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19 January 2012

Ms Anita Sit  
 Clerk to Bills Committee on  
 Securities and Futures (Amendment) Bill 2011  
 Legislative Council Secretariat  
 Legislative Council Complex  
 1 Legislative Council Road  
 Central  
 Hong Kong

Dear Ms Sit,

**Bills Committee on Securities and Futures (Amendment) Bill 2011  
 Follow-up to meeting on 3 January 2012**

Further to our letter of 18 January 2012, the Securities and Futures Commission (SFC) has prepared the paper on items (b) and (c) at **Annex**.

On the proposed direct institution of proceedings before the Market Misconduct Tribunal (MMT) by the SFC, we would like to add that the MMT proceedings in themselves provide the appropriate check-and-balance. MMT is an independent tribunal. It is chaired by a judge and comprises two members, with the appointments made by the Chief Executive or a person under delegated authority. MMT is able to inquire into a case referred to it and issue orders to obtain further evidence during the proceedings. Any person who is dissatisfied with the MMT's findings may appeal to the Court of Appeal.

Yours sincerely,

( Miss Belinda Kwan )

for Secretary for Financial Services  
 and the Treasury

c.c. SFC (Attn: Mr Donald Lai)  
 DoJ (Attn: Mr Boyce Yung)

## Securities and Futures (Amendment) Bill 2011: Direct Access and Checks and Balances

1. This paper summarises:
  - the reasons for the proposal to empower the Securities and Futures Commission (**SFC**) to institute proceedings before the Market Misconduct Tribunal (**MMT**) direct and to provide for the SFC to be responsible for appointing the Presenting Officer in MMT proceedings and explains the relevant arrangements of other comparable jurisdictions; and
  - the relevant checks and balances over the SFC in relation to such matters.

### *Criminal and MMT Processes for Market Misconduct*

2. The Securities & Futures Ordinance, Cap 571 (**SFO**) creates dual criminal and MMT processes for imposing deterrent sanctions on wrongdoers who contravene the SFO's market misconduct provisions. Criminal prosecution and MMT proceedings are mutually exclusive<sup>1</sup>.
3. Without derogating from the powers of the Secretary for Justice in respect of prosecution of criminal offences<sup>2</sup> before all courts and in line with the constitutional protection of prosecutorial independence under Article 63 of the Basic Law, clearance from the Prosecutions Division (PD) of the Department of Justice (DoJ) will be sought before the SFC institutes criminal proceedings bringing charges for offences of market misconduct under Part XIV of the SFO before the magistrates' courts in the SFC's own name pursuant to section 388(1) of the SFO.
4. The SFC has direct access to the High Court and routinely brings proceedings dealing with market misconduct under section 213<sup>3</sup> of the SFO. The SFC is

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1 Sections 283 and 307 of the SFO.

2 As set out in section 388(3) of the SFO.

3 Under section 213 of the SFO, where a person has contravened any of the relevant provisions and notice or requirement given or made under or pursuant to any of the relevant provisions, etc., the SFC could apply to the court for injunction and other orders.

also able to deal with market misconduct by brokers and other licensees in disciplinary proceedings under Part IX of the SFO.

5. These functions are consistent with the SFC's statutory responsibilities under section 4 of the SFO, especially the statutory objectives to ensure the market operates fairly, efficiently and in an orderly manner and to reduce crime and misconduct in the securities market.
6. In the above cases, the SFC is able to bring proceedings directly without the interposition or intermediation of DoJ or any other person or agency.
7. However, under section 252 of the SFO, MMT proceedings can only be instituted by the Financial Secretary (**FS**), with the case being presented to the MMT by a Presenting Officer who is appointed by the Secretary for Justice and instructed by the Civil Division of DoJ to conduct the proceedings.
8. When the SFO was enacted, the key objective of establishing the MMT was to create a speedy civil fast track for market misconduct cases. The Government's Consultation Document on the Securities and Futures Bill (April 2000) then refers to the MMT being able to

*"...hear market misconduct cases relatively quickly using efficient civil procedures...[the] range of orders will enable the MMT to deal comprehensively and relatively swiftly with market misconduct with all the attendant benefits of simpler evidentiary and procedural rules."<sup>4</sup>*

9. In the Government's Consultation Document on the Securities and Futures Bill, reference was drawn to the tribunal system under the then Insider Dealing Tribunal (IDT), and building on the strengths of the IDT in combating insider dealing, the then Bill extended the civil tribunal system and established an MMT to cover not only insider dealing but also other instances of market misconduct. The composition and procedures of the MMT, including the FS' instituting proceedings, largely emulated those of the IDT.

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<sup>4</sup> See Consultation Document on the Securities and Futures Bill published by the Government of the HKSAR in April 2000 (paragraphs 11.1 and 11.8 of Chapter 11).

10. It is also evident that the SFC had little or no experience, up until that point, in handling civil market misconduct cases or prosecuting insider dealing. All insider dealing cases, at that point in time, had been handled by the Government in proceedings before the IDT. The position is now different.

*Reasons in Summary*

11. Since the enactment of the SFO and, in particular, since 2007, the SFC has made full use of all its remedies to tackle market misconduct in Hong Kong:
  - the SFC criminally prosecutes insider dealing and market manipulation cases with frequency and, to this point, with almost 100% success rate. Two trials are scheduled to commence in the next two months: these cases are conducted by the SFC directly;
  - more civil cases are brought before the Court of First Instance by the SFC dealing with market misconduct. There are currently 10 cases before the Court of First Instance involving 31 people concerning market misconduct issues;
  - market misconduct cases are frequently brought against brokers and other licensees under the disciplinary procedures contained in Part IX of the SFO.
12. In short, the SFC has a substantial body of experience and expertise, as well as a consistent track record of successful outcomes, which did not exist before the enactment of the SFO and which raises, in a way that was not apparent before the SFO, the question of duplication of resources and the efficient use of available expertise in continuing with the present process for initiating cases before the MMT.
13. In conducting these cases, the SFC engages senior and/or junior barristers from the Hong Kong Bar to advise and represent the SFC and to present the case to the relevant Court or Tribunal involving the same process used by the DoJ in appointing a Presenting Officer in the MMT.
14. Accordingly, it is apparent that the current process of requiring the FS to initiate a case before the MMT following separate consideration by DoJ largely duplicates the process that has already been undertaken by the SFC. In other words, the

SFC, having already undertaken its own investigation and received legal advice, is in a position to decide whether proceedings should be initiated for all types of market misconduct and does so in every instance except where the decision is to refer the case to the MMT. In that instance, the decision-making process is duplicated with the process requiring additional and separate consideration of the FS and legal advice by DoJ. This inevitably reduces efficiencies and can be streamlined when there is no longer a strong policy rationale for duplication.

15. In summary, the proposal to grant the SFC direct access to the MMT together with the function of appointing and instructing the Presenting Officer:
- addresses the current anomaly that permits the SFC to initiate other civil proceedings dealing with market misconduct but not MMT proceedings for the same kind of misconduct;
  - ensures there is a single point of accountability and responsibility in the SFC for tackling market misconduct and disclosure issues
  - is consistent with the SFC's role as market regulator and the SFC's statutory objectives, functions and duties as set out in sections 4-6 of the SFO;
  - will assist in making the MMT a more expedient process which is in the interests of the investing public as well as in the interests of those suspected of market misconduct;
  - reduces the duplication of public resources and expenditure by both SFC and the Government;
  - reduces the cost of the MMT for the taxpayer because costs currently borne by the Government in funding the role of the Presenting Officer will in future be paid by the SFC (which is not funded by the taxpayer); and
  - is consistent with the function and power of statutory securities regulators in all comparative jurisdictions (see **Attachment**).

#### *Checks and Balances*

16. Since the establishment of the SFC, care has been taken to ensure the exercise of the powers and functions are checked by efficient safeguards. For instance, powers, functions and responsibilities of the SFC are set out in the SFO. Furthermore, the regulator's power to update or adjust existing regulatory

requirements and introduce new ones through the promulgation of the the rules are subject to public consultation and negative vetting of LegCo as appropriate.

17. Other well-established checks and balances include the following:
- all board members of the SFC are appointed by and holding office on the terms and conditions determined by the Chief Executive or the Financial Secretary under delegated authority;
  - each year, the annual estimates of income and expenditure are submitted to the Chief Executive for approval and the FS shall cause the approved annual estimates to be laid before LegCo;
  - the SFC is subject to regular reporting and furnishing of information to the Financial Secretary regarding its operational and other important issues; and
  - the availability of statutory appeal and judicial review and the external scrutiny by bodies (such as the Process Review Panel and the Ombudsman) help ensure that the SFC upholds fairness and observes due process.
18. The SFC is subject to various checks and balances as mentioned above that are comparable to those of other developed countries such as the United Kingdom (UK) and Australia.
19. The UK Financial Services Authority (FSA) is operationally independent from the Treasury, and its Board with majority of members being non-executive is appointed by the Treasury. The Deputy Governor (Financial Stability) of the Bank of England is an ex officio director. It is accountable to Treasury Ministers and, through them, Parliament. Under the legislation, the FSA must report on the achievement of its statutory objectives to the Treasury every year. Treasury Ministers must then lay the report before Parliament. The FSA is regularly called to give evidence to the Treasury Select Committee. The Financial Services and Markets Tribunal, run by the Department of Constitutional Affairs, considers afresh regulatory decisions in cases where the FSA cannot reach an agreement with the firm or individual concerned. Where disagreements arise between the FSA and firms or individuals about the FSA's regulatory decisions,

the matter can be referred to the Upper Tribunal (Tax and Chancery Chamber), an independent judicial body.

20. The Australian Securities and Investments Commission (ASIC) is an independent Commonwealth government body, operating under the direction of six full-time Commissioners. The Governor-General, on the nomination of the Treasurer, appoints Commissioners. The Commissioner appoints and evaluates the performance of senior executive leaders, and approves budgets and business plans for each team. The ASIC reports to the Commonwealth Parliament, the Treasurer and the Parliamentary Secretary to the Treasurer. The Parliamentary Joint Committee on Corporations and Financial Services provides parliamentary oversight of the ASIC. The ASIC also appears before the Senate Standing Committee on Economics, and before other parliamentary committees and inquiries as required. The Real Economy Business Advisory Committee provides ASIC with strategic advice and feedback on the initiatives and operations of its Real Economy team. The Markets Disciplinary Panel is the main forum for disciplinary action when market integrity rules are breached. The Market Supervision Advisory Panel advises ASIC on its approach to its responsibilities in day-to-day supervision of the Australian Securities Exchange.
21. Finally, with specific reference to this proposal, the MMT will continue to be chaired by a judge appointed by the Chief Executive on the recommendation of the Chief Justice and the members of the MMT will continue to be appointed by the Chief Executive. Accordingly, the proposal in no way changes or affects the independence of the MMT.
22. Moreover, the decision to commence MMT proceedings can only be made by the board of the SFC. At present, the board is chaired by a non-executive Chairman and has 7 independent non-executive directors<sup>5</sup>. They outnumber<sup>6</sup> the 5 executive directors (including the CEO and 4 executive directors<sup>7</sup>) in the board.

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<sup>5</sup> The non-executive Chairman is Dr Eddy Fong, GBS, JP. The 7 independent non-executive directors are The Hon Mr Chan Kam-lam, SBS, JP, Professor Leonard Cheng, JP, Mr Anderson Chow, SC, Ms Angelina Lee, SBS, JP, Mr Lawrence Lee, JP, Mr Carlson Tong, JP, Mr Wong Kai-man, BBS, JP

<sup>6</sup> Section 1(b) of Part 1 of Schedule 2 to the SFO provides that the number of non-executive directors of the SFC shall exceed the number of executive directors of the SFC.

<sup>7</sup> The CEO is Mr Ashley Alder. The 4 executive directors are Ms Alexa Lam, JP, Mr Brian Ho, Mr Keith Lui and Mr Mark Steward.

23. Relevantly, the Hong Kong Bar Association made the following submission to the Government on 27 August 2010:

*“6.1 At present, the SFC cannot institute MMT proceedings. It must refer the case to the Financial Secretary, who would consult the Department of Justice, after which step he/she shall decide whether to institute proceedings. The procedures require three arms of government (and countless staff) to review the same papers, viz. the SFC’s investigatory report and underlying materials.*

*6.2 This appears rather unnecessary. The SFC is the agency with the most direct and expert knowledge of the securities market, securities law, and the particular case. Its judgment (reached internally at a sufficiently senior level) on whether to bring proceedings before the MMT ought to suffice.*

*6.3 To any extent there may be concern about the SFC’s zealotry, the MMT itself provides the best check and balance.”*



### Direct Access: International Comparison

Name of the relevant regulator	Examples of comparable market misconduct	Does it have the power to bring civil actions?	Does it have direct access?
Financial Services Authority (UK)	<p>Market abuse is defined under section 118 of the Financial Services and Markets Act 2000 (FSMA). The major categories of market abuse include behaviour that:</p> <ul style="list-style-type: none"> <li>• is based on inside information;</li> <li>• is likely to give a false or misleading impression as to the supply of, or demand for, or as to the price or value of, investments; and</li> <li>• would or would be likely to distort the market.</li> </ul>	Yes. If the Financial Services Authority is satisfied that a person has engaged in market abuse, it has the power to bring civil action against him and impose a financial penalty on him under section 123 of the FSMA.	Yes
Ontario Securities Commission (Canada)	<ul style="list-style-type: none"> <li>• market manipulation</li> <li>• insider trading</li> <li>• misleading disclosure</li> </ul>	Yes under provincial law, Securities Act (Ontario).	Yes
Securities and Exchange Commission (USA)	<ul style="list-style-type: none"> <li>• market manipulation (sections 9 and 10 of the Securities Exchange Act of 1934 (SEA) and Rule 10b-5 under the SEA)</li> <li>• making of false or misleading statements (section 18 of the SEA)</li> <li>• insider dealing (section 21A of the SEA)</li> </ul>	Yes. The Securities and Exchange Commission can bring an action in district court to seek payment of a civil penalty by any person who has violated the SEA and other provisions under sections 21(d)(3) and 21A of the SEA.	Yes
Australian Securities and Investments Commission (Australia)	<ul style="list-style-type: none"> <li>• market manipulation, false trading and market rigging (sections 1041A-C of the Corporations Act 2001 (CA))</li> <li>• dissemination of information about illegal transactions (section 1041D of the CA)</li> <li>• insider trading (section 1043A of the CA)</li> </ul>	Yes. Once a declaration of contravention of any civil penalty provisions has been made by court under section 1317E of the CA, the Australian Securities and Investments Commission can seek a pecuniary penalty order under section 1317G of the CA.	Yes

Name of the relevant regulator	Examples of comparable market misconduct	Does it have the power to bring civil actions?	Does it have direct access?
The Monetary Authority of Singapore (Singapore)	Insider dealing, market manipulation, false trading and market rigging, etc under the Securities and Futures Act (SFA) can be either criminal or civil offences.	Yes. The Monetary Authority of Singapore, with the consent of the Public Prosecutor, may bring an action in court against a person who is suspected of any prohibited activity under the SFA, to seek an order for a civil penalty in respect of that contravention.	Yes with consent of the Public Prosecutor
Securities Commission (Malaysia)	A person who contravenes the market misconduct provisions under the Capital Markets and Services Act 2007 (e.g. insider dealing, market manipulation) commits a criminal offence and may also be subject to civil actions.	Yes	Yes
The Securities and Exchange Commission of Thailand (Thailand)	The Securities and Exchange Act provides that misconduct in the securities market amounts to a serious criminal offence. The Securities and Exchange Commission (SEC) of Thailand is entitled to institute criminal proceedings against parties engaging in market misconduct.	No, but the SEC can fine the wrongdoers by presenting the case to the Settlement Committee, appointed by the Minister of Finance. In this regard, the wrongdoers must agree to be fined by the committee and the SEC acts as a coordinator to the Settlement Committee, which comprises representatives of the Royal Thai Police, the Bank of Thailand, and the Fiscal Policy Office.	N/A
Financial Services Agency (Japan)	<ul style="list-style-type: none"> <li>• insider dealing</li> <li>• market manipulation</li> <li>• fraudulent disclosure</li> </ul>	Yes. The Securities and Exchange Surveillance Committee (SESC) is in charge of the investigation of market misconduct. The SESC is empowered to file complaints with the Financial Services Agency (FSA) to enforce compliance or administrative orders, including administrative surcharges. The FSA is empowered to bring proceedings in order to impose administrative surcharges.	Yes

Name of the relevant regulator	Examples of comparable market misconduct	Does it have the power to bring civil actions?	Does it have direct access?
BaFin - Federal Financial Supervisory Authority (Germany)	<ul style="list-style-type: none"> <li>• insider dealing</li> <li>• market manipulation</li> <li>• dissemination of false or misleading information</li> </ul> <p>These are criminal offences but severe administrative action (including fines) can also be brought against any person in some instances.</p>	BaFin can take administrative action leading to fines of up to Euro 1m against any person for less serious manipulation. BaFin can also take administrative action by insider dealers who are not primary insiders (e.g. people who are not company directors but who come to possess inside information). This form of action is termed administrative and is equivalent to civil cause of action.	Yes
Autorité des Marchés Financiers (France)	<ul style="list-style-type: none"> <li>• insider trading</li> <li>• market manipulation</li> <li>• dissemination of false information</li> </ul>	Similar to the BaFin position, administrative action can be taken against an ordinary citizen.	Yes
Financial Markets Authority (New Zealand)	<ul style="list-style-type: none"> <li>• market manipulation (section 42S of the Securities Markets Act 1988 (SMA))</li> <li>• insider dealing (section 42S of the SMA)</li> <li>• Criminal penalties apply also.</li> </ul>	Yes. Under section 42T of the SMA, the Financial Markets Authority can take court action seeking civil penalties.	Yes