Paper 8A/01

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			
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 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 Securities and Futures Appeals Tribunal (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	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.	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

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			necessary to protect the public and properly regulate licensees and those involved in their management.
		The SFC is the investigator, prosecutor, judge and jury. There must be more checks and balances.	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 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, 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 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.	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.

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			Similar grounds exist in current legislation and it is consistent with the practices in other leading jurisdictions (see Annex C to Paper 8/01).
		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.	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 (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.
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, the SF Bill indeed tightens the current automatic attribution to an officer of the misconduct of a licensed corporation with a

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			raised standard in that the SFC has to prove the misconduct as having occurred with his consent or connivance or attributable to his neglect.
187	HKISD	It is unfair that the HKMA cannot impose fines to AIs but the SFC can impose fines to regulated persons.	Fining powers are not a feature of the Banking Ordinance, as it currently stands. The fining power of the SFC is designed as an intermediate disciplinary power, in addition to reprimand, suspension and revocation of licence. This full range of available sanctions is appropriate for licensed persons as regulated activities represent their core business. It would not be in the interest of investors if a licensed person is immediately driven out of business (i.e. licence revoked) upon misconduct. The case is different for exempt AIs. These are already regulated entities and regulated activities generally do not represent the core business. In case of serious misconduct there would be the option of revocation of exemption so that the exempt AI either has to cease the regulated activities or to apply for licence. In the latter case (assuming that the SFC was prepared to grant a licence), the AI would become subject to the same requirements as brokers. For less serious cases, the Banking Ordinance already empowers the HKMA to take intermediate supervisory actions. These include issuing direction to and restricting business of exempt AIs, as well as attaching conditions to the authorization of the AIs concerned. We take the view that the proposal to empower the HKMA to issue private and public reprimands with respect to the regulated activities conducted by an exempt AI, coupled with the current range of supervisory powers and the stringent liabilities for breaches of requirements stipulated in the Banking Ordinance (for example, failure to comply with the direction issued under section 52 constitutes an offence), already provide strong deterrent against misconduct.
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.

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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 shall propose a Committee Stage Amendment accordingly. 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.
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 guarantees 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 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.

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190	Law Society	The SFC should have the power to suspend the exemption of an exempt AI.	Suspension by the SFC is designed as an intermediate disciplinary power, in addition to reprimand, and revocation of licence/exemption. Such is not necessary for exempt AIs as the Banking Ordinance already empowers the HKMA to take supervisory actions to deal with misconduct or non-compliance issues in respect of exempt AIs. These include issuing directions to and restricting the business of exempt AIs, as well as attaching conditions to the authorization of the AIs concerned. We take the view that the current range of supervisory powers, coupled with the proposed power to issue reprimands and the stringent liabilities for breaches of requirements stipulated in the Banking Ordinance (for example, failure to comply with the direction issued under section 52 constitutes an offence), already provide strong deterrents against misconduct.
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.

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	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

Financial Services Bureau
23 March 2001