# Securities and Futures Legislation (Provision of False Information) Bill 2000

## 1 Introduction

This paper is submitted on behalf of a group of financial institutions (the "Group"). The Group has certain concerns as to the scope of the Securities and Futures Legislation (Provision of False Information) Bill 2000 as currently drafted. The Group has already written to the Financial Services Bureau and the SFC to express these concerns. In summary, some of those concerns are:

- The Bill applies not only to information provided pursuant to a statutory requirement, but to all information, written or oral, including information provided informally, as long as it is relevant to the performance of regulatory functions.
- An offence could arise not just where information provided to the regulators is false or misleading, but also if it is incomplete in a material particular. It is simply not practicable to ensure that information provided, particularly at short notice, is complete in every material particular.
- A person may be guilty of an offence not just where he knows the information to be false, misleading or incomplete, but also if he does not believe it to be true, accurate and complete in every material particular. Absence of a positive belief should not attract criminal liability, at least not unless a person acts recklessly.
- The scope of the offence is unclear where one person passes on to the regulator information supplied by another person, or where an individual provides information to the regulator on behalf of a company. Who will be treated as having "provided" information in these circumstances?

## 2 Comparison with Other Major International Financial Markets

The Legislative Council Brief on the Bill states that the Government's proposals are in line with the regulatory practices in other major international financial markets including Australia, the US and the UK. However, our understanding of the position in those markets is as follows:

### 2.1 *The US*

There is a general offence under Section 32 of the Securities Exchange Act for wilful violations of the Act and rules made under it, which could apply to deliberate falsehoods in making reports to the SEC. Furthermore, Title 18 US Code [Crimes and Criminal Procedure] S 1001 makes it an offence to knowingly and wilfully make any false, fictitious or fraudulent statements in respect of matters within the jurisdiction of any department or agency of the United States. This would apply to all filings and submissions to the SEC.

It should be noted that:

- This only applies to false statements, not statements which are accurate but are not complete in every material particular.
- It must be proved that the defendant knew that the information was false, rather than a lower standard (such as absence of positive belief in its truth) being sufficient to attract criminal liability.

- The offence does not apply in respect of filings with the NASD or the Exchanges or clearing houses.

### 2.2 *United Kingdom*

Under the Financial Services Act 1986, the position is similar to that in Hong Kong at present: the provision of false information to securities regulators is only a criminal offence in specific situations, being applications for registration and where information is provided in purported compliance with particular statutory requirements.

Similarly, under Clause 380 of the Financial Services and Markets Bill, it is an offence for a person, in purported compliance with any requirement imposed by or under the Bill, knowingly or recklessly to give the FSA information which is false or misleading in a material particular. It should be noted that:

- the offence only applies to information provided in purported compliance with a specific statutory requirement
- it must be proved that the information is false or misleading in a material particular, and it would not be sufficient to show that the information was not complete in every material particular
- the defendant must have acted knowingly or recklessly
- the offence only applies to information provided to the FSA, and not to the Exchanges or clearing houses.

### 2.3 *Australia*

Under Section 64 of the ASIC Act 1986 it is an offence:

- in purported compliance with the requirements made under [this Part of the Act]; or
- in the course of an examination by the ASIC

to give information, or make a statement, that is false or misleading in a material particular. There is a defence if the person giving the information or making the statement believed on reasonable grounds that it was true and not misleading.

Again, it should be noted that:

- the offence is only committed if the person makes false statements during an examination, or where there is a statutory requirement to provide the relevant information
- the information must be false or misleading, rather than merely being incomplete in some material particular
- the offence applies to information provided to the ASIC, not the Exchanges or clearing houses.

## 3 Problems with the proposed legislation

### 3.1 *Type of information - oral or written, information provided formally or informally*

As a preliminary matter, it is unhelpful that the Bill draws no distinction (save as to penalties) between the types of information at issue and the degree of formality involved in its provision: oral or written; formally or informally.

There are already a number of statutory provisions relating to the provision of information to the SFC that impose criminal liability on persons who provide false or misleading information to the SFC in certain defined contexts (for example in response to formal investigations or enquiries conducted by the SFC). In the circumstances covered by the various offences, the information is provided in a formal context and to comply with specific statutory requirements, where the importance of providing accurate information will be clear to the person providing that information.

The Bill would extend the scope of criminal liability very substantially, and in our view, far too widely. In doing so, it may jeopardise the frank relationship between regulators and market participants that we consider ought to be encouraged. Market participants may well decide not to engage in dialogue with the SFC or otherwise volunteer information to the regulators in order to reduce the likelihood of an inadvertent violation of this Bill. Further, market participants may decide to forego the convenience of just picking up the telephone to the regulators on the basis that conversations are, inevitably, more imprecise than correspondence. We are concerned that the existence of the proposed wide-ranging criminal sanctions may well discourage the free flow of information to the regulatory authorities.

The SFC may find its workload increased by the need to make formal requests for information under its statutory powers and may find it more difficult to obtain market information and education on market-related issues, prejudicing its effectiveness as a regulator.

We set out below a number of scenarios illustrating the potentially damaging impact of the proposed legislation.

***Scenario 1 -*** *We have recently noted a growing trend on the part of the SFC of requesting information from registered persons without first issuing a section 33 notice. We also note SFC Management Supervision and Internal Control Guidelines which require prompt notification of material non-compliance with regulatory requirements. It is implicit in each of these contexts that information is provided promptly and, most probably, before a full investigation of the facts can be conducted. Such an approach would be encouraged in the normal course as it can often result in further time and cost being saved in avoiding a misconceived inquiry or by facilitating the prompt resolution of a problem. Subsequently, however, such information might prove to have been inaccurate. We would anticipate an increased reluctance on the part of market participants to volunteer information in either of the above contexts if such apparent "good citizenship" might be rewarded by criminal sanctions.*

*We note that unlike, for example, section 33 of the Securities and Futures Commission Ordinance the Bill does not preserve the privilege against self-incrimination. We regard this privilege as a fundamental legal tenet in any common law jurisdiction and are of the view that it should be preserved in this context.*

### 3.2 *Information not "complete"*

An offence would be committed not just where the information provided is false or misleading, but also if it is incomplete in a material particular (or the person concerned does not believe it to be complete in every material particular). As a matter of common law, information may be misleading as a consequence of an omission from that information. Any such information would be covered by the words "false or misleading" in any event. However, as the Bill is drafted, even if the information provided to the regulators is not false

or misleading, there would still be a risk of prosecution if the regulators could say that the information was not "complete".

***Scenario 2 -*** *It is inherent in the nature of non-statutory regulation (e.g. under the Stock Exchange's Listing Rules or Takeovers and Share Repurchase Codes), particularly in the context of takeovers, that information is frequently requested at very short notice. It is also the case that enquiries made by the regulatory authorities may not be particularly clear in their scope, and that providing responses may involve highly subjective exercises of judgment within a very short time frame. For example, the Stock Exchange may require listed companies to explain share price fluctuations. The company might be able to identify one or two reasons for the fluctuations but might suspect that other factors, that it has not had an opportunity to research, have also contributed to the variation. In such circumstances, the company would be reluctant to give an explanation that it believes to be correct and not misleading but suspects may be incomplete, in the face of possible criminal sanctions. However, we feel sure that, in the interests of obtaining some timely reassurance on behalf of the market, the Stock Exchange would rather receive a prompt but potentially incomplete answer rather than wait for the company to conduct an extensive investigation that might take days whilst the market continues to speculate.*

***Scenario 3 -*** *Information provided to regulators often takes the form of a summary of extensive and complex background circumstances, provided at short notice. A person should not be exposed to the risk of criminal liability because the regulators do not consider that summary to be sufficiently detailed.*

***Scenario 4 -*** *The process of producing an announcement or listing document with which the relevant regulators are happy is an iterative one. This process of submission and comment is most likely to produce results with which both market participants and regulators are happy. If the threat of criminal sanctions forces companies not to submit "draft" documentation until it is complete in every material respect, we suspect that such companies will be more reluctant to make changes in respect of the information provided as a consequence of the additional resources, time and capital that have been committed to produce such documentation. Is the submission of draft, incomplete documentation to be criminalised?*

### 3.3 *Absence of belief in truth, accuracy and completeness*

Under the Bill, an offence is committed if the person knows the information to be false, misleading or incomplete, or does not believe it to be true, accurate and complete in every material particular.

In most Hong Kong Ordinances where criminal liability is imposed on a person who provides false or misleading information to an authority, the usual test for liability is whether the person knowingly makes the false or misleading statement (or, in some cases, knowingly or recklessly). It is unusual to criminalise the making of a statement in the absence of positive belief in its truth, except in the very specific cases of perjury, false statements on oath or statements made in criminal proceedings (see Crimes Ordinance, Cap. 200). Even in these cases, an absence of belief that the statement was "complete" would not attract criminal liability. We do not consider that absence of belief should be used as a test for imposing criminal liability.

***Scenario 5 -*** *Often a person will provide information to the regulators where the truth, accuracy and completeness of that information is not within his personal knowledge, for example because that information has been produced by his colleagues or clients (e.g. a*

*dealing director signing financial returns in accordance with the Financial Resources Rules). A person would only have such a positive belief if the information concerned was wholly within his personal knowledge or he had taken positive steps to verify the accuracy of the information. This would impose an entirely unreasonable burden on anyone who was responsible for providing to a regulator information supplied by third parties, or relating to matters outside his immediate personal knowledge. Inevitably, the discharge of any such burden would result in spiralling costs and potentially damaging delays.*

**3.4** ***The offence may be committed by any person***

The proposed offence may be committed by any person, rather than specific categories of persons. Where false or misleading information is supplied to a regulatory authority, there may be considerable uncertainty as to whether an offence has been committed and, if so, by whom. We are concerned about the apparent potential for multiple liability.

***Scenario 6 -*** *If a lawyer or other professional adviser like a financial adviser writes to the SFC, and the letter includes information received from the client which turns out to be false and misleading, would the adviser and/or the client be regarded as having "provided information" to the SFC? Likewise if a director of a company provides information to the SFC, would the director and/or the company itself be considered to have committed the offence?*

**3.5** ***Relationship with existing offence - e.g. section 56A(4)***

The proposed section 56A(4) of the Securities and Futures Commission Ordinance (by way of example) provides that the proposed section 56(A) (again by way of example) does not apply if a statutory provision already exists imposing a requirement to provide information and creating criminal liability for the provision of false, misleading or incomplete information.

The current statutory provisions relating to the provision of information to regulatory bodies are not often consistent but they generally require that the person knowingly provides information which was false or misleading. They do not extend to incomplete information and do not require a person to have a positive belief that the information is true, accurate and complete before he provides such information to the regulator. There are significant differences between the wording and scope of the existing offences and the proposed new offence.

The Bill would therefore exacerbate the current situation, where there are various different thresholds for establishing criminal liability for the provision of false information. The existing provisions presumably already cover the information regarded as particularly important to the SFC, whereas the new "catchall" provisions cover information which does not currently attract criminal liability. Surprisingly, as the Bill is drafted, it would be easier to impose criminal sanctions under the new provisions, and the penalties imposed are higher for a breach of the new provisions. This is anomalous and unsatisfactory.

***Scenario 7 -*** *The proposed legislation might result in the increased "lawyerisation" of the financial markets. Given the severe nature of the sanctions for any infraction, market participants will require lawyers to assess whether an offence under the new legislation might be committed before the submission of any information to the regulators. Further, advice may be sought on whether, for example, section 56A applies as opposed to some other provision requiring the submission of information in any given context. Once again,*

*this will result in increased costs and delays and/or a reduction in the information volunteered to regulators.*

## 4 Proposals for redrafting the Bill

We consider that the provision of information, especially oral information, to regulatory authorities should only constitute a criminal offence in clearly defined circumstances. The existing law already imposes criminal sanctions in respect of oral information provided for the purpose of obtaining registration (Section 62 Securities Ordinance), and in respect of oral information provided to SFC investigators (Section 127 Securities Ordinance, Sections 29A and 33 SFC Ordinance). We see no justification for extending the law to criminalise oral information provided in other circumstances. As regards written information, if there are specific types of information which the SFC wishes to obtain, we strongly believe that the correct approach would be to create a new statutory obligation to provide that information, and to make non-compliance with that obligation (including knowing provision of false or misleading information) a criminal offence. The proposed approach of the Bill - to impose criminal sanctions for supplying false information without specifying the type or purpose of information against which the criminal penalty is directed, is draconian.

In summary, it would avoid many of the above concerns if the new offence were only to extend the existing law as follows:

- to further, specified circumstances where written information is provided, in a formal context, to the SFC (where it would be consistent with the existing provisions to impose a criminal sanction for deliberately providing false information). Examples might be: quarterly financial returns and other information required to be provided under the SFC Financial Resources Rules, and the provision of false information in an application to become a substantial shareholder of a registered person;
- where false information is deliberately provided to the exchanges and the clearing houses (but only when they are exercising regulatory powers), in the same circumstances in which the information would have involved an offence if the information had been provided to the SFC.

Extending the scope of the existing offences in this way would seem to give effect to the Government's proposals in the 30-point plan of September 1998, without extending the scope of criminal sanctions too far.

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