HONG KONG BAR ASSOCATION'S COMMENTS ON SECURITIES AND FUTURES BILL AND BANKING (AMENDMENT) BILL 2000

General

1. The proposal to modernise and consolidate the legislative framework for the securities and futures markets is to be welcomed.

Part IV: Offers of Investments

2. The provisions relating to the Commission's power to authorise advertisements, invitations or documents or the investment products themselves (clauses 103 & 104) are unobjectionable. We note that according to Part 2 of Schedule 7, the relevant decisions of the Commission to refuse authorisation or to withdrawal authorisation are subject to review by the Securities and Futures Appeal Tribunal.

3. We note that Clause 107 makes provision for civil liability for fraudulent, reckless or negligent misrepresentation inducing a person to acquire or dispose of investment. This gives rise to a concern as to how this provision is supposed to interact with Clause 208, which apparently imposes civil liability for misleading public communications.

Part VII: Business Conduct, etc. of Intermediaries

4. Clause 163(1) empowers the Commission to make rules generally requiring compliance with specified practices and standards. The rule-making power is very wide, especially as the subject matters enumerated under Clause 163(2) are expressly said to be "without limiting the generality of subsection (1)". A specific constraint is imposed on the power to require certain terms and conditions to be included in client contracts under Clause 163(2)(b) (see Clause 163(3)), but otherwise the power appears to be unlimited except perhaps by reference to the general objects and duties of the Commission as set out in Clauses 4 to 6 of the Bill. In this connection, it should be noted that these rules made by the Commission can also make contravention of them an offence punishable upon indictment by a fine of $200,000 and a term of imprisonment of 2 years. It is not clear whether those rules will be subject to negative vetting by the LegCo. Whereas any code of conduct published by the Commission under Clause 164 is expressly stated not to be subsidiary legislation (see Clause 164(6)), there is no equivalent provision as to the rules made under Clause 163. It may be added that those rules will probably not even be subject to scrutiny by the (already established) non-statutory Process Review Panel which, as its title suggests, focusses on the internal procedures and processes of the Commission. The Bar is therefore concerned that offences with hefty penalties may be summarily created under rules made by the Commission without proper scrutiny and safeguards. In contrast, under Clause 384(8), it is for the Chief Executive in Council to make regulations

to provide for offences and penalties arising from contravention of other rules made by the Commission.

Part VIII: Supervision and Investigations

5. Part VIII of the Bill covers production of books and records, supervision of intermediaries and their associated entities, information relating to transactions, investigations and a miscellaneous division addressing matter such as certification to the Court of First Instance in relation to non-compliance with the foregoing provisions, assistance to foreign regulators, liens on documents, production of computerised information, inspection of records or documents seized and magistrates warrants.

6. The current law allows the Commission to seek the production of books and records when the Commission has reason to suspect fraud, misfeasance or other misconduct in the management of a listed company. Part VIII expands upon those powers by broadening the circumstances in which the Commission may seek production of documents and by introducing additional powers by which the Commission may check the veracity of the books and records produced and/or place them in context. Subject to certain safeguards (such as the inadmissibility of statements which may tend to incriminate in any criminal proceedings) under the new provisions the Commission is empowered to require an explanation in respect of any record or document produced, from the various parties, including the company itself, an associated company, an authorised financial institution, an auditor or any other person.

7. These additional powers will significantly enhance the Commission's investigatory powers in cases of abuse, and as such are to be welcomed. The new provisions set out a clear code and provide the Commission with "teeth" to enforce it.

Part X: Powers of Intervention and Proceedings

8. The Bar supports the extension of the powers of the Commission to seek orders from the Court under clause 198 of the Bill, so that orders may be obtained against persons who have assisted in contravention of any relevant law or regulation, and so that a wider range of orders may be made.

9. The Administration has stated that Clause 208 "is not intended to go further than the common law". The Bar is concerned, however, that the effect of the clause, as presently drafted, will be to create a new cause of action which is different from the common law tort of negligent misstatement. Clause 208(10) provides that nothing in the section affects, limits or diminishes any rights conferred or liabilities incurred under the common law. Is that intended to mean that the provision says no more than what is the position at common law? If so, what is the purpose of the enactment? In particular, it is notable that:

(1) Liability attaches to any person who is "responsible for" a statement, including any person who makes or issues it and any person who participated in or approved the making or issuing of it (clause 208(2)). Certain specific classes of persons are exempted: printers, re-transmitters and broadcasters (clause 208(4), (5) & (6)). It may be considered unclear who is a person who "participated in" the making of a statement. Does it include a person who provided information to a company, which was then used in a public announcement by the company? What about executive and non-executive directors of listed companies? The fact that specific exceptions are required to deal with persons like printers shows that the class of persons caught by Clause 208(2) is understood by the draftsman to be very wide.

(2) The defendant is potentially liable to any member of the public who has suffered pecuniary loss as a result of relying on the statement (Clause 208(1)). The emphasis is on the plaintiff's reliance on the statement to his detriment. However, the clause as drafted does not discriminate as to the nature of the act of reliance and whether that act is related to the purpose for which the statement is made. At common law, it would seem that liability depends upon the statement-maker's actual or presumed knowledge as to the purpose of the information.[1]

(3) A control mechanism is provided by Clause 208(3): that no person is to be held liable unless he has assumed responsibility with respect to the other person in connection with the communication, or it is "fair, just and reasonable" in the circumstances of the case. As such, Clause 208(3) seems to be an attempt to incorporate the common law rubric of "fair, just and reasonable". There is some doubt whether this is any longer the touchstone at common law.[2] The concept of assumption of responsibility is again to be found in the common law,[3] but the Bar is concerned that to enact a statute on the basis of such elusive concepts in a fluid area of the common law may lead to confusion as to the relationship of the provision with common law.

(4) Further, it has to be carefully considered whether the provision potentially makes issuers of relevant statements liable "in an indeterminate amount for an indeterminate time to an indeterminate class", subject only to the rubric of what is "fair, just and reasonable" or "assumption of responsibility".

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1 See, e.g. BCCI v Price Waterhouse (No.2) [1998] PNLR 564 at 588.

2 In Henderson v Merrett [1995] 2 AC 145, Lord Goff stated that once a case had been identified as falling within the "assumption of responsibility" principle, "there should be no need to embark on any further inquiry whether it is fair, just and reasonable" to impose liability for economic loss. This has since been endorsed by the House of Lords in Williams v Natural Life Health Foods Ltd [1998] 1 WLR 830 (*per* Lord Steyn).

3 Hedley Byrne v Heller [1964] AC 465.

10. Further, as stated above, there is a potential overlap between Clause 208 and Clause 107 which makes provision for civil liability for fraudulent, reckless or negligent misrepresentation.

Part XI: Securities and Futures Appeal Tribunal

11. Part XI of the Bill establishes a statutory tribunal for the purposes of hearing and determining applications for review under that Part and Schedule 7. Under the provisions, the Chairman of the Tribunal will be a judge and there will be 2 other members who will not be public officers. The tribunal will review certain decisions made by the Commission. The provisions prescribe a procedure, a timetable and provide for the powers of the tribunal.

12. Schedule 7 to the Bill sets out those decisions of the Commission which are amenable to review, certain "excluded decisions" and deals with certain procedures. In addition, Clause 226 provides that the Chief Justice may make rules regulating the procedures. Clause 225 provides for a person aggrieved by an excluded decision made in respect of him to appeal to the Chief Executive in Council, whose decision shall be final.

13. By virtue of the more formal proceeding, a review may prove to be more costly and time consuming for the parties, which may deter some parties from pursuing their rights.

14. The appointment of a Judge to be chairman of the SFAT, together with the appointment of a Judge to be chairman of the MMT, will pose additional burden on the resources of the Judiciary, possibly affecting the ordinary conduct of litigation in the courts. Moreover, the workload of the MMT can be expected to be heavier than that of the present Insider Dealing Tribunal, as the MMT covers a range of misconduct other than insider dealing as well. Consideration must therefore be given to providing sufficient resources for the Judiciary to take up the responsibilities under the Bill without adverse consequences for ordinary litigation in the courts and the discharge of other functions of the Judiciary.

Part XIII: Market Misconduct Tribunal

Elimination of the Power to Impose Penalties of up to 3 Times the Profit Made or Loss Avoided

15. The civil sanctions for the MMT have been expanded to include a "cold shoulder" order where a person could be denied access to the market for up to 5 years (clause 249(1)(b)), and a "cease and desist" order not to breach the market misconduct provisions (clause 249(1)(a)). Although an order to disgorge the profit made or loss avoided has been retained (clause 249(1)(d)), the MMT would lose the power to impose financial penalties of up to 3 times the profit made and loss avoided.

16. The Government has apparently decided not to retain the power to impose substantial financial penalties on advice received to the effect that jurisprudence is developing before the European Court of Human Rights that such orders could be construed as "criminal" for human rights purposes. We have previously called for but have not had the opportunity of seeing and considering the opinion obtained by the administration on this question. Reliance may have been placed on a line of cases of the European Convention on Human Rights (for example, the case of Pierre-Bloch v France (1997) 26 EHRR 202) but at present we have yet to see the concrete arguments that the 3-times-profit penalty is necessarily in breach of human rights. Such arguments will have to be balanced against arguments, based upon jurisprudence of the same court, that penalties imposed on a limited class of persons having a common nexus (such as members of the same profession, or as applied to the present case, participants in the financial markets) may not lead to the characterisation of the regulatory or disciplinary process involved as the "determination of a criminal charge". Further, even if proceedings in the IDT or MMT are to be characterised as the "determination of a criminal charge", it does not necessarily mean (and we have yet to see the detailed arguments) that there amounts to a violation of, for example, Article 14(1) of the ICCPR.

17. To date, the prospect of substantial penalties has provided an effective deterrent to insider dealing in Hong Kong. As well, the IDT and Court of Appeal have accepted that proceedings before the Tribunal are not criminal. Changing the present regime so that insider dealing and other market misconduct would not attract substantial financial penalties may not be the way forward. The change is based upon an unpublished advice from counsel who is in all likelihood outside of Hong Kong. Such change will dramatically alter the effectiveness and deterrent value of proceedings before the MMT, especially for insider dealing, one of the most significant and prevalent forms of market misconduct. In addition, the change has no doubt influenced the Government to criminalize insider dealing.

18. In the meantime it is recommended that serious consideration be given to retaining the substantial financial penalty under Part XIII of the Bill for the following additional reasons:

    (1) Prosecutions under the Securities Ordinance for creating a false market and market manipulation have been rare.

    (2) The Commission has had difficulty in gathering sufficient evidence to the criminal standard. One reason is section 33 of the SFC Ordinance which renders answers from a suspect to the Commission inadmissible in criminal proceedings if privilege is claimed. Normally, suspects are legally represented and privilege is claimed. This sensible provision is continued under clause 180 of the Bill so that answers to the Commission will only be admissible for civil proceedings under Part XIII. It is therefore unlikely that the Bill will lead to more prosecutions for market misconduct.

(3) The lack of prosecutions under present legislation may have contributed to the decision to decriminalize market misconduct under Part XIII. However, only one route will be possible under the Bill. If the criminal route continues to be impractical, then most proceedings will take place before the MMT. In such case, an effective sanction of substantial financial penalties will not be available to the Tribunal.

(4) The new "cold Shoulder" and "cease and desist" orders together would not be as effective as substantial financial penalties.

The MMT and the Independence of the Presenting Officer

19. Under the Securities (Insider Dealing) Ordinance, the IDT conducts an "inquiry" concerning the matters referred to it by the Financial Secretary. Under Part XIII, the MMT will "have jurisdiction to hear and determine ... any question or issue ... in connection with the proceedings" instituted by the Financial Secretary with respect to alleged market misconduct (clauses 243(1) and 244).

20. The Bill appears to signal a move away from an inquisitorial procedure by the removal of the term "inquiry" and the substitution of the more neutral expression "hear and determine". If this interpretation is correct, it is to be welcomed.

21. "Counsel of the Tribunal" under Cap.395 will be replaced by a "Presenting Officer" appointed by the Secretary for Justice. The Officer will "conduct the proceedings" (clause 243(4)) and present to the MMT "such available evidence" to enable the Tribunal to reach an informed decision as to alleged market misconduct (para. 20, Schedule 8). This suggests that the Presenting Officer will be more independent than Counsel to the IDT under Cap. 395. However, under para. 20, the Presenting Officer is also required to present "any evidence which the Tribunal requests him to present to it." As well, under para. 16 of Schedule 8, the MMT may order the Presenting Officer to provide a written statement concerning any additional market misconduct discovered during the proceedings by a person not included in the original notice from the Financial Secretary. Accordingly, the inquisitorial nature of the proceedings has not been removed; however, it could be said that the intent of Part XIII of the Bill is to make the proceedings more adversarial in character. With the court decisions in the *Paragon Holdings Ltd* case in mind, and the amendments in the Bill, the role of the Presenting Officer should be clear.

Part XIV: Offences Relating to Securities and Futures Contracts

Criminalization of Insider Dealing

22. The MMT will have an enlarged civil jurisdiction to hear proceedings concerning insider dealing, and conduct such as stock market manipulation (clause 269), false trading in securities or future contracts (clause 265) and disclosure of false or misleading information inducing transactions in securities or future contracts

(clause 268).

23. In addition, a dual system has been created so that all civil market misconduct under Part XIII, including insider dealing, will be covered by the criminal offence provisions in Part XIV. In fact, the civil market misconduct provision under Part XIII are similarly worded to the market misconduct offences under Part XIV. The Commission will initially recommend a civil or criminal route, and later, the Financial Secretary or the Secretary for Justice will make the final decision as to the course of the proceedings.

24. The rationale for criminalizing insider dealing is set out in the Consultation Document, and is summarized as follows: other jurisdictions including the U.S., the U.K. and Australia have done so; the provisions have become familiar to participants and the Hong Kong market is experienced; and it would be inconsistent to exclude insider dealing from the dual system. Accordingly, the document concluded that it is an "appropriate time to introduce criminal sanctions to send a clear message that insider dealing would not be tolerated."

25. These reasons do not necessarily justify the criminalization of insider dealing. That other jurisdictions have adopted a dual system should not determine the position in Hong Kong. It appears that criminalization flows more from the decision to remove the present substantial financial penalties than from the reasons stated. To date, about 10 inquiries have been conducted by the IDT and substantial penalties have been imposed. A "clear message" has already been sent to market participants. There is no evidence that insider dealing has become more prevalent or that the orders imposed by the Tribunal have not had an appropriate deterrent effect. Finally, no message will be sent to the market if insider dealing cannot be effectively investigated by the Commission and evidence gathered to the high standard required in criminal prosecutions. If criminalisation is seen to be necessary because of the removal of the 3-times-profit penalty, we would refer to the comments above in that regard and recommend serious consideration whether the proposed reform will produce a route by MMT proceedings without sufficient deterrent effect and a criminal route which will be rarely used because of difficulty of proof to the criminal standard and the restrictions on admissibility of evidence.

Dated 14 February 2001