

**For discussion  
on 4 April 2005**

**Legislative Council Panel on Financial Affairs  
Securities and Futures (Amendment) (No.2) Bill 2005**

**Proposals to Give Statutory Backing to Major Listing Requirements**

**Purpose**

This paper briefs Members on the Administration's proposal to amend the Securities and Futures Ordinance (SFO) to give statutory backing to major listing requirements.

**Background**

2. At the meeting of the Legislative Council (LegCo) Panel on Financial Affairs on 2 April 2004, we briefed Members on the recommendations in the Consultation Conclusions on Proposals to Enhance the Regulation of Listing ("Consultation Conclusions on Regulation of Listing"). As shown in the Consultation Conclusions on Regulation of Listing, the majority of the submissions agreed to promote compliance and enhance market quality by including major listing requirements in the statute, i.e. giving statutory backing to major listing requirements.

3. Building on public support for giving statutory backing to major listing requirements, we published on 7 January 2005 the Consultation Paper on Proposed Amendments to the Securities and Futures Ordinance to Give Statutory Backing to Major Listing Requirements ("Consultation Paper on Amendments to the SFO") to which details of our proposed legislative amendments are attached. The consultation closed on 7 March 2005, but a number of submissions were received after the deadline. In preparing this paper, we have endeavoured to take into account these late submissions.

**Public Comments on the Proposed Legislative Amendments and the Administration's Response**

4. We have received 37 submissions from corporations, professional associations, trade bodies, regulators and individuals. A list

of these submissions and a summary of the views therein are at **Annexes A** and **B** respectively.

5. The majority of submissions support the amendments to Parts IX, XIII and XIV of the SFO proposed by the Administration which aim to -

- (a) provide that the Securities and Futures Commission (SFC) may make rules to prescribe listing requirements and ongoing obligations of listed corporations under s.36 of the SFO;
- (b) extend the market misconduct regime in Parts XIII and XIV of the SFO to cover breaches of the statutory listing rules made by the SFC;
- (c) empower the Market Misconduct Tribunal (MMT) to impose, in addition to existing sanctions such as disqualification orders and disgorgement orders, new civil sanctions, namely public reprimands and civil fines, on the primary targets, i.e. issuers, directors and officers<sup>1</sup>, for breaches of the statutory listing rules made by the SFC; and
- (d) empower the SFC to impose civil sanctions, namely public reprimands, disqualification orders and disgorgement orders, on the primary targets for breaches of the statutory listing rules made by the SFC under the amended Part IX of the SFO.

6. We also note from the submissions received comments on a few specific issues concerning the proposal for giving major listing requirements statutory backing. The views expressed and our response are summarized in the following paragraphs.

**(A) *Proposals for empowering the MMT and the SFC to impose civil fines***

7. As pointed out in the Consultation Conclusions on Regulation of Listing, previous legal advice indicated that substantial financial penalties by the regulator on any person found to have breached statutory listing requirements that went beyond compensatory function may turn

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<sup>1</sup> Due to human rights concern, officers will not be subject to civil fines to be imposed by the MMT.

the regulatory regime into a criminal one for human rights purposes. In this context, we undertook to explore the possibility of empowering the MMT to impose financial penalties as a new type of sanctions on well-defined groups of persons/entities for breaching statutory listing requirements.

8. Subsequent to the issue of the Consultation Conclusions on Regulation of Listing, we sought advice from Leading Counsel in the United Kingdom on the issue of civil fines to keep ourselves abreast of developments in the jurisprudence elsewhere. The latest legal advice indicates that fines to be imposed by the SFC and the MMT on issuers and directors (but not officers) for breaches of the statutory listing rules would be regarded as civil rather than criminal for human rights purposes based on certain principles, one of which being that the fines are only imposed for a regulatory purpose.

9. In light of the latest legal advice which indicates that it is possible to empower the SFC and the MMT to impose civil fines on issuers and directors for breaching statutory listing rules without infringing upon the human rights principles, we sought public views in our Consultation Paper on Amendments to the SFO published in January 2005 on whether the proposed civil fines on issuers and directors should be pursued.

#### Civil Fines by the MMT

10. Of the 37 submissions received, 34 submissions provide comments on the proposal. Among these 34 submissions, a vast majority support the proposal for empowering the MMT to impose civil fines.

11. In view of strong public support, we would pursue the proposal for empowering the MMT to impose civil fines on issuers and directors. This proposal will no doubt give effective enforcement teeth to the regulatory regime.

12. On the level of fines, while a number of submissions agree with the proposal for empowering the MMT to impose a civil fine of up to \$8 million on issuers and directors, some submissions call for the power for the MMT to impose much higher fines or unlimited fines.

13. We agree that imposing a ceiling on the level of civil fines that may be imposed by the MMT on issuers and directors will severely limit

the MMT's flexibility in determining the amount of a fine which should be commensurate with the severity of the contravention and its damage to the stability of the market and investors' interests. Moreover, given the significant financial gains that can be made with respect to listed securities, the high levels of compensation received by senior management of listed corporations and the potential losses that can be incurred by investors, it would not be realistic to set out in the law the maximum level of fines that may be imposed by the MMT. We would therefore propose not to specify in the SFO the maximum level of civil fines that may be imposed by the MMT.

### Civil Fines by the SFC

14. More than half of the submissions do not support the proposal for empowering the SFC to impose civil fines. The reasons for not supporting the SFC's fining powers include –

- (a) Since the SFC will be responsible for enforcing the statutory listing requirements, empowering the SFC to impose fines would effectively transform itself into the police, the prosecutor and the judge. There is also a risk that the SFC may simply impose fines on issuers and directors which will pre-empt referral of cases to the MMT due to the “no double jeopardy” provisions, thus marginalizing the MMT.
- (b) Unlike the MMT which is a quasi-judicial body subject to the due process of hearing, the SFC's disciplinary hearing which is conducted by way of “paper hearing” gives rise to concern about fairness of the disciplinary process to issuers and directors.
- (c) The proposal for empowering the SFC, in addition to the MMT, to impose fines will result in two similar civil regimes and hence confusion and uncertainty as to which authority should be responsible for handling a particular breach.

15. On the other hand, about one third of the submissions support the proposal for empowering the SFC to impose fines. The reasons for supporting the proposal include –

- (a) It could ensure efficiency, timeliness and cost-effectiveness. It could enable the SFC to take swift action to uphold its regulatory objectives of maintaining a fair and transparent

market and protecting members of the public investing in or holding securities.

- (b) Civil fines represent medium sanctions in between lighter reprimands and heavier disqualifications. Empowering the SFC to impose civil fines would enable regulatory action to be tailored more proportionately to misconduct.

16. On the level of civil fines to be imposed by the SFC, only a few submissions, including the one from the SFC, believe that the proposed level of fine, i.e. HK\$5 million, is too low to deter breaches and for the listed sector to take it seriously.

17. For the rest of the submissions that provide comments on the level of fines to be imposed by the SFC, they point out that the proposed HK\$5 million is too high as the SFC should be responsible for handling minor and technical breaches. One suggests that the cap should be HK\$200,000; some suggest HK\$2 million; another suggests HK\$3 million.

18. Members are invited to comment on whether the proposal for empowering the SFC to impose civil fines on issuers and directors for breaches of statutory listing requirements should be pursued, and if yes, the maximum level of fines that may be imposed by the SFC.

***(B) Factor to be considered when imposing a fine***

19. Some submissions point out that there may be a case for a requirement to consider the size and financial resources and other circumstances of the person (who may be an issuer or a director) when determining the amount of fines.

20. We agree that the impact of a breach on the integrity and reputation of the market may be linked to the size of the issuer. Moreover, in most cases, the damage to the market resulting from a breach by an issuer is potentially more significant than the damage resulting from a breach by an individual. Drawing reference from the fining guidelines of the United Kingdom's Financial Services Authority (UK FSA), we would include in the proposed legislative amendments that the MMT would take into account the fact that a person is an individual or a corporation, and the individual/corporation's financial resources, before imposing a civil fine.

***(C) Checks and balances on the SFC's rule-making power***

21. There is a submission asking for an expansion of mandatory consultees to cover all listed corporations before the SFC makes any statutory listing rules.

22. In fact, under our proposal, the SFC's powers to make statutory listing rules are subject to checks and balances as provided for in the existing SFO. These include –

- the general duty to publish draft rules for public consultation;
- the duty to consult the Stock Exchange of Hong Kong (SEHK) and the Financial Secretary before making rules to prescribe statutory listing requirements; and
- the Commission's power to make subsidiary legislation is not delegable to the Commission's executives.

23. Notwithstanding the above, we would consider introducing new checks and balances on the SFC's powers to make codes and guidelines governing its performance of functions relating to listing. We would propose to amend the SFO to the effect that the Commission's powers to make such codes and guidelines would, as in the case of the making of statutory listing rules, be non-delegable to the executives. This can help ensure the proper exercise of the SFC's powers to make code and guidelines relating to listing.

**Other Comments**

24. We note from the submissions received comments on administrative checks and balances on the SFC's disciplinary power relating to listing, and the division of responsibilities between the SFC and the SEHK. Though they are not necessarily related to the amendments to the SFO proposed by the Administration, we would like to set out below the SFC's response to those comments to facilitate members' consideration of the Administration's legislative proposal.

***(A) Checks on the SFC's disciplinary powers***

25. The submissions in general support the proposal for setting up a committee comprised of the SFC and independent members to deal with the SFC's disciplinary decisions relating to listing. This would help to allay any remaining concern that the SFC would become the

investigator, the prosecutor, and the judge in respect of enforcement actions against issuers and their management. A number of submissions agree that the Regulatory Decisions Committee (RDC) set up by the UK FSA can provide a useful reference.

26. We agree that the establishment of a committee comprising external members to deal with the SFC's regulatory decisions relating to listing can provide an effective safeguard for the rights of issuers, directors and officers. The committee can also alleviate market's concern about the role of the SFC as the investigator, the prosecutor and the judge in dealing with breaches of statutory listing rules by issuers, directors and officers. Based on the UK FSA model, the proposed committee may comprise current practitioners, retired practitioners as well as non-practitioners, all of whom represent the public interest. We have invited the SFC to actively consider this proposal or any other measures that can effectively enhance the checks and balances on the SFC's new regulatory responsibilities relating to listing.

***(B) Division of responsibilities between the SFC and the SEHK***

27. In the Consultation Conclusions on Listing published in March 2004, we recommend giving statutory backing to the more important listing requirements (i.e. those under the following categories : **financial reporting and other periodic disclosure, disclosure of price-sensitive information and shareholders' approval for certain notifiable transactions**). We have invited the SFC to expose the draft statutory listing rules for public consultation before the amendments to the SFO are introduced to the LegCo. The purpose is to facilitate consideration of the amendments to the SFO by the legislature and the public.

28. In this context, the SFC published on 7 January 2005 a Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules (SFSMLR) to be made by the SFC under the amended SFO. SFC's consultation closed on 31 March 2005.

29. We note from the response to the Consultation Paper on Amendments to the SFO market's concern about potential mismatch between the SFC's statutory listing rules and the non-statutory listing rules of SEHK in terms of content, interpretation and administration.

30. There is already statutory safeguard to prevent inconsistency between the SFC's statutory listing rules and SEHK's Listing Rules. The current SFO provides that SEHK's Listing Rules shall have effect only to the extent that they are not repugnant to any rule made by the SFC governing listing. To address market's concern about the potential problems concerning the interface between the SFC and the SEHK, we have recommended in the Consultation Conclusions on Regulation of Listing published in March 2004 to articulate in a public statement their division of responsibilities, both as at present and upon the introduction of statutory listing rules. The statement on existing arrangement will soon be published by the SFC and the SEHK. We hope this will enhance public understanding about the respective roles and duties of the SFC and the SEHK in the performance of the listing functions.

## **Conclusions**

31. Giving statutory backing to listing requirements is indeed a significant step forward in upgrading the regulation of the listed sector. Market acceptance of, and confidence in, the proposed legislative changes are critical to the success of this exercise. Therefore, we attach great importance to public views when refining the proposed legislative amendments set out in the Consultation Paper on Amendments to the SFO. We are also mindful of the need to strike an appropriate balance between the need to enhance regulation with a view to upgrading market quality, and the need to preserve the efficiency of the listing process and hence the competitiveness of our market. This would entail giving major listing requirements the necessary enforcement teeth, and at the same time avoiding the imposition of unnecessary compliance burden on market players.

## **Way Forward**

32. The Administration plans to introduce a Securities and Futures (Amendment) (No. 2) Bill 2005 in June 2005 based on the proposed legislative amendments attached to the Consultation Paper on Amendments to the SFO, subject to the amendments in paragraphs 13, 20 and 23 above.

Financial Services Branch  
Financial Services and the Treasury Bureau  
March 2005



**Consultation Paper on Proposed Amendments to the Securities and Futures Ordinance to Give Statutory Backing to Major Listing Requirements**

*List of Submissions*

1. Bank Consortium Trust Company Limited
2. Cynthia Tang
3. David Cheung
4. Far East Technology International Limited
5. Hong Kong Exchanges and Clearing Limited
6. Hong Kong Bar Association
7. Hong Kong Federation of Women Lawyers
8. Hong Kong Institute of Certified Public Accountants
9. Hong Kong Institute of Company Secretaries
10. Hong Kong Stockbrokers Association
11. Hong Kong Trustees' Association
12. KPMG Corporate Finance Limited
13. Liberal Party
14. Linklaters and Freshfields Bruckhaus Deringer [on behalf of 9 financial institutions] <sup>1</sup>
15. P.C. Woo & Co
16. Securities and Futures Commission
17. So Wai Man, Raymond
18. Standing Committee on Company Law Reform
19. The Association of Chartered Certified Accountants
20. The Chamber of Hong Kong Listed Companies
21. The Chinese General Chamber of Commerce
22. The DTC Association
23. The Hong Kong Association of Banks
24. The Hong Kong Society of Financial Analysts
25. The Law Society of Hong Kong
26. Timothy Loh, Solicitors
27. VC Asset Management Limited
28. VC Brokerage Limited
29. VC Capital Limited
30. 張志強先生

Plus 7 submissions have requested their names not to be disclosed.

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<sup>1</sup> Citigroup Global Markets Asia Limited; Credit Suisse First Boston (Hong Kong) Limited; Deutsche Bank AG, Hong Kong Branch; Goldman Sachs (Asia) L.L.C.; J.P. Morgan Securities (Asia Pacific) Limited; Merrill Lynch (Asia Pacific) Limited; Morgan Stanley Dean Witter Asia Limited; Nomura International (Hong Kong) Limited; and UBS AG.

**Consultation Paper on Proposed Amendments to  
the Securities and Futures Ordinance to  
Give Statutory Backing to Major Listing Requirements**

**SUMMARY OF SUBMISSIONS**

1. We have received 37 submissions from corporations, professional associations, trade bodies, regulators and individuals.

**Overview**

2. There is general support for the proposed legislative amendments to Parts IX, XIII and XIV of the Securities and Futures Ordinance (SFO) which aim to –
  - (a) provide that the Securities and Futures Commission (SFC) may make rules to prescribe listing requirements and ongoing obligations of listed corporations under s.36 of the SFO;
  - (b) extend the market misconduct regime in Parts XIII and XIV of the SFO to cover breaches of the statutory listing rules made by the SFC;
  - (c) empower the Market Misconduct Tribunal (MMT) to impose, in addition to existing sanctions such as disqualification orders and disgorgement orders, new civil sanctions, namely public reprimands and civil fines, on the primary targets, i.e. issuers, directors and officers<sup>1</sup>, for breaches of the statutory listing rules made by the SFC; and
  - (d) empower the SFC to impose civil sanctions, namely public reprimands, disqualification orders and disgorgement orders, on the primary targets for breaches of the statutory listing rules made by the SFC under the amended Part IX of the SFO.
3. The submissions have also provided comments on the issues concerning the three-pronged approach, the SFC and the MMT's power to impose civil fines, liabilities of the primary targets as well as checks and balances on the SFC, etc.

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<sup>1</sup> Officers will not be subject to civil fines to be imposed by the SFC or the MMT due to human rights concern. See paragraph 3.7 of the Consultation Paper on Proposed Amendments to the Securities and Futures Ordinance (SFO) to Give Statutory Backing to Major Listing Requirements for details.

## **Three-pronged Approach to Tackle Non-compliance with Statutory Listing Requirements**

4. The majority of submissions indicate support for the three-pronged approach to deal with non-compliance with statutory listing requirements, i.e. direct civil sanctions on issuers, directors and officers (i.e. the primary targets) by the SFC, civil sanctions by the MMT on the primary targets and any person assisting in the breach; and criminal sanctions on the primary targets, as well as any person aiding and abetting the breach. The submissions welcome the provision of a “no double jeopardy” provision which ensures that an issuer, a director or an officer breaching statutory listing requirements will not be sanctioned by both the SFC and the MMT for the same misconduct.
5. One submission notes that the three-pronged approach appears to allow a great deal of flexibility for the SFC and the MMT to use a wide variety of enforcement tools, some of which are duplicated. It is questionable whether there is a need to provide so many procedural options to the respective bodies. There is also a comment that the proposal does not contain sufficient graduation or demarcation in the level of sanctions that may be imposed by the SFC and the MMT.
6. A few submissions question whether breaches of statutory listing requirements should be subject to additional civil sanctions by the SFC and the MMT on top of the existing sanctions applicable to the other six types of market misconduct, as this would suggest that breaches of statutory listing requirements are more serious than the other six types of market misconduct.
7. A few submissions express reservations about subjecting breaches of statutory listing requirements to criminal sanctions given that interpretation of listing requirements often involves judgement. A few submissions believe that the criminal regime may deter well-qualified directors from taking up the posts of non-executive directors.
8. A submission points out that the proposed amendments to the SFO do not appear to deal with “double jeopardy” between the SFC’s disciplinary regime and criminal prosecution. It is also noted that that the proposed legislative amendments have not addressed the “double jeopardy” risk between statutory sanctions under the SFO and disciplinary actions under the non-statutory Listing Rules

promulgated by the Stock Exchange of Hong Kong (SEHK).

**(a) The SFC's Sanctioning Powers**

9. Most submissions support the proposal for vesting the SFC with additional sanctioning powers, viz. reprimand, disqualification order and disgorgement order, to deal with breaches of statutory listing requirements. Many hold the view that empowering the SFC to impose sanctions could ensure efficiency and timeliness in dealing with breaches of statutory listing requirements, especially minor and technical breaches.
10. A few submissions query whether it is necessary to confer sanctioning powers on the SFC which will, under the proposal, be responsible for enforcing the statutory listing requirements, investigating possible breaches and imposing sanctions for such breaches. This will effectively transform the SFC into the police, the prosecutor and the judge. There is a risk that the SFC may simply impose sanctions on breaches without referring suspected breaches to the MMT, thus marginalizing the MMT.
11. A few submissions query the need for empowering SFC to disqualify directors and officers for breaching statutory listing requirements. It is noted that none of the statutory regulators in the United States, the United Kingdom, Singapore and Australia has such power to disqualify directors.
12. Market views on the proposal for vesting the SFC with the fining power will be discussed in the section "The SFC and The MMT's Powers to Impose Civil Fines" below.

**(b) The MMT's Sanctioning Powers**

13. There is general support for empowering the MMT to impose, in addition to existing sanctions such as disqualification orders and disgorgement orders, a new civil sanction, i.e. reprimand, on the primary targets for breaches of statutory listing requirements.
14. Market views on the proposal for vesting the MMT with the fining power will be discussed in the section "The SFC and The MMT's Powers to Impose Civil Fines" below.

**The SFC and The MMT's Powers to Impose Civil Fines**

15. The submissions in general agree that issuers and directors should be

subject to civil fines for breaching statutory listing requirements, as fines could act as a deterrent against breaches of statutory listing requirements and allow a wider range of sanctions which would be commensurate with the severity of a breach. Many submissions prefer empowering either the SFC or the MMT, instead of both the SFC and the MMT, to impose civil fines. Among these submissions, most of them believe that the fining power should be confined to the MMT which is a quasi-judicial body.

16. There is a submission questioning the SFC and the MMT's powers to impose civil fines. It is argued that the proposed fines to be used in addition to disgorgement order cannot possibly be regarded as performing a mere regulatory purpose which is, according to the legal advice set out in the consultation paper, one of the measures that should be adopted if the fine is to remain civil in nature.

*(a) Civil Fines by the SFC*

17. 12 submissions support the proposal for empowering the SFC to impose fines. Their major reasons for supporting the proposal are as follows –

- (a) It could ensure efficiency, timeliness and cost-effectiveness. It could enable the SFC to take swift action to uphold its regulatory objectives of maintaining a fair and transparent market and protecting members of the public investing in or holding securities.

- (b) Civil fines represent medium sanctions in between lighter reprimands and heavier disqualifications. Empowering the SFC to impose civil fines would enable regulatory action to be tailored more proportionately to misconduct.

18. 21 submissions do not support the proposal for empowering the SFC with fining powers. The major reasons are summarized below –

- (a) Interpretation of listing requirements often calls for judgement. Unlike the MMT which is a quasi-judicial body subject to the due process of hearing, the SFC's disciplinary hearing which is conducted by way of "paper hearing" gives rise to concern about fairness of the disciplinary process to issuers and directors.

- (b) The proposed sanctioning powers for the SFC and the MMT do not have material difference. It is not necessary to empower

two bodies with similar sanctioning powers dealing with same kind of breach. Civil fines are regarded as more serious sanctions and should be left within the realm of the MMT.

- (c) The SFC's powers to impose reprimands, disqualification orders and disgorgement orders to handle less serious misconduct are already sufficient. There is no need to vest the SFC with the fining power.
  - (d) The existing sanctioning regime is already complicated, and vesting the SFC with additional sanctioning powers will create more confusion and uncertainty to the regulatory regime.
  - (e) A "primary target" is different from the SFC's licensees such as brokers. Disciplinary hearings involving the "primary targets" should be done through the due civil hearing process under the MMT regime.
  - (f) Under the SFO, the MMT findings are admissible as prima facie evidence of the misconduct in any court action by investors to claim compensation for losses arising from the misconduct. Should the SFC be empowered to impose civil fines on issuers and directors, there would be a risk that the SFC may simply impose sanctions without referring suspected breaches to the MMT. This is not facilitative to investors' claim for compensation.
19. On the level of civil fines to be imposed by the SFC, only 5 submissions, including the one from the SFC, believe that the proposed level of fine, i.e. HK\$5 million, is too low. They consider that the proposed amount is too small to deter breaches and for the listed sector to take it seriously. A higher penalty is needed to have the desired degree of impact and to link to commercial interest in question more realistically. There is a suggestion that the cap should be HK\$5 million or multiples of profits gained/loss avoided, whichever is greater. One submission calls for a maximum fine of HK\$10 million. 2 submissions comment that the cap should be HK\$20 million. A submission suggests that the maximum should be in the region of HK\$20 million to HK\$50 million.
20. 13 submissions point out that the proposed HK\$5 million is too high as the SFC should be responsible for handling minor and technical breaches. One suggests that the cap should be HK\$200,000; some suggest HK\$2 million; another suggests HK\$3 million.

***(b) Civil Fines by the MMT***

21. 9 submissions agree with the proposal for empowering the MMT to impose civil fine of up to HK\$8 million on issuers and directors. 8 submissions consider HK\$8 million too low in the case of severe misconduct. Many of them point out that the MMT which would be dealing with cases involving more serious breaches should be empowered to impose a fine that is much higher than the fines that may be imposed by the SFC. This arrangement can better reflect the division of responsibilities between the SFC and the MMT. A submission suggests that the maximum should be in the region of HK\$20 million to HK\$50 million. 2 submissions suggest that there should not be any limit on the maximum level of fines to be imposed by the MMT. One submission considers the proposed cap of HK\$8 million appropriate for individuals, but suggests that no limit be set on fines that may be imposed on issuers.
22. Some submissions point out that the proposed level of fines to be imposed by the SFC and the MMT are not large for many issuers, but would be proportionately considerably larger for an individual. Moreover, the market impact of a contravention may be linked to the size of the issuers. As such, there may be a case for a requirement to consider the size and financial resources and other circumstances of the person when determining the amount of any fine.

**Liabilities of the Primary Targets**

***(a) Issuer***

23. A submission calls for a defence for issuers on whom strict liability is to be imposed under the civil and criminal regimes.

***(b) Director and Officer***

24. While a “mens rea” test proposed for directors and officers is welcome, a few submissions suggest that a defence be provided for them. Possible defences include that issuers, directors and officers in question have acted reasonably, honestly and in good faith in the performance of their duties; or the person had reasonable grounds to believe he was in compliance.
25. A few submissions suggest that the element of “negligence” be removed from the civil regimes. It is noted that compliance of certain statutory listing requirements may be difficult, e.g.

identification of all connected persons within a listed conglomerate. Hence, directors and officers should only be subject to the SFC or the MMT's sanctions if they are knowingly or intentionally, but not negligently, concerned in the breach. As regards the proposal for empowering the SFC to impose civil fines, a submission points out that no other major financial centre confers on its regulatory authority the power of holding directors or issuers liable for negligence.

26. There is also a suggestion that non-executive directors, especially independent ones, should not be subject to civil fines as they do not have any executive role in the companies and their remuneration is often nominal. It might be difficult for them to find insurers to cover potential liabilities if they have to be subject to civil fines or criminal sanctions.
27. A submission points out that the definition of "officer" should be restricted further as the existing definition of "officer" in the SFO is very broad given the reference to managers and persons "involved in the management of the corporation". It is suggested that "officer" be limited to a company's senior management, i.e., to those persons to whom the board of directors has directly delegated management responsibilities.
28. A submission suggests that the exposure of persons other than primary targets be restricted to the more serious aiding or abetting offences which are the subjects of the criminal regime and where a higher standard of proof and normal rules of evidence apply. Persons other than the primary targets should not be subject to the MMT proceedings and sanctions given that the primary responsibilities for compliance rest with issuers and their directors, and that the standard of proof for the MMT is civil and not as high as the criminal standard of proof.

## **Checks and Balances**

### ***(a) Rule-making power***

29. The majority of submissions consider that additional checks and balances necessary in view of the SFC's new functions and powers in the regulation of listing. Some submissions specifically point out the need for additional checks and balances on the SFC's rule-making power. One of them calls for the strengthening of the consultative mechanism for the SFC's power to make rules by, for example, widening the categories of mandatory consultees from the



Financial Secretary and the SEHK to all listed companies.

***(b) Disciplinary power***

30. Many submissions support the establishment of a new committee to review the SFC's decisions in respect of listing. A few submissions state that the committee's authority to review the SFC's decisions should cover settlement decisions. One of them suggests that the committee should not be established as an appeal body as such, but as a decision-making body in respect of disciplinary actions by the SFC.
31. Many submissions point out that the proposed new committee to review the SFC's decisions in respect of listing should be independent and transparent, and not a mere executive arm of the SFC. Hence, it is suggested that the majority of the committee members should be represented by market participants, investor representatives and independent professionals.
32. There is a suggestion that, instead of establishing a new committee to review the SFC's decisions in respect of listing, the terms of reference of the existing SFC Dual Filing Advisory Group be expanded to cover the SFC's listing-related decisions.

**Other Comments**

***(a) Delineation of responsibilities between the SFC and the SEHK***

33. A submission notes that if the listing requirements which have been statutorily backed remain in the Red Book, there will be a potential mismatch between the SFC's statutory listing rules and the Red Book requirements. This will cause further confusion if the SFC and the SEHK adopt different interpretations of similar requirements. One possible way to address this concern is to remove requirements which are to be statutorily backed from the Red Book.
34. A few submissions raise concern over the future arrangement concerning issue of company announcements. It is not clear whether the SEHK will continue its present practice of pre-vetting company announcements, and, if not, a reasonable transitional period should be provided to enable market practitioners to have a better understanding of the new regulatory requirements.
35. A submission envisages that the Hong Kong market may not be ready for immediate adoption of a post-vetting only regime. There

is also a concern that in eliminating the existing pre-vetting practice and thus the interactive relationship between the SEHK and issuers on disclosure matters, issuers may shift from a culture of disclosure to a culture of compliance (i.e. disclosure occurs from fear of enforcement rather than from a genuine acceptance that striving to apply best practice standards of disclosure is a necessary feature of listing status), which may have the unintended consequence of lowering the quality of disclosure by listed companies.

**(b) *Delineation of responsibilities between the MMT and the SFC***

36. Some submissions consider that there should be clearer demarcation of the roles between the MMT and the SFC, and guidelines on handling/referral of cases of suspected breaches should be developed. A possible way is that the SFC should be responsible for cases which involve routine or less serious breaches and the MMT would deal with more serious ones.

**(c) *Resource implications on SFC/SEHK***

37. A submission points out that the proposal of statutory backing of major listing requirements should be revenue neutral, i.e. the overall cost of administering and enforcing the new requirements by the SFC should be equivalent to savings by the SEHK from reducing the resources it devotes to such regulatory activities. However, given the potential overlap in administration and enforcement, it is not clear that the current proposal will be revenue neutral. Another submission also stresses that no additional levies or fees should be required to support SFC's administration and enforcement of statutory listing requirements.

**(d) *The SFC's statutory listing rules***

38. A submission points out that the proposed SFC's statutory listing rules, as presently drafted, would result in significant administrative and enforcement duplication between the SEHK and the SFC. This is inconsistent with the recommendations in the Consultation Conclusions on Proposals to Enhance the Regulation of Listing (Consultation Conclusions on Regulation of Listing) published in March 2004 that the SEHK continue to be the frontline regulator. The overlap in the roles and responsibilities of the SFC and the SEHK will raise the cost of compliance and increase uncertainty on the part of issuers and directors. Moreover, to minimize the problem of duplication between the Red Book and SFC's statutory listing rules, the SEHK, when seeking to amend those requirements

also covered by the SFC's statutory listing rules, would have to ensure that the rules are amended in the same respect. Since amendments to the SFC's statutory listing rules are subject to negative vetting by the Legislative Council, the process of amending the Red Book will be complicated.

39. A submission expresses concerns that the proposed SFC's statutory listing rules, as presently drafted, is more extensive than is necessary to give "teeth" to the key Listing Rules disclosure requirements. The proposed statutory listing rules contain too many minor and technical requirements. They also go beyond the recommendation in the Consultation Conclusions on Regulation of Listing. For example, while it is recommended in the Consultation Conclusions on Regulation of Listing that listing requirements on shareholders' approval for certain notifiable transactions should be statutorily backed, SFC's draft statutory listing rules cover discloseable transactions in addition to notifiable transactions. It is considered that for those disclosure obligations a breach of which is not serious enough to warrant SFC's investigation, they should be left to the SEHK to administer and enforce.
40. A few submissions note that while it is stated in the SFC's Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules that the proposed statutory listing rules have not made substantial changes to the existing provisions of the Red Book, they do come across some material changes in the SFC's draft statutory listing rules which have not been highlighted in the SFC's consultation paper. A notable example can be found in the disclosure of price sensitive information (PSI). The SFC has changed the test of PSI from information affecting "market activity" to information affecting "market activity and price". It is noted that even slight differences in wording could give rise to confusion. To avoid contradictory interpretations by different regulators and to facilitate consistent implementation, the provisions in the Red Book and the SFC's statutory listing rules should be exactly the same.
41. A submission points out the importance for the SFC's statutory listing rules to be drafted without reference to hindsight or interpretation, or a discretion in interpretation between the SEHK and the SFC.
42. A submission notes that while the Consultation Conclusions on Regulation of Listing suggested that SFC's statutory listing rules contain carve-outs or safe harbours from statutory obligations, SFC's

draft rules do not have any carve-outs or safe harbours. The submission is concerned that the listing requirements contained in SFC's draft rules, breach of which attracts criminal or civil sanctions, are not sufficiently clear. It is suggested that a suitably qualified working group be established to assist with framing the key and substantive obligations in clear terms.

43. One submission points out that the SFC's statutory listing rules can be confined to the principles aspect of the Red Book, leaving the details to the SFC's codes and guidelines.

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