Paper No. 8A/01 (Revised)

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

Summary of public comments and Administration's Response on Part IX of the Securities and Futures Bill

Clause no.	Respondent	Respondent's comments	Administration's response
Part IX – Discipline			
Rights of appeal*	Hon Henry Wu	The Securities and Futures Appeals Tribunal (the "SFAT") should have power to hear and review all decisions of the SFC so that any stockbroker aggrieved by a decision of the SFC can appeal against the decision.	The policy intention and the reasons regarding the right of appeal are set out at great length in paragraphs 7-14 of Paper 10/01 dated 18 April 2001. The general policy is that any person who is the subject of a decision made by the SFC should enjoy a right of appeal against such decision unless there are compelling policy reasons to the contrary. The reasons cover broadly (a) intermediate decisions with no substantial conclusive effect on the rights or interests of the subject persons (but the granting of such right of appeal would hamper or frustrate the regulatory efforts of the SFC to the detriment of the interests of the investing public, for example, an appeal against an investigator's direction requiring attendance at an interview might mean that important regulatory process cannot be performed or completed); (b) decisions followed by application to the court; (c) decisions involving broad policy such as the making of subsidiary legislation; and (d) decisions subject to other specialized merits review appeal mechanisms. In addition to the rights of appeal under the SF Bill, a person who is the subject of action taken by the SFC may, if there are grounds, consider applying for judicial review, reporting to the Ombudsman, the Privacy Commissioner or the ICAC (if corruption is alleged to be involved). The newly established Process Review Panel also serves as an additional check on the SFC's exercise of its power.

* Response to comment not incorporated in Paper 8A/01 when last issued.

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186(1)(d)[#]	Law Society	The legislation should explicitly state that the opinion of the SFC with respect to whether a licensed person's conduct is or is likely to be prejudicial to the interest of the investing public or the public interest, should be reasonable.	When making a disciplinary decision, the SFC has to act professionally and impartially. The forming of "opinion" inevitably involves a degree of subjective judgement. In making such disciplinary decisions, the SFC is required to observe the procedural requirements as specified in clause 189 (combined with the original clause 191 into the new clause 191 of the draft mark-up Bill in Paper CE08/01 dated 17 July 2001) which will ensure that the SFC forms its opinion in an informed and transparent manner. Any party aggrieved by the decision as regards misconduct made in respect of him can lodge an appeal with the SFAT. Furthermore, the common law grounds of judicial review already require a decision-maker to have sound grounds for its opinion and make a properly informed and balanced decision. Otherwise, the decision may be struck down. Therefore, there is no need for the suggested change.
186 (1)(d)*	HKSbA Hon Henry Wu	The opinion of the Commission is a fact which is beyond challenge and that fact alone is sufficient to find a person "guilty of misconduct" and trigger the rest of the disciplinary action in motion. Matters arising from section 186 are not within the ambit of review under Part 2 of Schedule 7. There is no redress at all to dispute the opinion of the Commission if it is conceived in error. The phrase "in the opinion of the Commission" can be removed without affecting the basic definition of misconduct.	- The making of a decision by any person inevitably involves forming of an "opinion" on the situation to which the decision relates. In exercise of its disciplinary powers, the SFC as the statutory regulator needs to form an opinion as to whether any relevant act or omission is or likely to be prejudicial to the interest of the investing public or to the public interest. This is part of SFC's statutory functions which could not be passed on to other parties. - SFC makes a disciplinary decision (and other decisions as well) in a professional, impartial, informed and transparent manner as a usual practice required under administrative law. - A party aggrieved by SFC' disciplinary decisions may appeal to the SFAT. - Appeal to the SFAT provides a powerful remedy (than judicial review) to the persons affected by SFC's decisions as the SFAT will be able to review both the merits of an SFC decision and its procedural regularity and legality. The SFAT will be able to substitute its own decisions for SFC's decisions and the appeals will be de novo – the SFAT can entirely re-hear the matter. - SFAT proceedings are considered speedier and cheaper than judicial review.

[#] Response to comment set out in Paper 8A/01 updated.

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			- SFC issues extensive guidance about the standards of ongoing conduct it expects of licensed persons, e.g. Code of Conduct, Fit and Proper Criteria, etc. SFC forms its opinion as to whether "misconduct" has occurred in the light of such guidance. The industry is well aware of SFC's standards under the disciplinary regime. - In the UK and the US, securities regulators exercise similar disciplinary powers based on their subjective judgement. - Similar reference to "in the opinion of" in other legislation in Hong Kong, e.g. the Telecom Ordinance and the Broadcasting Ordinance. Please see also Paper 8F/01 dated 24 July 2001.
186(1)(d)#	HKSbA	A person should only be guilty of misconduct if he has breached a relevant provision, a term or condition of his licence or another condition imposed under or pursuant to the Bill. The SFC should not have a residual power to find people guilty of misconduct on the strength only of its own opinion. The SFC is the investigator, prosecutor, judge and jury. There must be more checks and balances.	Licensed persons and those involved in their management are put in a privileged position, by virtue of the licensed persons being recognized as fit and proper to conduct certain types of regulated activities, with respect to the market, investors and their clients. They have great scope to abuse that position. As such, they are subject to a regulatory and disciplinary regime to ensure that they are fit and proper and do not abuse their position. Conduct that might suggest that a licensee or person involved in their management is not fit and proper or guilty of misconduct is broader than breach of the Securities and Futures [Ordinance] or licensing conditions; and is impossible to conclusively enumerate. The residual ability of the SFC to discipline licensees and those involved in their management for not being fit and proper and for prejudicing the interest of the investing public or the public interest is therefore necessary to protect the public and properly regulate licensees and those involved in their management. Sections 36 of the Commodities Trading Ordinance, 56, 121S and 121U of the Securities Ordinance and 12 of the Leveraged Foreign Exchange Trading Ordinance all provide for disciplinary action to be taken if the relevant conduct is likely to be prejudicial to the interests of members of the investing public. As the SFC is the specialist body charged with licensing and regulating licensed intermediaries, it is appropriate that it also decides when licensed intermediaries and others fall short of the appropriate standards and imposes appropriate disciplinary sanctions. Only breaches of the legislation may result in criminal sanction if so stipulated therein, the prosecution of which will be decided by the Department of

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			Justice and the imposition of sanctions, the court. There are a number of safeguards to ensure that the disciplinary functions of the SFC are exercised fairly, transparently and consistently. They include the procedural requirements prescribed in clauses 189 and 191 (combined into the new clause 191 of the draft mark-up Bill in Paper CE08/01 dated 17 July 2001), the appeal mechanism provided for in Part XI of the SF Bill (see also the response to the Law Society on clause 186(1)(d)). The Process Review Panel appointed by the Chief Executive in November 2000 also serves this safeguarding purpose. Moreover, the decisions of the SFC are subject to challenge by the Ombudsman and by way of judicial review. The administration of the disciplinary regime is similar in all leading jurisdictions. Please see paragraph 32 of Paper 8/01 dated 23 March 2001 for details.
186(1)(d) 187(1)(b) #	HKISD	The definition of 'misconduct' gives too much power to the SFC. The regulated persons will lose their ability to or chances of self-defence. Clause 187(1)(b) empowers the SFC to take disciplinary action on the basis of a person's fitness and properness. This sub-clause and other similar clauses that follow give the SFC the chance of abusing its power. Once the SFC considers a regulated person to be not fit and proper, he/she will lose the ability to and chances of self-defence.	See the response to the HKSbA for the rationale in delineating the definition of misconduct. A person is licensed or exempted on the basis that it is fit and proper to carry on a regulated activity. If it ceases to be fit and proper, the SFC must in the interest of investor protection have the power to suspend or revoke its licence or exemption. Similar grounds exist in current legislation and it is consistent with the practices in other leading jurisdictions (see Annex C to Paper 8/01 dated 23 March 2001). There is no question of the regulated persons losing their ability or chances of self-defence. When making a disciplinary decision, the SFC has to act professionally and impartially. The SFC is required to observe the procedural requirements as specified in clause 189 (combined with the original clause 191 into the new clause 191 of the draft mark-up Bill in Paper CE08/01 dated 17 July 2001) (which include among others, providing the concerned party an opportunity of being heard) for making an informed and transparent decision. Any party aggrieved by the decision as regards misconduct made in respect of him can lodge an appeal with the SFAT. Furthermore, the common law grounds of judicial review already require a decision-maker to have sound grounds for its opinion and make a properly informed and balanced decision. Otherwise, the decision may be struck down. If the SFC failed to have adequate regard to any defence submission, its decision would be vulnerable to being overturned.

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186(2)	Group of nine investment bankers, HKSbA	Clause 186(2) deems a responsible officer or other person involved in the management of a licensed person guilty of misconduct if the licensed person is guilty of misconduct and that misconduct occurred with the consent or connivance of, or owing to the neglect of the responsible person or person involved in the management of the licensed person. The neglect standard for attribution is unfair.	The SFC must prove that the licensed person's misconduct was attributable to the neglect, consent or connivance of a responsible officer or other person involved in the licensed person's management. The SFC's disciplinary powers are a regime that is meant to protect the public from actions of intermediaries which are regulated in the public interest. More is expected of licensed intermediaries – higher standards are a quid pro quo for the privilege of being licensed. Many significant intermediary failures (for example, Barings) were due to management incompetence. Managers must manage their companies which means taking reasonable measures to supervise. Neglect is an appropriate standard for attributing disciplinary liability to corporate management who are the ones directing the acts of the corporation. The sanction imposed upon the manager will not necessarily be the same as that imposed upon the licensed person as the failings of each will be judged in context. As explained also in paragraph 6 of Paper 8/01 dated 23 March 2001, the SF Bill indeed tightens the current automatic attribution to an officer of the misconduct of a licensed corporation with a raised standard in that the SFC has to prove the misconduct as having occurred with his consent or connivance or attributable to his neglect.
186(2)*	HKSbA Hon Henry Wu	Here neglect is put in the same category as consent or connivance, a provision which disregards the element of intent in the mind of the person in question. Culpability may go to a responsible officer or a person involved in management.	The SFC's disciplinary powers are a regime that is meant to protect the public from actions of intermediaries which are regulated in the public interest. More is expected of licensed intermediaries – higher standards are a quid pro quo for the privilege of being licensed. Many significant intermediary failures (for example, Barings) were due to management incompetence. Managers must manage their companies, which means taking reasonable measures to supervise. Neglect is an appropriate standard for attributing disciplinary liability to corporate management who are the ones directing the acts of the corporation. The sanction imposed upon the manager will not necessarily be the same as that imposed upon the licensed person as the failings of each will be judged in the context. As explained in paragraph 6 of Paper 8/01 dated 23 March 2001, the SF Bill indeed

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			tightens the current automatic attribution to an officer of the misconduct of a licensed corporation with a higher standard in that the SFC has to prove the misconduct as having occurred with his consent or connivance or attributable to his neglect. We do not therefore consider that there is a need for charge.
		The phrase "a person involved in the management of the business" creates uncertainty as to its interpretation.	The concept of a "person involved in the management of a business has a clear ordinary meaning, which does not require further definition. The reference to "person involved in the management of a business" is in existing law.
187(1)*	HKSbA	Do not agree that the Commission plays the role of prosecution, jury and judge at the same time, with a wide range of administrative sanctions in addition to its power to make a heavy fine. The power to order a pecuniary penalty should be vested in the courts.	As the SFC is the regulatory body charged with licensing and regulating licensed intermediaries, it is appropriate that it also decides when licensed intermediaries and others fall short of the appropriate standards and imposes appropriate disciplinary sanctions. Only breaches of the legislation may result in criminal sanction, the prosecution of which is the prerogative of the Department of Justice and the imposition of sanctions, the court. To ensure transparency in the exercise of its disciplinary functions by the SFC, there are a number of safeguards to ensure they are exercised fairly, transparently and consistently. They include the procedural requirements prescribed in clauses 189 and 191(combined into the new clause 191 of the draft mark-up Bill in Paper CE08/01 dated 17 July 2001) and, the appeal mechanism provided for in Part XI of the SF Bill. The Process Review Panel appointed by the Chief Executive in late 2000 also serves this safeguarding purpose. Moreover, the decisions of the SFC are subject to challenge by the Ombudsman and by way of judicial review. The administration of the disciplinary regime is similar in all leading jurisdictions, and is the same in the existing regime under which the SFC is empowered to discipline its registrants, including reprimand, revocation and suspension of registration. The power to impose disciplinary fines is intended as an intermediate disciplinary measure to "reprimand" and "suspension/revocation". We take the view the proposed disciplinary fines will serve as an effective deterrent against misconduct, as understandably, the SFC may feel inhibited in suspending or revoking the licence of a licensed corporation given the impact on innocent third parties, including clients and employees of the licensed corporation.

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			The availability of fining power to the market regulator is in keeping with the practice in other leading jurisdictions. Please see paragraphs 26 and 32 of and Annex C to Paper 8/01 dated 23 March 2001 for details
187(2)	Consumer Council	The Council had suggested that there was some uncertainty as to the maximum fines and proposed that, where there is no profit or loss involved fines be based on a sliding scale tied to some other appropriate variable. This was not adopted, but the Council participated in the SFC's Disciplinary Fining Guidelines Working Group and its comments on the draft guidelines were taken into account.	A maximum of $10m or three times the profit made or loss avoided should be sufficient. Tying the maximum fine to a variable such as a firm's turnover or annual profit would not calibrate the fine to the circumstances of a particular breach and may lead to arbitrary fines. The SFC's proposed fining guidelines, which have taken into account the comments of the Consumer Council, provide sufficient structure for fining decisions. The approach adopted is consistent with that in the US and the UK.
187[#]	HKISD	It is unfair that the HKMA cannot impose fines to AIs but the SFC can impose fines to regulated persons.	An amendment to empower the SFC to impose pecuniary penalties regarding misconduct in relation to exempt AIs is proposed. See Paper 8D/01 dated 28 May and clause 189A under Paper CE08/01 dated 17 July 2001.
187(2)*	Hon Henry Wu	Why is the power to impose a pecuniary penalty (of up to HK$10 million) vested in the SFC and not the courts? Does the HKMA have similar power to fine in relation to disciplinary action for misconduct of banks?	See above response to HKSbA's comment on clause 187(1) An amendment to empower the SFC to impose pecuniary penalties regarding misconduct in relation to exempt AIs is proposed. See Paper 8D/01 dated 28 May 2001 and clause 189A under Paper CE08/01 dated 17 July 2001.
188*	HKSbA Hon Henry Wu	Section 188 provides for the revocation of a licence of a licensed corporation. The points at issue are paragraphs (vi) and (vii) of subsection (1)(b) where a director's mental incapacity or conviction of an offence may result in the revocation of licence for the licensed corporation. The SFC should only revoke the licence of the person concerned and not	The intention is that only corporations that are fit and proper to be licensed should remain licensed, and in view of the significant influence of directors over the conduct of licensed corporations, clause 188(1)(b)(iv) is introduced to provide the SFC with the power to revoke a licence to a corporation which director suffers mental illness. In the light of Members' concerns, we have proposed a CSA to require that disciplinary sanction by reference to the mental incapacity of a director should only be established if such would impact upon the fitness and properness of the licensed corporation

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		of the corporation.	concerned. See clause 188 under Paper CE08/01 dated 17 July 2001.
188(1)(d)#	Group of nine investment bankers	Clause 188(1)(d) allows the SFC to revoke or suspend a licence if circumstances exist which would require or entitle the SFC to refuse to issue a licence to the licensed person if the licence had not been already issued. This would enable the SFC to revoke or suspend a licence if it changed its licensing standards, for example, to introduce new requirements. This is unfair to existing registrants for whom there should be some scope for grandfathering in respect for matters such as qualifications and an adequate transitional period to adapt to matters such as new operational requirements.	This is equivalent to existing law (sections 11(2)(h), 35(2)(a)(i), (b)(i) and (c)(i) of the Leveraged Foreign Exchange Trading Ordinance). In the interest of investor protection, generally speaking, existing participants will have to be capable of satisfying new requirements introduced to match market development and changing market practice. We, however, take the point that there should be a transitional period for existing registrants to adapt to certain new requirements; and agree to the deletion of clause 188(1)(d) and have proposed a CSA accordingly. See clause 188 under Paper CE08/01 dated 17 July 2001. This should strike an appropriate balance with investor protection. Failure to comply with the requirements after the transitional period will be caught within the meaning of "misconduct" defined in clause 186, which entitles the SFC to take disciplinary action where necessary.
189(2)*	Hon Henry Wu	The details of the procedural requirements under clause 189(2) in respect of the exercise of the powers under clauses 187 and 188 should be subject to appeal. The procedural requirements for exempt persons under clause 191 are different.	The exercise of the powers under clauses 187 and 188 are themselves subject to review by the SFAT and as such the details set out in 189(2) such as the duration of the suspension would fall within the ambit of the SFAT's review. We have proposed a CSA to merge the provisions on procedural safeguards applicable in relation to a licensed corporation and an exempt AI into the new clause 191. See clause 191 under Paper CE08/01 dated 17 July 2001.
190	HKAB Law Society	In conformity with clause 118 governing the granting of exempt status, the SFC should only be able to revoke a declaration of exemption with the HKMA's approval. The HKMA should, in practice, have the final say on SFC disciplinary action against an exempt AI.	The SFC remains the authority to grant a declaration of exemption to an AI under Clause 118(4) upon the advice by the HKMA. In considering an application for exemption under clause 118(3), the HKMA which has detailed knowledge about AIs, must take into account the criteria set out in clause 128 of the SF Bill for determination of "fitness and properness" as elaborated by the guidelines issued by the SFC. Moreover, the HKMA is statutorily required to consult the SFC in formulating the advice, which will guarantee both the input of detailed information about the AIs by the HKMA and a uniform interpretation of the fitness and properness criteria agreed by the two regulators in the process. In the context of a revocation of exemption, the misconduct involved varies significantly and in most cases, is complicated and we take the view such goes beyond

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			the frontline regulator role of the HKMA and should fall within the role of the SFC as the ultimate authority. Under clause 190(4), the SFC must consult with the HKMA before revoking a declaration of exemption**.** This should guarantee the consideration of all relevant facts and circumstances before the SFC revokes an exemption. Similar to other decisions made by the SFC, this is subject to statutory procedural requirements and adequate checks and balances.
190[#]	Law Society	The SFC should have the power to suspend the exemption of an exempt AI.	An amendment to empower the SFC to suspend the exemption of an exempt AI is proposed. See Paper 8D/01 dated 28 May 2001 and clause 189A under Paper CE08/01 dated 17 July 2001.
193	Law Society	Clause 193 allows the SFC when exercising its disciplinary powers to refer to any information in its possession, regardless of how it came into its possession. The SFC should be obliged to disclose all the information it relies on to the subject of its disciplinary proceedings.	The SFC already is obliged to disclose the information it relies upon in disciplinary proceedings through the obligation to accord the subject of the disciplinary proceedings a reasonable opportunity of being heard.
193	HKISD	This clause allows the SFC to use evidence that is obtained by unlawful means. Such evidence is not admissible in a court of law. Even police in investigating murder cannot use unlawful means to obtain evidence. The SFC should not be given such wide and drastic power.	It is noted that in criminal cases, illegally obtained evidence may be admitted. There are no rules of evidence for an administrative decision other than that the material referred to should be relevant and capable of logical proof. In particular, no evidence is automatically excluded from consideration. If the SFC departs from the principles governing the determination of an administrative decision and accords undue weight to unreliable evidence owing to its source or accuracy, its decision will be open to review by the SFAT or vulnerable to judicial review.
193(1)*	HKSbA Hon Henry Wu	Commission may have regard to any information or material in its possession which is relevant, regardless of how the information or material has come into its possession. If such information and material is validly obtained and authentic, bearing no doubt as to its truthfulness, there is no reason to be secretive about its source.	The SFC already is obliged to disclose the information it relies upon in disciplinary proceedings through the obligation to accord a person the subject of the disciplinary proceedings a reasonable opportunity of being heard. As is the current practice, the SFC will always inform the party the nature of the concern and usually reveal the source of the information (there may be circumstances in which this would be inappropriate, for example, a whistleblowing employee who deserved anonymity because he reasonably feared reprisals) and consider his side of story. The SFC would judge whether the information is trustworthy and whether it is fair to use the

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			information. Again, any party aggrieved by the decision of the SFC made in respect of him can appeal to the SFAT. The practice is consistent with that in other jurisdictions. It should be noted even in criminal proceedings, illegally obtained information may be admissible. See Paper 8E/01 dated 1 June 2001.
194*	HKSbA	There is always a possibility that the requirement in subsection (1) cannot be complied with in some circumstances. The defence to a charge under subsection (2) for failing to comply with a requirement under subsection (1) i.e. that the person acted reasonably in purported compliance with the requirement, which was contained in the White Bill should be reinstated.	The defence was removed because it was considered superfluous in view of the requirement to prove "without reasonable excuse" by the prosecution, the defence would unlikely be established in such circumstances (i.e. where the person had acted reasonably in purported compliance but was unable to comply with the requirement.)

Details of Submissions referred to in the Comment/Response Table

Date Received	Organization/Party
30 January 2001	Hong Kong Institute of Securities Dealers ("HKISD")
23 January 2001	Hong Kong Association of Banks ("HKAB")
29 January 2001, 15 February 2001, 23 March 2001* and 5 June 2001*	Hong Kong Stockbrokers Association ("HKSbA")
23 January 2001, 15 February 2001	Linklaters & Alliance representing – Bear Stearns Asia Limited – Credit Suisse First Boston (Hong Kong) Limited – Dresdner Kleinwort Wasserstein – Goldman Sachs (Asia) L.L.C. – Merrill Lynch (Asia Pacific) Limited – JP Morgan – Morgan Stanley Dean Witter Asia Limited – Salomon Smith Barney Hong Kong limited – UBS Warburg ("Group of nine investment bankers")
23 January 2001	Law Society of Hong Kong ("Law Society")
3 February 2001, 19 February 2001	Consumer Council
31 March 2001*	Written comments from the Hon Henry Wu

Securities and Futures Commission
Financial Services Bureau
24 July 2001