立法會
Legislative Council

LC Paper No. CB(1)1179/05-06(08)

Ref: CB1/PL/FA

Panel on Financial Affairs
Meeting on 3 April 2006

Background Brief
on regulation of market misconduct

Purpose

This paper sets out the existing regulatory regime for market misconduct under the Securities and Futures Ordinance (SFO)[1] (Cap. 571) and the Administration's proposals to improve the regime. It also summarizes the major views and concerns expressed by Members on the subject at meetings of the Legislative Council (LegCo) and the Panel on Financial Affairs (FA Panel).

Existing regulatory regime under SFO

Six types of market misconduct

2. The existing regulatory regime for market misconduct is provided for in Parts XIII and XIV of SFO. Under section 245(1) of SFO, "market misconduct" means -

(a) insider dealing;

(b) false trading within the meaning of section 274;

(c) price rigging within the meaning of section 275;

(d) disclosure of information about prohibited transactions within the meaning of section 276;

---

1 The SFO came into effect on 1 April 2003.

(e) disclosure of false or misleading information inducing transactions within the meaning of section 277; or

(f) stock market manipulation within the meaning of section 278, and includes attempting to engage in, or assisting, counselling or procuring another person to engage in, any of the conduct referred to in items (a) to (f).

Civil or criminal sanctions

3. The existing regulatory regime provides for a dual regime, i.e. parallel civil and criminal regimes, to deter market misconduct. Any person who has committed market misconduct may either be subject to civil sanctions imposed by the Market Misconduct Tribunal (MMT) under Part XIII of SFO, or criminal sanctions under Part XIV of SFO following prosecution. The MMT may impose a range of civil sanctions under section 257 of SFO, including -

(a) disgorgement of profits made or loss avoided, subject to compound interest thereon;

(b) disqualification of a person from being a director or otherwise involved in the management of a listed company for up to five years;

(c) a "cold shoulder" order on a person (i.e. the person is deprived of access to market facilities) for up to five years;

(d) a "cease and desist" order (i.e. an order not to breach any of the market misconduct provisions in Part XIII of SFO again);

(e) a recommendation order that the person be disciplined by any body of which that person is a member; and

(f) payment of the costs of the MMT inquiry and/or the Securities and Futures Commission (SFC)'s investigation.

4. For offences tried under the criminal route under Part XIV of SFO, the maximum penalties the court may impose are fines of $10 million and 10 years' imprisonment.

Investors' claims for compensation

5. Under section 281 of SFO, a person who has sustained any pecuniary loss as a result of a relevant act in relation to market misconduct committed by another person can claim compensation from the person concerned by exercising the right of civil action.

Proposed improvements to the regulatory regime

6. In the light of the Report of the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure (the Expert Group)[2] published on 21 March 2003 and public comments thereon, the Administration identified a number of issues that were critical for the better regulation of listing and published the "Consultation Paper on Proposals to Enhance the Regulation of Listing" on 3 October 2003. When the FA Panel was briefed on the Consultation Conclusions on 2 April 2004, members noted that the submissions received during the consultation period indicated an overwhelming support for introducing improvements to the existing regime, and a majority of the submissions supported the Administration's proposal to promote compliance and enhance market quality by giving statutory backing to the major listing requirements, including the following listing requirements –

(a) Financial reporting and other periodic disclosure (e.g. annual and interim reports) by listed companies;

(b) Disclosure of price-sensitive information by listed companies; and

(c) Shareholders' approval for certain notifiable transactions.

The Administration also recommended making breaches of the statutory listing requirements a new type of market misconduct under SFO.

7. On 7 January 2005, the Administration published the "Consultation Paper on the Proposed Amendments to the Securities and Futures Ordinance to Give Statutory Backing to Major Listing Requirements". When the FA Panel was briefed on 4 April 2005 on the comments received during the consultation period, members noted that a majority of the respondents supported the Administration's proposed amendments to SFO which aimed to -

(a) provide that SFC may make rules to prescribe listing requirements and ongoing obligations of listed corporations under section 36 of SFO[3];

(b) extend the market misconduct regime in Parts XIII and XIV of SFO to cover breaches of the statutory listing rules made by SFC;

---

[2] The Expert Group was appointed by the Financial Secretary on 26 September 2002 to take forward the recommendation of the Panel of Inquiry on the Penny Stocks Incident that the Government should review the three-tier regulatory structure of the securities and futures market relating to listing matters, with a view to increasing the effectiveness, efficiency, clarity, fairness and credibility of the regulatory system.

[3] Under the current section 36 of SFO, SFC may make rules to prescribe statutory listing requirements after consulting the Stock Exchange of Hong Kong and the Financial Secretary. The rules made by SFC are subsidiary legislation subject to negative vetting of LegCo.

(c) empower 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, for breaches of the statutory listing rules made by SFC; and

(d) empower SFC to impose civil sanctions, namely public reprimands, disqualification orders, disgorgement orders and civil fines, on the primary targets for breaches of the statutory listing rules made by SFC under the amended Part IX of SFO.

8. The Administration planned to introduce a Securities and Futures (Amendment) Bill into LegCo to effect the proposed amendments mentioned in paragraph 7 above. SFC planned to make statutory rules under the amended section 36 of SFO to codify in statute the major listing requirements mentioned in paragraph 6 above.

Members' major views and concerns expressed at meetings of LegCo and FA Panel

9. At the LegCo meetings on 24 November 2004 and 1 March 2006, Members raised written and oral questions expressing their concern about the cases in which listed companies or their directors had provided price-sensitive or misleading information or remarks, and the impact of such cases on the reputation of Hong Kong as an international financial centre and the interests of investors. The two questions and the Administration's written replies are in **Appendices I and II** respectively.

10. At the FA Panel meetings on 2 April 2004 and 4 April 2005, members stressed the importance of strengthening regulation of listing matters with a view to increasing protection of investors, upgrading market quality, and reinforcing Hong Kong's position as an international financial centre. Members supported in principle the Administration's proposals to improve the market misconduct regime. However, while some members supported the proposal for empowering SFC to impose civil fines so as to provide SFC with the power necessary for the effective performance of its new regulatory responsibilities relating to listing, some considered it more appropriate for the Administration to review at a later stage the need to empower SFC to impose civil fines. An extract from the minutes of the FA Panel meeting on 4 April 2005 is in **Appendix III**.

References

11. A list of relevant papers is in **Appendix IV**.

Council Business Division 1
Legislative Council Secretariat
30 March 2006

~~(a) We have invited persons in the relevant fields to lay down the competency requirements for "reimbursable courses" for each economic and generic skill sector covered under the CEF. Any course, including IT courses, meeting the stipulated competency requirements are eligible to apply for enlisting on the list of "reimbursable course". Although IT is not included as an independent sector, IT courses are already covered under most of the other sectors under the CEF.~~

~~(b) There are already courses in information security, systems audit and project management on the list of "reimbursable course". Like any another courses eligible under the CEF, these courses are required to meet the stipulated competency requirements to be eligible to be enlisted.~~

~~(c) We regularly review the mode of operation of the CEF to ensure its effective operation and to achieve the purpose of its establishment. We have reservations about the proposal of not maintaining a list of "reimbursable courses". We would like to set out clearly the courses eligible for subsidy under the stipulated sectors of the CEF and to have them regulated to ensure that the limited fund is used in a meaningful manner. Maintaining a list of eligible courses enables us to achieve this purpose and also let those wishing to pursue continuing education be clear about the courses eligible. We consider that the present arrangement is conducive to ensuring the effective operation of the CEF.~~

Price-sensitive or Misleading Remarks Made by Directors of Listed Companies

15. **MR LEE WING-TAT** (in Chinese): *Madam President, in reply to press enquiries after the company's extraordinary general meeting (EGM) on the 2nd of this month, the Chairman of the Melco International Development Limited, a listed company, indicated that there were plans for injecting certain businesses into the company. The closing share price of the company rose by 16% on the day after the EGM. The company made an announcement that evening to clarify that the above remarks were made by the Chairman in his personal capacity. The closing share price of the company dropped 4% on the following*

day. In this connection, will the Government inform this Council whether it knows:

(a) if the Securities and Futures Commission (SFC) has conducted an investigation into the above incident; if not, of the reasons for that and whether the SFC will conduct an investigation;

(b) the number of enquiries or investigations made by the SFC on listed companies in the past three years regarding price-sensitive or misleading remarks made by directors of the companies concerned;

(c) if the Hong Kong Exchanges and Clearing Limited (HKEx) and the SFC will initiate investigations upon receiving complaints from members of the public about price-sensitive or misleading remarks made by directors of listed companies; and

(d) when investigating allegations of misleading remarks made by directors of listed companies, if the SFC may have different ways of handling the cases according to whether or not the persons concerned have subsequently claimed that such remarks were made in their personal capacity?

SECRETARY FOR FINANCIAL SERVICES AND THE TREASURY (in Chinese): Madam President, we have consulted the SFC. The reply of the SFC, with contributions from the HKEx, is as follows.

(a) The SFC is constrained under section 378 of the Securities and Futures Ordinance (SFO) from disclosing information about individual cases.

(b) Under section 277 of the SFO, a person may be regarded as having engaged in market misconduct by reason of disclosure/dissemination of false or misleading information that is likely to induce transactions, if the misinformation is material and the person is aware of that. Such conduct may be referred to the Financial Secretary to consider whether to institute civil proceedings before the Market Misconduct Tribunal. Alternatively, a person engaging in this type of conduct may commit an offence under section 298 of

the SFO and may be prosecuted. Since the SFO came into effect on 1 April 2003, the SFC has conducted four investigations into such suspected market misconduct involving directors of listed companies.

(c) The SFC will follow up all complaints it receives including those on price-sensitive or misleading remarks by directors of listed companies. All such complaints are tabled before the Complaints Control Committee of the SFC, chaired by an Executive Director and consists of senior executives from various SFC departments, which decides whether the complaints should be taken further.

The Listing Rules promulgated by the Stock Exchange of Hong Kong Limited (SEHK), a wholly owned subsidiary of the HKEx, govern, amongst others, timely and accurate disclosure of material price-sensitive information by listed companies. The SEHK as the administrator of the Listing Rules has primary responsibility for handling any complaint or case of alleged or suspected misconduct that involves issuers under or in respect of the Listing Rules. The SEHK reviews and evaluates each complaint it receives to determine what action to take.

Through regular meetings, the SFC and the SEHK share relevant information and co-ordinate enforcement efforts.

(d) In investigating an allegation of misleading remarks made by a director of a listed company, the deciding factor is not the capacity in which the statement has been made by a director but whether the statement made appears to be false or misleading.

~~Food Samples Taken for Testing~~

~~16. **MR FRED LI** (in Chinese): *Madam President, the number of food samples taken by the Food and Environmental Hygiene Department (FEHD) for microbiological and chemical testing each year reduced progressively from some 58 000 in 2000 to some 53 000 in last year. In this connection, will the Government inform this Council:*~~

Appendix II

[PLEASE CHECK AGAINST DELIVERY]
(Translation)
LEGCO QUESTION No. 1
(Oral Reply)

Asked by: Hon Albert HO Date of Meeting: 1 March 2006

Replied by: Secretary for Financial Services and the Treasury

Question:

It has been reported that in November last year, Pacific Century Insurance Holdings Limited, a listed company, announced profits of about $105 million for the first three quarters as at end of September last year. Following the suspension of trading of its shares in January this year, the company announced that, as it had not applied the new accounting standards, it had made an error in reporting its profits, and the actual profits should be $8.01 million, representing a drastic reduction of 92% as compared to the amount previously announced. In this connection, will the Government inform this Council:

(a) of the total number of cases in the past three years involving announcements of incorrect or misleading price sensitive information by companies listed in Hong Kong with subsequent amendments made; the investigations carried out by the authorities in respect of these cases and the number of cases in which the listed companies concerned were penalized or prosecuted by monitoring bodies;

(b) whether it has assessed the impact of the above cases on the reputation of Hong Kong as an international financial centre as well as the interests of investors; if it has, of the assessment results; and

(c) how it will prevent the recurrence of similar cases and whether it will consider amending the relevant legislation, with a view to strengthening controls (such as imposing heavier penalties, introducing a fine system and allowing investors to claim compensation) and providing for "the investors' right of derivative action", so as to allow minority shareholders to take legal actions on behalf of listed companies against the management and defaulters concerned?

Reply:

Madam President,

(a) Under the existing regulatory regime, the Securities and Futures Commission (SFC) is the regulator of the securities market and is responsible for the regulation of the market and enforcement of relevant statutory requirements. The Stock Exchange of Hong Kong (SEHK) is the front-line regulator of the market. All companies listed on the SEHK must comply with its Listing Rules. The Listing Rules stipulate the requirements for initial public offerings and continuing obligations of listed companies including ongoing disclosure of price-sensitive information. When there is a breach of the Listing Rules of the SEHK such as disclosure of false or misleading price-sensitive information, the SEHK may request the concerned listed company to clarify. The SEHK may also impose non-statutory sanctions such as public censure and a public statement which involves criticism etc.

Separately, under the Securities and Futures (Stock Market Listing) Rules which came into effect in April 2003, listed companies are required to file with the SFC a copy of any announcement, circular or other document issued under the Listing Rules. Under sections 182 and 384 of the Securities and Futures Ordinance (SFO), if a person knowingly or recklessly provides false or misleading information in the statutory filing with the SFC, the SFC may exercise its statutory power to conduct investigation and gather evidence. A person who breaches these sections shall be liable to criminal fines and imprisonment.

According to the information provided by the SEHK, during 2003 and 2005, there were about 1000 listed companies. The SEHK has conducted investigation into 38 suspected cases involving disclosure of false or misleading price-sensitive information by listed companies. Listed companies involved in all these 38 cases subsequently made clarifications. Persons concerned in four of these cases were sanctioned by the SEHK.

According to the information provided by the SFC, since 1 April 2003, the SFC has conducted investigations into 22 suspected cases of disclosure by listed companies in breach of section 384 of the SFO, and

has instituted prosecution in three cases. The parties involved in two of these cases have been convicted.

(b) We certainly do not want to see cases like this taking place in Hong Kong. However, this is only an isolated case. In fact, the position of Hong Kong being an international financial centre has been built on solid foundation. Both overseas and local investors have full confidence in our market, which is evidenced from the active turnover of Hong Kong stock market. Last year, the market turnover, amount of initial public offering equity funds raised and the market capitalisation all reached record high. The total market turnover amounted to HK$4,520.4 billion in 2005. The market capitalisation exceeded HK$9,000 billion in February this year. Even overseas investors cast a vote of confidence in Hong Kong's market: overseas investors have constantly contribute to 35% to 40% of Hong Kong's stock market turnover. It can be seen from the above that Hong Kong's position as an international financial centre is secure as ever. However, we will not be complacent, and will continue with various improvement measures to ensure that our regulatory regime is conducive to the development of a quality market which is fair, open and transparent.

(c) In fact, the existing system has already provided investors with a lot of protection. In respect of investors' claims for compensation, under section 281 of the SFO, a person who has sustained any pecuniary loss as a result of a relevant act in relation to market misconduct committed by another person can claim compensation from the person concerned by exercising the right of civil action. Such market misconduct includes disclosure of false or misleading information to induce the purchase or sale of securities by another person.

As regards derivative action instituted by investors, the relevant provisions in the Companies (Amendment) Ordinance 2004, which came into effect on 15 July last year, have significantly enhanced shareholders' remedies, including allowing minority shareholders to bring statutory derivative actions on behalf of the company against wrongdoers in relation to the company. The Ordinance also empowers the court to award damages to company members whose interests have been unfairly prejudiced.

As regards sanctions, under sections 277 and 298 of the SFO, market misconduct takes place when a person discloses, circulates or disseminates information that is likely to induce the purchase or sale of securities by another person if he knows that, or is reckless or negligent as to whether, some information is false or misleading. The person concerned shall be subject to civil sanctions by the Market Misconduct Tribunal or criminal prosecution. The civil sanctions that may be imposed by the Market Misconduct Tribunal include disgorgement order and disqualification order, etc. If the person is prosecuted and convicted, he may be liable to a fine of HK$10,000,000 and to imprisonment for 10 years.

To further strengthen the position of Hong Kong as an international financial centre and protect investors' interests, we will continue to work closely with the regulators in improving the regulatory regime. One of the key initiatives is to give statutory backing to major listing requirements so that the SFC can impose civil sanctions on listed companies as well as their directors and officers for breaches of the statutory listing rules. Or such breaches may be brought to the Market Misconduct Tribunal for civil proceedings or be subject to criminal prosecution.

To further enhance the quality of financial reporting by listed companies so as to safeguard the interests of investors, the Government introduced the Financial Reporting Council Bill into the Legislative Council last June to set up the Financial Reporting Council (FRC). The FRC will be responsible for investigating the professional misconduct committed by auditors of listed companies and collective investment schemes, and enquiring into the financial reports of such companies and schemes to see if they comply with the relevant legal, accounting or regulatory requirements. The Administration will continue to give full support to the Bills Committee of the Legislative Council in scrutinising the Bill so that the FRC can be established as soon as possible. We expect that after the establishment of the FRC, independence of investigation can be strengthened. As this independent investigatory body will be vested with more effective statutory investigative powers, the effectiveness of investigation and hence the quality of financial reporting by listed companies can be enhanced.

Thank you, Madam President.

Appendix III

Extract from the minutes of meeting of the Panel on Financial Affairs on 4 April 2005

*　　*　　*　　*　　*　　*

V. Briefing on the Securities and Futures (Amendment) (No. 2) Bill 2005 - Proposals to give statutory backing to major listing requirements

(LC Paper No. CB(1)1160/04-05(04) — Paper provided by the Administration

LC Paper No. CB(1)1200/04-05(01) — Submission dated 31 March 2005 from the Securities and Futures Commission

LC Paper No. CB(1)1160/04-05(05) — Background brief prepared by the Legislative Council Secretariat

LC Paper No. CB(1)670/04-05 — Consultation papers on:
(a) Proposed amendments to the Securities and Futures Ordinance to give statutory backing to major listing requirements; and
(b) Proposed amendments to the Securities and Futures (Stock Market Listing) Rules)

37. The Chairman pointed out that according to the agreed arrangement between LegCo and the Administration, the Administration was required to provide a paper for a discussion item at least five clear days before the relevant Panel meeting. For the Chinese version of the paper for this discussion item, the Administration had missed the agreed deadline (i.e. 24 March 2005) by one day. He reminded the Administration to adhere to the agreed deadline for submission of papers in future.

Briefing by the Administration

38. At the invitation of the Chairman, SFST briefed the Panel on the Administration's proposal to amend the SFO to give statutory backing to major listing requirements. He highlighted the following points:

(a) To maintain Hong Kong's position as an international financial centre, it was important to enhance market quality and investors' protection. The Government had all along attached great importance to the regulatory regime of the financial markets, and giving statutory backing to major listing requirements was one of its major tasks in this area.

(b) The existing legislation did not prescribe positive obligations on disclosure and no statutory sanctions were imposed on non-disclosure, late disclosure or selective disclosure. Giving statutory backing to major listing requirements would create a positive statutory obligation for compliance with these requirements and enable the imposition of a wide range of statutory sanctions which would be commensurate with the seriousness of the breach.

(c) The Government proposed giving statutory backing to the following major listing requirements –
   (i) financial reporting and other periodic disclosure;
   (ii) disclosure of price-sensitive information; and
   (iii) shareholders' approval for certain notifiable transactions.

   The Administration had consulted the public on the above proposals which received wide support. The Administration briefed the Panel on the consultation outcome in 2004.

(d) In early 2005, the Administration consulted the public on proposed legislative amendments. The majority of submissions received supported the proposed amendments which aimed to -
   (i) provide SFC with power to make rules for prescribing listing requirements and ongoing obligations of listed corporations under section 36 of the SFO;
   (ii) extend the market misconduct regime in the SFO to cover breaches of the statutory listing rules made by SFC;
   (iii) 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, for breaches of the statutory listing rules made by SFC; and
   (iv) empower 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 SFC.

(e) On the proposal of empowering the MMT to impose civil fines, some submissions called for the power for the MMT to impose much higher fines or even unlimited fines. Having considered the views received and practices in other jurisdictions, the Administration proposed not to

specify in the SFO the upper limit on the level of civil fines that might be imposed by the MMT.

(f) There were different views on the proposal for empowering SFC to impose civil fines. Those supported the proposal considered that the proposal would enable SFC to take swift action to deal with breaches, and to adopt regulatory actions commensurate with the severity of the misconduct. Those against the proposal considered that -

(i) Since SFC would be responsible for enforcing the statutory listing requirements, the proposal would effectively transform SFC into the police, the prosecutor and the judge;

(ii) Unlike the MMT which was a quasi-judicial body subject to the due process of hearing, SFC's disciplinary hearing which was conducted by way of "paper hearing" gave rise to concern about fairness of the disciplinary process to issuers and directors; and

(iii) The proposal for empowering SFC, in addition to the MMT, to impose fines would result in two similar civil regimes and hence confusion and uncertainty as to which authority should be responsible for handling a particular breach.

(g) The Administration had not taken a stance on whether SFC should be given the power to impose civil fines. Members' views were welcomed in this respect.

(h) Giving statutory backing to listing requirements was a significant step forward in upgrading the regulation of the listed sector with a view to enhancing market quality and protection for investors. The Administration recognized the need to strike a balance so as not to cause unnecessary compliance burden to market participants, which would not be conducive to market development. The current proposal sought to achieve an appropriate balance. Members' comments were welcomed.

(i) The Administration planned to introduce the relevant bill to LegCo in June 2005.

39. Upon invitation by the Chairman, the Permanent Secretary for Financial Services and the Treasury (Financial Services) took members through other proposals relating to enhancement of regulation of listing. He highlighted the following points:

(a) Following the publication of the Consultation Conclusions on Proposals to Enhance the Regulation of Listing in March 2004, the Administration invited SFC to expose the draft statutory listing rules

for public consultation before introducing to LegCo the amendments to the SFO. The purpose was to facilitate consideration of the amendments to the SFO by the legislature and the public. In this context, SFC published on 7 January 2005 the Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules (SFSMLR) to be made by SFC under the amended SFO. The consultation closed on 31 March 2005.

(b) The Administration noted from the responses to the Consultation Paper on Amendments to the SFO market's concern about potential mismatch between SFC's statutory listing rules and the non-statutory listing rules of the Stocks Exchange of Hong Kong (SEHK) in terms of content, interpretation and administration. It had to be noted that there were already statutory safeguards to prevent inconsistency between SFC's statutory listing rules and SEHK's Listing Rules. The current SFO provided that SEHK's Listing Rules should have effect only to the extent that they were not repugnant to any rule made by SFC governing listing. To address market's concern about the potential problems concerning the interface between SFC and SEHK, the Administration had recommended in the Consultation Conclusions on Proposals to Enhance the Regulation of Listing to articulate in a public statement their division of responsibilities, both as at present and upon the introduction of statutory listing rules. On 31 March 2005, SFC and SEHK published a joint statement on existing arrangements for listing regulation to enhance public understanding about their respective roles and duties in this area.

(c) As regards administrative checks and balances on SFC's disciplinary power relating to listing, submissions received in the Consultation Paper on Amendments to the SFO in general supported the proposal for setting up a committee comprising SFC and independent members to deal with SFC's disciplinary decisions relating to listing. This would help to allay concern that SFC would become the investigator, the prosecutor, and the judge in respect of enforcement actions against issuers and their management. A number of submissions agreed that the Regulatory Decisions Committee (RDC) set up by the Financial Services Authority (FSA) in the United Kingdom (UK) could provide a useful reference. The Administration had invited SFC to consider this proposal or any other measures that could effectively enhance the checks and balances on SFC's new regulatory responsibilities relating to listing.

Discussion

Proposal for empowering SFC to impose civil fines

40. Mr Ronny TONG indicated support for the proposal for empowering SFC to impose civil fines so as to provide SFC with the power necessary for the effective performance of its new regulatory responsibilities relating to listing. Otherwise, SFC would become a toothless tiger. Miss Mandy TAM shared Mr TONG's views and expressed support for the proposal in principle.

41. Ms Emily LAU said that she supported the proposal in principle with a view to enhancing SFC's regulatory power in listing. However, noting that 12 submissions supported the proposal but 21 submissions did not support it, Ms LAU considered that SFC should elaborate on the merits of the proposal.

42. On the merits of the proposal, Mr Peter AU-YANG, Executive Director (Corporate Finance), SFC pointed out that the power to impose civil fines would enable SFC to take swift action to uphold its regulatory objectives of maintaining a fair and transparent market and enhancing protection for investors. In view of the nature of breaches under the listing regime, the available sanctions other than civil fines would be ineffective against an issuer. For instance, disqualification as a director did not apply to an issuer. Disgorgement did not come into play either as it would be some or all of the shareholders, not the company, who had made the profit or avoided a loss as a result of the breach. The failure of the existing regime also showed that public reprimands did not work. Mr AU-YANG further pointed out that reliance on the MMT fines alone would deny a key enforcement tool to SFC. SFC would be deprived of medium sanctions in between reprimands and disqualifications. There were likely to be many cases in between, calling for a sanction more severe than a public reprimand but which were not serious enough to merit disqualification. Without the power to impose civil fines as the most appropriate sanction in these cases, SFC would be compelled to refer a large number of cases to the MMT, creating workload which the MMT was not equipped to deal with or to handle efficiently as required for the proper regulation of the listed sector. Moreover, the cost and time involved in taking most cases to the MMT would be prohibitive for both SFC and offenders (who would also have to bear SFC's costs if they lost). The practical experience of the Insider Dealing Tribunal (replaced by the MMT established under the SFO) illustrated that it worked best in dealing with the more important and complex cases involving the serious sanctions. Mr AU-YANG added that there was strong support from the industry to provide SFC with the power to impose civil fines as showed in the consolidated submission by nine major investment banks. He stressed that there was significant support backed up by sound reasons for proceeding with the proposal.

43. Responding to Ms Emily LAU's enquiry about the MMT's existing and anticipated workload with the proposed expansion of the market misconduct regime to cover breaches of the statutory listing rules, Mr Peter AU-YANG advised that

under the existing listing regime, breaches of SEHK's Listing Rules were handled by the Listing Committee. During the period between 1 July 2004 to 31 January 2005, the Committee had dealt with 18 cases. As at 31 January 2005, there were 26 cases pending consideration by the Committee. As for the MMT, given the complex nature of market misconduct cases, SFC had not yet referred any suspected breach for action by the MMT since the commencement of the SFO in April 2003. While two cases were being studied by SFC's legal services department for referral to the MMT, investigation for another four cases had been completed pending study by the legal services department on whether referral to the MMT should be made.

44. Ms Emily LAU noted from the SFC's submission to the Panel that the European Union had recently directed that all member countries should pass legislation to provide for administrative sanctions to be imposed on public companies and their directors. It seemed that the legislation was not yet in place. Ms LAU was concerned whether it was appropriate for SFC to take the lead in adopting a civil fine regime for breaches of listing requirements.

45. In response, Mr Peter AU-YANG advised that most major jurisdictions which Hong Kong benchmarked with had put in place a disclosure regime that relied heavily on the ability to impose civil sanctions. A number of jurisdictions, including the UK, Canada, France, Spain, and Japan, had adopted a regime enabling the regulators, rather than the courts, to impose civil fines against public companies and their directors. Hence, it was the worldwide trend for securities regulators to use fining powers given the complexity of the issues that arose in relation to the securities industry. It was an appropriate model for Hong Kong to follow.

46. Mr SIN Chung-kai said that the proposal would be in line with similar powers conferred to securities regulators in overseas markets, such as the Securities and Exchange Commission (SEC) in the United States (US), and other regulators in Hong Kong, such as Office of the Telecommunications Authority. However, given the short history of SFC and the fact that its credibility had yet to be established, Members of the Democratic Party considered it more appropriate for SFC to concentrate on its work at the present stage and for the Administration to review at a later stage the need to empower SFC to impose civil fines. Mr SIN also noted that currently SFC could impose disciplinary fines on parties for non-compliance with the requirements under the SFO. He enquired about the difference between such disciplinary fines and the proposed civil fines.

47. In respect of the situation of SEC in US, SFST advised that, as far as he understood, the regulator could agree with listed corporations for the latter to pay a specific amount of money to settle instead of SEC taking disciplinary actions. For other types of breaches, SEC would refer them to courts where a range of sanctions, including civil fines, were available.

48. Mr Peter AU-YANG added that, as far as he understood, SEC was not conferred the power to impose civil fines on listed corporations and their officers. As for the situation in Hong Kong, while SFC was empowered under Part IX of the

SFO to impose financial penalty on its licensees for breaches of requirements, such fines did not apply to issuers and directors. SFC considered it essential for it to be empowered to impose civil fines to enable effective enforcement of the statutory listing rules. Imposition of civil fines was a medium sanction in between public reprimands for lesser infractions and disqualification of directors or officers for more serious breaches. For more severe breaches, SFC would refer them to the MMT.

49. While supporting the proposal for empowering the MMT to impose civil fines on breaches of the statutory listing rules, Mr Abraham SHEK expressed reservation on the proposal to provide SFC with the power to impose civil fines, as it might turn SFC into the police, the prosecutor and the judge.

50. While SFST claimed that the Administration adopted an open mind on whether the proposal for empowering SFC to impose civil fines should be pursued, members noted from recent press reports that the Administration inclined not to support the proposal. Given the apparent difference in views between SFC and the Administration over the proposal, Mr Ronny TONG, Mr SIN Chun-kai and Ms Emily LAU considered that the Administration should clarify its stance. Mr Albert CHENG opined that the Administration should have resolved the differences with SFC before presenting the proposal to LegCo.

51. In response, SFST stressed that the Administration had not taken any stance on the matter. It respected SFC's views from the perspective of a regulator, and also welcomed views from Members. In considering the proposal, the Administration would be mindful of the need to strike an appropriate balance between enhancing regulation of the market and preserving the efficiency of the listing process and hence competitiveness of the market. SFST assured Members that the Administration would carefully consider the views and concerns expressed by various parties before making the final decision on the proposal.

Admin

Targets of sanctions

52. Mr CHIM Pui-chung supported the idea of imposing civil fines on listed corporations for beaches of the statutory listing rules. He was however concerned whether listed corporations or the responsible staff would be the targets of sanctions. He pointed out that if civil fines were to be imposed on listed corporations, it would be the small shareholders bearing the ultimate penalty. On determining the level of civil fines, Mr CHIM emphasized the need to work out a mechanism in order to facilitate enforcement and enhance transparency. He further suggested that factors, such as the damage and severity of a breach, should be taken into account in determining the level of civil fines.

53. In response, Mr Peter AU-YANG said that the primary targets would include issuers, their directors and officers. The specific target accountable for the breach, irrespective whether it was the issuer (the corporation itself) or its directors or officers, would be subject to sanctions as appropriate. Mr AU-YANG added that at

present, the MMT was empowered to impose disgorgement on a corporation, or its director, or both which/who was proven responsible for the market misconduct. The responsible party was required to surrender the profits gained or loss avoided as a result of engaging the misconduct.

Division of responsibilities between SFC and SEHK over listing

54. While expressing support for the enhancement of the quality of the local market and reinforcement of Hong Kong's status as an international financial centre, Mr Albert CHENG was concerned that the proposal of giving statutory backing to major listing requirements would not provide SFC with effective regulatory power in listing and would not enhance the protection for investors. Pointing out that there were overlap and confusion in the roles and functions of SFC and HKEx in the current listing regime, Mr CHENG urged the Administration to clarify the roles and functions of the two parties before providing SFC with new regulatory powers in listing.

55. SFST stressed that the lack of regulatory teeth in SEHK's Listing Rules had remained an issue of concern to the market and the general public. The purposes of giving statutory backing to major listing rules relating to financial reporting and disclosure of information by listed corporations were to create a positive statutory obligation for compliance with the requirements with a view to enhancing the regulation of listing. On the concern about overlap in roles of SFC and SEHK in the listing regime, SFST advised that SFC and SEHK had entered into Memorandum of Understanding delineating their respective roles and functions in listing. The two parties also published a joint statement on 31 March 2005 to outline the existing arrangements to enhance public understanding. SFST pointed out that there would be a clear division of responsibilities between SFC and SEHK in administering the listing functions and dual filing system under the proposal of giving statutory backing to listing rules. SFC would be responsible for enforcing the new statutory listing requirements while SEHK would continue to enforce the non-statutory listing rules. SEHK would continue to receive initial public offer applications at the frontline and be responsible for administering the listing process. All documents filed with SEHK would also be filed with SFC. Mr Peter AU-YANG supplemented that SFC appreciated market's concern about potential problems concerning enforcement of the statutory and non-statutory listing rules by SFC and SEHK respectively. He assured Members that SFC and SEHK would maintain close communication to avoid possible regulatory gaps or overlaps.

56. Miss Mandy TAM expressed concern about the possible confusion arising from tackling non-compliance with statutory listing requirements by imposing civil sanctions by SFC and by the MMT, and the existing civil and criminal regimes under the SFO.

57. In response, Mr Peter AU-YANG said that there were clear mechanisms and procedures for instituting the civil and criminal regimes for tackling market misconduct. Moreover, there were provisions in the SFO to avoid "double

jeopardy" on a person so that he would not be subject to both the MMT and criminal regimes for the same misconduct committed. The same provisions would be applied to breaches of statutory listing rules.

Checks and balances on SFC's disciplinary power relating to listing

58. Mr Abraham SHEK expressed concern about the lack of sufficient checks on powers of SFC. Noting that other jurisdictions had put in place independent committees comprising lay persons to review regulatory decisions relating to listing made by their respective regulatory bodies, Mr SHEK enquired about SFC's plan to enhance checks and balances on its powers after taking up new regulatory responsibilities in listing.

59. Mr Peter AU-YANG stressed that there were sufficient safeguards on SFC's regulatory powers. Details of the existing checks and balances measures were set out in Appendix B to the Consultation Paper on Amendments to the SFO. He emphasized that, in making the disciplinary decisions relating to listings, SFC would observe due procedures for exercising civil sanctions to ensure fairness and transparency in the process. SFC would be required to inform the party, which was the subject of disciplinary decision, of its decision in writing together with written statement of the reasons for the decision. The party would be given an opportunity of being heard before SFC imposed a disciplinary sanction. All types of SFC's disciplinary decisions against issuers, directors and officers would be subject to appeal to the Securities and Futures Appeals Tribunal (SFAT), which was established under the SFO as an independent body responsible for hearing appeals against a wide range of SFC's decisions. SFAT was chaired by a full-time judge and with Government-appointed market participants as its members. SFAT was empowered to conduct full merit review of a case. It might affirm, vary or substitute SFC's decisions. Mr AU-YANG added that SFC was prepared to explore additional measures to strengthen the existing checks and balances regime. It also noted a proposal of establishing a committee modelled on the RDC. He pointed out that the RDC had been in operation for three years in UK. SFC was aware that the FSA had commenced an in-depth review of the structure and functioning of the committee in March 2005, which was expected to be completed in this summer. Mr AU-YANG assured Members that SFC would take into account the results of the review before making the decision on the issue.

60. To address the concern about the checks and balances on the powers of SFC in the regulation of listing, Mr Abraham SHEK requested the Administration to provide the following information on practices in overseas jurisdictions (including UK and Canada):

(a) The compositions of relevant overseas regulatory bodies and whether they were comparable to that of SFC;

(b) The powers of relevant overseas regulatory bodies, in particular whether they had the power to impose civil fines on issuers, directors

and officers and if they had, the upper limit; and

(c) The mechanism for reviews/appeals on the regulatory decisions relating to listing made by relevant overseas regulatory bodies.

(*Post-meeting note:* Information provided by the Administration was circulated to Members vide LC Paper No. CB(1)1463/04-05(01) on 5 May 2005.)

Conclusion

61. There being no further questions from members, the Chairman concluded the discussion. He invited members' views on whether they supported in principle the Administration's proposal to amend the SFO to give statutory backing to major listing requirements. In this connection, Ms Emily LAU requested the Administration to confirm whether it supported the proposal for empowering SFC to impose civil fines for breaches of the statutory listing rules.

Admin

62. SFST re-iterated that the Administration would consider the views and concerns expressed by various parties carefully before making a decision on the matter. The final proposal would be incorporated in the Bill.

63. The Chairman concluded that the Panel supported in principle the Administration's proposal to amend the SFO to give statutory backing to major listing requirements.

Appendix IV

Regulation of market misconduct

List of relevant papers
(Position as at 30 March 2006)

Meeting	**Paper**
Meeting of Panel on Financial Affairs (FA Panel) on 2 April 2004	Information note on "Consultation conclusions on proposals to enhance the regulation of listing" *(LC Paper No. CB(1)1393/03-04(03)* Consultation paper on proposals to enhance the regulation of listing *(LC Paper No. CB(1)2545/02-03)* Extract of minutes of FA Panel meeting on 13 June 2003 *(LC Paper No. CB(1)1393/03-04 — Agenda Item II)* Report by the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure *(LC Paper No. CB(1)1199/02-03)* Paper provided by the Administration on "Regulation of listing" *(LC Paper No. CB(1)1908/02-03(03))* Minutes of meeting *(LC Paper No. CB(1)2084/03-04 — Agenda Item IV)* Supplementary information provided by the Administration *(LC Paper No. CB(1)1639/03-04(02) issued on 27 April 2004)*
<u>Council meeting on 24 November 2004</u> Written question raised by Hon LEE Wing-tat on price sensitive or misleading remarks made by directors of listed companies	Hansard — *Question number 15*

Meeting	Paper
FA Panel meeting on 4 April 2005	Paper provided by the Administration on "Proposals to give statutory backing to major listing requirements" *(LC Paper No. CB(1)1160/04-05(04))* Background brief prepared by the LegCo Secretariat *(LC Paper No. CB(1)1160/04-05(05))* Consultation papers on: (a) Proposed amendments to the Securities and Futures Ordinance to give statutory backing to major listing requirements; and (b) Proposed amendments to the Securities and Futures (Stock Market Listing) Rules *(LC Paper No. CB(1)670/04-05)* Minutes of meeting *(LC Paper No. CB(1)1677/04-05 — Agenda Item V)* Supplementary information provided by the Administration *(LC Paper No. CB(1)1463/04-05(01) issued on 5 May 2005)*
<u>Council meeting on 1 March 2006</u> Oral question raised by Hon Albert HO on incorrect or misleading information released by listed companies	—