

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

**Securities and Futures Bill
“Misconduct” under the disciplinary regime**

At the Bills Committee meeting on 30 March 2001, we undertook to provide examples of disciplinary action taken by the Securities and Futures Commission (SFC) in the past to illustrate the four types of conduct, which are modelled on existing law, prescribed in clause 186(1)(a) to (d) of the Securities and Futures Bill (SF Bill) as constituting “misconduct”.

The four types of conduct

2. The equivalents of the four types of conduct prescribed in clause 186(1)(a) to (d) under existing legislation are respectively set out in subparagraphs (a) to (d) below:

- (a) any failure to comply with the relevant provisions of the existing Ordinances¹ (*ss56(5)(a)&(d), 121S(5)(a) and 121U(5)(a) SO, s36(5)(a)&(d) CTO and s12(7)(a) LFETO*);
- (b) any failure to observe the terms and conditions of a certificate of registration/ licence (*ss56(5)(b), 121S(5)(c) and 121U(5)(c) SO, s36(5)(b) CTO and s12(7)(b) LFETO*);
- (c) any failure to comply with a requirement made by the Commission under the SO or the SFCO that relates to carrying on a business of securities margin financing (*ss 121S(5)(b) and 121U(5)(b)*); and
- (d) any act or omission relating to the conduct of business of the regulatee which is or is likely to be prejudicial to the interest of members of the investing public (*ss56(5)(c), 121S(5)(d) and*

¹ “Relevant provisions of the existing Ordinances” refer to those provisions in the Securities Ordinance (“SO”), the Commodities Trading Ordinance (“CTO”), the Leveraged Foreign Exchange Trading Ordinance (“LFETO”) and the Securities and Futures Commission Ordinance (“SFCO”) as applicable to dealers, investment advisers, securities margin financiers, commodity traders, commodity trading advisers, leveraged foreign exchange traders and their representatives (collectively referred to in the paper as “the regulatees”).

121U(5)(d) SO, s36(5)(c) CTO and s12(7)(c) LFETO) or the general public (s12(7)(c) LFETO).

3. Examples of disciplinary action taken by the SFC in the past two years (i.e. April 1999 to March 2001) on each of the above grounds, if any, are given in the **Annex**.

4. In relation to each action taken under the ground specified in paragraph 2(d) above (*see examples at Annex*), the improper conduct involved clearly deviated from normal or acceptable market practice to the detriment of the interests of the investing public, which, in many cases are the clients of the broker firms involved. To better protect investors, there are therefore strong regulatory reasons for the SFC to retain the power to discipline the conduct of regulatees which is or is likely to be prejudicial to the interest of the investing public.

5. Over the past two years, no disciplinary action has been taken on the ground of “public interest” alone as set out in paragraph 2(d). The matter at issue concerns the conduct of individual regulatees. It may be argued that such misconduct would unlikely be causing systemic risks to other sectors of the community or having a wider impact on the interests of the general public. However, it may also be argued that such misconduct, on the most extreme occasions, may not only affect the interest of individual investors, but also erode investors’ confidence and tarnish our image as an international financial centre, hence affecting the interest of the general public. We therefore invite Members to consider retaining the phrase “public interest” in clause 186(1)(d) to cover these extreme cases.

6. Adequate checks and balances against abuse of power by the SFC have been put in place in the disciplinary process under clauses 189 and 191 of the SF Bill. The SFC cannot take action without first giving a regulatee a reasonable opportunity of being heard. To do so, the SFC would have to set out in detail the conduct at issue and its concerns. The regulatee would be left in no doubt as to the nature of the concerns that must be addressed. The SFC would then be obliged, having considered any representations received, to provide a written statement of the reason for the ultimate decision made.

7. Furthermore, **all** SFC decisions as regards the taking of disciplinary action would be appealable to the Securities and Futures Appeals Tribunal and in most circumstances can take effect only after the time for an appeal has expired or, if an appeal is made, after the appeal is withdrawn or determined. Judicial review and complaint to the Ombudsman are also available.

Securities and Futures Commission
Financial Services Bureau
4 May 2001

**Examples of grounds of misconduct
for disciplinary action taken by SFC
(during the period 4/1999 – 3/2001)**

**Failure to comply with relevant provisions of existing ordinances
(paragraph 2(a) of the paper)**

- breach of the financial resources rules
- late submission of audited accounts
- failure to restructure share margin financing activities so as to comply with the financial resources rules and to abide by the trading caps imposed by the Exchange

**Failure to observe terms and conditions of registration/licence
(paragraph 2(b) of the paper)**

- breach of registration or licence conditions, e.g. in the case of a licensed representative under LEFTO, not to provide discretionary account services for clients; for a dealer's representative who had committed trading malpractice previously, no trading through an account maintained with any dealer other than his/her employer.

**Act or omission which is or is likely to be prejudicial
to interest of investing public/public interest
(paragraph 2(d) of the paper)**

- misuse of clients' accounts, funds or shares
- trading through nominee accounts to the detriment of other clients
- misapplication of cash clients scrip for settlement purposes

- inputting a series of buy orders near the close of trading with the effect of raising the closing price of a share (commonly known as ‘marking the close’)
- failure to supervise staff and putting in place proper system of internal control
- conducting trades on a discretionary basis without the accounts being designated as “discretionary accounts”
- submitting multiple applications in an initial public offering and making false declarations in regard to such
- dealer’s representatives giving prior information of large orders to trade Hang Seng Index futures contracts to be executed by their company to a dealer’s representative of another company, who then took a trading position to profit from the knowledge of these large orders
- acting as agents for an unlicensed Macau-based entity to carry on a business of leveraged foreign exchange trading
- knowingly facilitating former staff members of another registered intermediary in conducting improper trading activities in derivative warrants
- making inaccurate statements concerning the exempt status of a retirement scheme under the Mandatory Provident Fund Schemes Ordinance and advising clients on the proposed exempt status of the scheme without properly verifying the truth of the information

Note : During the period, no disciplinary action was taken on the ground of misconduct due to failure to comply with a requirement for margin financing business made by the SFC (paragraph 2(c) of the paper). The regulatory framework for margin financing business only came into operation on commencement of the Securities (Margin Financing) (Amendment) Ordinance in June 2000.