMA.

23 Section 129 FSMA.

24 Section 384 FSMA.

25 Section 385 FSMA.

26 Sections 401 and 402 FSMA.

27 Sections 997-999, 1001, 1259-1261 and 1263 ACL.

these offences[28]. Those who suffer loss as a result of such conduct may also take civil action for compensation or various court orders[29].

15. Australia's insider dealing laws are also contained in the ACL[30]. Separate provisions apply to insider dealing in securities and insider dealing in futures contracts relating to the securities of a body corporate. The insider dealing provisions for securities differ from existing provisions in Hong Kong in that they apply to anyone who is in possession of information which they know is not generally available to the public and which would, if it were so available, have a material effect on the price of the securities concerned. There is no need to establish that the person was an insider to the corporation concerned. The insider dealing provisions for futures, however, require that it be proven that a person is connected with the body corporate the securities of which the futures contracts relate to. There are various defences. Insider dealing is a crime in Australia prosecuted by the criminal prosecutor but the ASIC may take civil action for a variety of civil orders to remedy the conduct, including injunctions[31]. Those affected by insider dealing may also apply for compensation and various other court order[32].

16. Lastly, Australian law contains a number of offences specifically aimed at acts of fraud and deception involving securities and futures contracts[33] . Again, the ASIC may seek civil court orders to remedy the conduct[34] and there are private rights of civil action available[35].

17. The Australian laws are all enforced in the courts, either civil or criminal. The decision to take criminal action is made in accordance with a criminal prosecution policy very similar to that which exists in Hong Kong and in the UK and US.

---

28 Sections 1268, 1323, 1324 and 1325 ACL.

29 Sections 1005, 1014, 1265, 1223, 1224 and 1325 ACL.

30 Sections 1002-1002U and 1251-1257 ACL.

31 Section 1002U, 1268, 1323, 1324 and 1325 ACL.

32 Sections 1002U, 1005, 1013, 1265, 1323, 1324 and 1325 ACL.

33 Sections 1000 and 1264 ACL.

34 Sections 1268, 1323, 1324 and 1325 ACL.

35 Sections 1005, 1014, 1265, 1223, 1224 and 1325 ACL.