10 May 2001

Mr Paul Bailey
Executive Director of Enforcement
Securities & Futures Commission
12/F Edinburgh Tower
15 Queen's Road C
Hong Kong

Dear Paul,

Re: Public Consultation on draft Disciplinary Fining Guidelines

Thank you for your letter dated 28 March 2001 on the captioned subject.

Our Committee Members had a thorough discussion on the Draft and our comments on the Disciplinary Fining Guidelines are made on the following fundamental principles:

(1) As mentioned in our earlier submissions to both the White Bill and the Blue Bill, it remains our belief that, as a matter of natural justice, SFC should not play all the roles of investigation, prosecution, judge and jury in disciplinary matters up to the stage of ordering a fine. We believe fining, as a punitive measure, should be left with the courts as a matter of natural justice.

(2) On the strength of the argument that there is no uniformity in the application of the disciplinary actions if exempt persons" are excluded, we suggest that fining, in order to be fair, should be applicable to all persons engaged in the same regulated activities, including authorized financial institutions.

(3) If the Legislature is unable to take on board our submission under (1) above, we are prepared to accept the power of fining if it is limited to market misconduct only, as defined in clause 237 of the Bill (namely, insider dealing, false trading, price rigging, disclosure of false information and stock market manipulation etc.) and not universally applied to all misconducts" which include everything from contravention of any of the relevant provisions" [186(1)(a)] to "an act or omission, which in the opinion of the Commission, is likely to be prejudicial to the interest of the investing public or the public interest" [186(1)(d)].

Paragraph 6 of the Paper on the draft guidelines mentioned one side of the truth in saying that the UK Financial Services Authority (FSA) will be empowered to impose unlimited fines upon intermediaries. However, it did not mention the other side that this power is only imposed on market abuses (the equivalent of our market misconduct) in the UK model in respect of intermediaries. Secondly, it is not imposed on a person if he has a reasonable defence. Thirdly, the court is entitled to consider whether such penalty should be imposed. To make these representations more self-contained, the relevant part of the text of section 123 of the UK Financial Services and Markets Act is quoted hereunder:

> "123. — (1) If the Authority is satisfied that a person ("A") —
>
> (a) is or has engaged in market abuse, or
> (b) by taking or refraining from taking any action has required or encouraged another person or persons to engage in behaviour which, if engaged in by A, would amount to market abuse,
>
> it may impose on him a penalty of such amount as it considers appropriate.
>
> (2) But the Authority may not impose a penalty on a person if, having considered any representations made to it in response to a warning notice, there are reasonable grounds for it to be satisfied that—
> (a) he believed, on reasonable grounds, that his behaviour did not fall within paragraph (a) or (b) of subsection (1), or
> (b) he took all reasonable precautions and exercised all due diligence to avoid behaving in a way which fell within paragraph (a) or (b) of that subsection."

Without mitigating our above principles, our comments on the draft Guidelines are summarised as follows:

1. Inadvertent conduct is conduct which is neither intentional nor reckless and therefore should not attract anything above the lowest disciplinary action. We believe a warning, and a reprimand in any case, is sufficient. A fine is described by the draft as primarily an intermediate sanction between a reprimand at the lower end to a revocation or suspension of licence at the upper end. If inadvertent conduct without causing any harm to anybody is sanctioned by a fine, what conduct can one expect to be dealt with by a reprimand? If this basic principle of imposing a fine is not clarified we can envisage that fines will be imposed on virtually all categories of breaches whether serious or trivial, whether inadvertent or intentional.

2. Technical breach is again a breach without intent of default of any kind or causing any damage. Similar to inadvertent conduct, we do not believe it deserves a fine. A reprimand is a sufficient warning. The underlying principle in the above paragraph similarly applies here.

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3. If similar cases are treated consistently, a fine shall not be distinguished between a large international firm and a small local firm. A relatively moderate fine to an international firm would be colossal in the case of a small firm. How is this going to be reconciled with the proposal that a fine should not have the likely effect of putting a firm in financial jeopardy?

4. A fine of say $100,000 (1% of a fine of $10 million) may be considered moderate by the SFC. However, for a licensed representative it may cause more financial damage than the suspension of his licence for a long duration. Can such a person elect the higher level of discipline, namely a suspension instead of a fine?

5. We suggest that, in order that everybody would have a fair expectation of what the fines will be, the guidelines should list a range of fines for breaches which are separated into different categories according to their seriousness in nature.

6. We suggest that there is merit in the UK model in showing the public with transparency what the Authority is proposing to do and how the industry or public is reacting by publishing, together with the Guidelines, the representations made to it and its response to them. We recommend that this be done.

7. At present, market practitioners are appointed into the working group for the fining guidelines. This tends to increase the transparency of the fining process and is to be welcomed.

Should you have any query or require further discussion, please do not hesitate to contact us.

Yours sincerely,

Paul Fan
Chairman