SUBMISSIONS BY THE SECURITIES LAW COMMITTEE OF THE LAW SOCIETY OF HONG KONG ON THE SECURITIES AND FUTURES LEGISLATION (PROVISION OF FALSE INFORMATION) BILL 2000

Executive Summary

Background to the Bill

The Government announced on 7 September 1998 its "Measures to Strengthen the Order and Transparency of the Securities and Futures Markets". The Measures included a proposal to criminalise false reporting to the SFC and the Exchanges. This was followed by a SFC Consultation Paper in February 1999 and, following on from this, the Bill was gazetted on 3 March 2000.

Overview of the Bill

In summary, the Bill would make it a criminal offence for a person to provide to the SFC, Hong Kong Exchanges and Clearing Limited, the Exchanges or their clearing houses any information that:

- he knows to be false, misleading or incomplete in a material particular; or
- he does not believe to be true, accurate and complete in every material particular.

If the information was provided in purported compliance with a legal requirement, the offence would be punishable with a fine of HK$1,000,000 and imprisonment for 2 years. If the information was provided in other circumstances, but was relevant to or was connected with the performance of the regulators' functions, the offence would be punishable with a fine of HK$500,000 and imprisonment for up to 6 months.

The Bill seeks to introduce provisions to the above effect in the Securities and Futures Commission Ordinance, Commodities Trading Ordinance, Stock Exchanges Unification Ordinance, Securities and Futures (Clearing Houses) Ordinance and Exchanges and Clearing Houses (Merger) Ordinance.

The Securities Law Committee's concerns

We recognise the importance of the regulatory authorities receiving accurate and timely information, to assist them in the performance of their functions. We also endorse the view that appropriate sanctions should be taken against anyone who deliberately misleads regulatory authorities in the exercise of their functions, and that this should apply to misleading HKEx, the Exchanges and the clearing houses, as well as the SFC. Nevertheless, we have a number of serious concerns on the scope of the proposed offence.

1 We do not believe that it is appropriate to extend the criminal law to the provision of information to regulators except in clearly specified circumstances. The Bill would create an all-encompassing offence which would extend to information provided orally and in an informal context.

2 As presently drafted, the Bill would also lead to potential criminal liabilities extending far wider than the situation of a person who deliberately provides false or misleading information to a regulator. The offence would apply not only to information which was false or misleading, but also where the information provided was not **complete** in every material

particular. This imposes an impracticably broad requirement, for the reasons discussed in the Appendix.

3 The offence would apply if the person **did not believe** the information to be true, accurate and complete in every material particular. Very often, a person will supply information to regulators which is not within his personal knowledge, but has been provided by someone else, where he has no reason to believe it is inaccurate. However, it is difficult to say that he positively believed it to be true, accurate and complete unless he takes steps to verify that information. Again, for the reasons mentioned in the Appendix, we do not believe that this is practical and unfairly exposes a person who deals with the regulators to the risk of criminal liability.

The combined effect of 1-3 above would, in our view, create an extremely unsatisfactory position. Persons in the financial services industry who communicate with the SFC, exchanges and clearing houses would be at risk of criminal liability for errors and oversights (whether their own or other peoples) in the course of their day to day activities.

We are concerned that the introduction of such a wide-ranging offence would, rather than assisting the regulators in the performance of their functions, instead be counter-productive and constrain open dialogue between the regulators and participants in the financial markets. The Bill is likely to make the financial markets industry very reluctant to co-operate with the regulators by providing information to the regulators on an informal basis. It will create great difficulties for financial intermediaries and lawyers who liaise with the regulators on behalf of their clients and potentially hinder the efficiency of Hong Kong as a centre for capital raising and corporate finance activity. It may well discourage people from accepting roles where they will be responsible for providing information to regulators.

We set out in the Appendix our comments as regards the drafting of the new offence. It is to be hoped that significant drafting changes will be made to the Bill before it is enacted.

Securities Law Committee
The Law Society of Hong Kong

15 March 2000

Appendix

Drafting Comments on the Securities and Futures Legislation (Provision of False Information) Bill 2000

1 Type of information - oral or written, information provided formally or informally

There are already a number of statutory provisions relating to the provision of information to the SFC, imposing 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 being 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 wide. Not only would it apply to all situations where information is provided pursuant to a statutory requirement, but also to information provided informally, as long as the information is connected with the performance of the regulator's functions, and the regulator relied on the information (or the defendant knew that the regulator might do so or was reckless as to whether the regulator would do so). This would apply to statements made in telephone calls and meetings, as well as to written communications with the regulators.

Market participants may well avoid giving voluntary information to the regulators in order not to attract potential criminal liabilities. We are concerned that the existence of such wide-ranging criminal sanctions may well discourage the free flow of information to the regulatory authorities.

An illustration of the practical concerns is the applicability of the proposal to the regulation of listed companies (in particular under the Stock Exchange's Listing Rules and under the Takeovers and Share Repurchase Codes). It is inherent in the nature of non-statutory regulation, 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 exercise of judgement in a very short period of time. An example is responses by a listed company to the Stock Exchange in response to price movement enquiries. With the benefit of hindsight, there is a risk that the regulators will say that the information given was inaccurate and/or incomplete in a material particular.

We consider that, if responses to enquiries of this nature are to involve potential criminal liability (as well as the existing risks under the Codes and the Listing Rules), the speed and flexibility of operation of the Codes and the Listing Rules may well be prejudiced. This could be addressed if the scope of the new offence is limited as proposed below.

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 general principle, information may be misleading because of something which has been omitted from that information and, if this is the case, this would fall within the scope of 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 the information was not “complete”. Information provided to regulators often takes the form of a summary of extensive and complex background circumstances, provided at short notice, and a person should not be exposed to the risk of criminal liability because the regulators do not consider that the summary was sufficiently detailed. This would inevitably raise the spectre of potentially arbitrary and inconsistent application of these provisions.

There are also situations, for example during an investigation by the SFC, that the regulatory authorities want the person concerned to provide them with information within extremely short deadlines. More generally, the SFC Management Supervision and Internal Control Guidelines require prompt notification of material non-compliance with regulatory requirements. However, if the information is provided before full investigation of the facts has been completed, there is a high risk that the disclosure may turn out to be “incomplete”. This would create a dilemma for regulated persons.

Furthermore, in the context of an inquiry by regulators, so long as a person responds truthfully to specific inquiries made by regulators, he should not run the risk of criminal liability for not volunteering additional information that might tend to incriminate him.

3 Absence of belief in truth, accuracy and completeness

Under the Bill, the 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.

This is very troubling, because very 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. If the legislation was drafted so that it was an offence to provide information which the person **believed to be inaccurate**, the person who provided information in good faith from a reliable source would not be guilty of the offence. However, having on reasonable grounds treated information as correct is **not** the same as having a positive belief that it is true, accurate and complete. 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.

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 not common to criminalise a person who makes 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.

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. For example, if a lawyer writes to the SFC, and the lawyer's letter includes information received from the lawyer's client, which turns out to be false and misleading, would the lawyer 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? We are concerned about the potential for multiple liability.

5 Relationship with existing offence - section 56A(4)

Section 56A(4) provides that this new section 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 in purported compliance with that requirement.

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, that 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.

6 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 wants 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, appears to be too much of a sledgehammer approach.

In summary, it would avoid many of the 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, 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, without extending the scope of criminal sanctions too far.

Securities Law Committee

The Law Society of Hong Kong

15 March 2000