

**For discussion  
on 2 March 2007**

## **Legislative Council Panel on Financial Affairs Securities and Futures (Amendment) Bill 2007**

### **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 4 April 2005, we briefed Members on public comments on 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") published on 7 January 2005. The Panel supported in principle the Administration's proposal to amend the SFO to give statutory backing to major listing requirements which comprised the following proposals –

- (i) to extend the market misconduct regime in Parts XIII and XIV of the SFO to cover breaches of the statutory listing requirements;
- (ii) to 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 unlimited civil fines, on the primary targets, i.e. issuers, directors and officers<sup>Note 1</sup>, for breaches of the statutory listing requirements; and
- (iii) to empower the Securities and Futures Commission ("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 requirements under the amended Part IX of the SFO.

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

3. Apart from the above proposals, there are a few outstanding issues that require further consideration. The views expressed and our responses are summarized in the following paragraphs.

## **Public Comments on the Outstanding Issues and the Response of the Administration and the SFC**

### ***(A) Statutory Listing Rules – Legislative Approach***

#### Market Comments

4. In conjunction with the Government’s Consultation Paper on Amendments to SFO which sought to provide a sanctioning framework to deal with breaches of statutory listing requirements, the SFC published the Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules (“Consultation paper on Amendments to SFSMLR”) in January 2005. The Consultation Paper on Amendments to SFSMLR proposed to codify the more important listing requirements by incorporating the detailed provisions in the existing Stock Exchange of Hong Kong (SEHK)’s Listing Rules into the subsidiary legislation to be made by the SFC.

5. Some respondents had reservations about the proposal for replicating the detailed SEHK Listing Rules in the subsidiary legislation on the ground that it might reduce flexibility and hence hinder expeditious administration of the rules in response to market needs. There were also concerns that the proposed statutory listing rules were unduly detailed and hence a breach of minor detailed requirements in the rules might attract severe statutory sanctions.

6. Apart from the concerns about the content of the proposed statutory listing rules, there were calls for additional checks and balances on the SFC should the regulator be empowered to make statutory listing rules by way of subsidiary legislation. This concern was prompted by the fact that under the proposal, a breach of the statutory listing requirements might attract heavy sanctions including substantial fines under the civil regime or even imprisonment under the criminal regime. Moreover, there were questions as to whether the SFC as the law enforcement agency to enforce the statutory listing rules should also be empowered to make such rules by way of subsidiary legislation.

## Current Proposal

7. To address these concerns, the Government and the SFC have come up with a new legislative approach in relation to the statutory listing requirements. Under the new legislative approach, the statutory listing requirements will comprise a set of general principles to be prescribed in the SFO. These principles would represent fundamental obligations of listed corporations. They would be based on the existing requirements provided for in the SEHK's Listing Rules and similar general principles in other leading jurisdictions such as the UK or international organizations such as the International Organisation of Securities Commissions (IOSCO). Breaches of these general principles will be regarded as market misconduct which may be subject to SFC disciplinary action, sanction by the MMT, or criminal prosecution.

8. The general principles will be supported by provisions in a new schedule to the SFO which will set out the factors for the SFC/MMT/court to consider when determining whether there is a breach of general principles. A breach of the schedule provisions would not be regarded as market misconduct by itself, but will be a factor to be taken into consideration when determining whether there is a breach of the general principles, and will be admissible as evidence in enforcement procedures or civil/criminal proceedings.

9. To assist compliance with the statutory provisions, the SFC will promulgate a non-statutory listing code to provide guidance for the market on how the statutory listing requirements are to be interpreted and complied with. Breaches of the code are not a breach of the law but may be taken as evidence in enforcement procedures or civil/criminal proceedings.

10. The new approach which comprises general principles supported by a set of factors for consideration and a listing code to be promulgated by the SFC seeks to strike an appropriate balance between certainty and flexibility. Under the new proposal, the statutory listing requirements will be set out in the primary law in the form of general principles. The question as to whether the SFC as the law enforcement agency should be empowered to make statutory listing rules by way of subsidiary legislation will not arise. The new legislative approach which focuses on the general principles instead of the technical requirements also addresses the concerns expressed that minor breaches could potentially attract severe statutory sanctions which would be contrary to the purpose of this legislative exercise.

## ***(B) SFC's Fining Power***

### Market Comments

11. At the meeting on 4 April 2005, we consulted Members on the proposal for empowering the SFC to impose civil fines on issuers and directors for breaches of statutory listing requirements, and the maximum level of civil fines that might be imposed by the SFC. In response to Members' comments, we undertook to consider the views expressed by the relevant parties carefully before finalising the Administration's proposal.

### Current Proposal

12. According to the SFC's proposal, the maximum level of fines that the SFC may impose on issuers and directors should be pitched at \$10 million which will align with the SFC's current power to impose a fine of up to \$10 million on regulated persons. They believe that the differentiation between this \$10 million limit for the SFC and the unlimited fining power proposed for the MMT would produce a balanced and effective sanctioning regime.

13. We believe that the proposal for empowering the SFC to impose a fine of up to \$10 million is appropriate on the basis of the following considerations –

- (i) Section 194 of the SFO empowers the SFC to impose a fine on a regulated person up to \$10 million or three times the amount of profit gained or loss avoided whichever is higher where a regulated person is guilty of misconduct or is not fit and proper. The proposed fining limit of \$10 million by the SFC on listed issuers and directors would be on a par with the fining limit applicable to the fines imposed by the SFC on regulated persons.
- (ii) Under the new proposal, the obligations of listed issuers and directors would be clearly stipulated in the primary law (i.e. SFO) instead of subsidiary legislation to be made by the SFC following negative vetting by the legislature. This legislative approach would give the market more certainty about the content of the statutory listing requirements applicable to listed corporations and their management.

- (iii) The primary law would set out the factors that the SFC has to consider before imposing fines on listed corporations and their directors, e.g. whether a person to be fined is an individual or a corporation, and the individual/corporation's financial resources.<sup>Note 2</sup>

### ***(C) Checks and Balances on the SFC's New Disciplinary Powers***

#### Market Comments

14. We noted in the Panel meeting on 4 April 2005<sup>Note 3</sup> that there was general support for the proposal to establish a committee comprised of the SFC and independent members to deal with the SFC's disciplinary decisions relating to listing to allay any remaining concern that the SFC would become the investigator, the prosecutor, and the judge in respect of enforcement actions against listed corporations and their management. In this context, 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.

#### Current Proposal

15. The SFC has reviewed international practice in this area, and as a result proposes to address any such remaining concerns by separating the decision-maker from the enforcement team. This involves the establishment of a panel of full time decision-makers employed by the SFC to make enforcement decisions in relation to breaches of statutory listing requirements. Under the SFC's proposal, the panel of decision makers would comprise senior staff e.g. experienced lawyers, regulators, tribunal members, etc. They would be functionally separate from the SFC operational divisions including Enforcement Division, and would report directly to the Chief Executive Officer of the SFC, instead of the Executive Director (Enforcement). The Administration agrees that the SFC's proposal could help ensure the independence of the decision-maker from the investigation team by setting up an internal Chinese wall between the investigators and the decision makers. This will also alleviate the concern expressed that the same group of SFC executives would play the dual roles of an investigator and the judge at the same time.

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<sup>Note 2</sup> See paragraph 20 of LC Paper No. CB (1)1160/04-05(04).

<sup>Note 3</sup> See paragraphs 25 and 26 of LC Paper No. CB(1)1160/04-05(04).

## *(D) Administration of the New Regime*

### Market Comments

16. We noted the market's concern about the division of responsibilities between the SFC and the SEHK under the new regime.<sup>Note 4</sup> Though this issue is not necessarily related to the content of the Securities and Futures (Amendment) Bill proposed by the Administration, we would like to set out below the SFC response to the market's concern to facilitate members' consideration of the Administration's legislative proposal.

### Response from the SFC

17. The SFC has discussed with market practitioners as well as investor representatives on issues relating to the responsibilities of the SFC and the SEHK under the new regime. Most respondents pointed out that the new regime should –

- (i) avoid dual regulation to minimize the possibility of conflicting decisions between two regulators and compliance costs;
- (ii) ensure certainty and clarity so that issuers would know whether they should deal with the SFC or the SEHK; and
- (iii) ensure that the SEHK's existing practice of interpreting the listing requirements will continue into the new regime to provide a smooth transition.

18. To facilitate the implementation of the new regime, the Administration, the SFC and the SEHK would work out an agreed approach on the basis of the above principles before the commencement of the Securities and Futures (Amendment) Bill. Our aim is to arrive at a mechanism agreed with the SFC and the SEHK, and to explain clearly to market players the respective responsibilities of the SFC and the SEHK in administering the new regulatory regime which would include the following tasks –

- (i) providing informal consultation for listed corporations;
- (ii) monitoring price and volume movements; and
- (iii) giving formal rulings on compliance with the statutory listing requirements.

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<sup>Note 4</sup> See paragraphs 27 – 29 in LC Paper No. CB(1)1160/04-05(04).

## **Conclusions**

19. Building on public support for giving statutory backing to major listing requirements, the Administration has been working closely with the SFC and the Hong Kong Exchanges and Clearing Limited (HKEx) to arrive at a proposal that can effectively enhance the quality and hence the reputation of our equity market without stifling market development. That would require a piece of legislation that would give sufficient enforcement teeth to major listing requirements so that a breach of these requirements would attract a range of proportionate and calibrated statutory sanctions. In preparing the legislative proposal, we are mindful of the need to avoid imposing an undue compliance burden on listed corporations by subjecting minor breaches of the listing requirements to severe statutory sanctions.

20. To ensure a smooth transition to the statutory regime, we will work closely with the SFC and the HKEx on an implementation plan prior to the coming into effect of the Securities and Futures (Amendment) Bill.

## **Way Forward**

21. The Administration plans to introduce a Securities and Futures (Amendment) Bill 2007 within the current legislative session based on the proposed legislative amendments attached to the Consultation Paper on Amendments to the SFO and the new legislative approach in relation to the statutory listing requirements set out in paragraphs 7 – 10 above.

Financial Services and the Treasury Bureau  
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