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

1 Introduction

This is the second paper submitted on behalf of a group of financial institutions (the "Group") which has concerns about the scope of the Securities and Futures Legislation (Provision of False Information) Bill 2000 (the "Bill").

The Group was grateful for the opportunity to meet with FSB and SFC to discuss its concerns and also for the opportunity to make submissions "in person" to the Bills Committee at its meeting on 25 May 2000.

The Group has now received a copy of a submission from FSB/SFC. Unfortunately, this submission was not received by Linklaters until Saturday, 27 May 2000 and, consequently, was not reviewed by the Group until yesterday morning. This second paper is not intended as a comprehensive response to the SFC/FSB submission. There was little time to produce such a paper. Rather, this paper is intended to highlight the residual "headline" concerns of the Group.

2 Stated objective of Bill

Both in their meeting with the Group and in session with the Bills Committee last Thursday, SFC/FSB said that the principle underlying the proposed legislation was that "people should not lie to the regulators". The Group is in absolute agreement with this principle. The Group's concerns stem from the fact that the Bill appears to go beyond its stated objective in a number of respects.

3 Comparison with other major international financial markets

3.1 Singapore

Whilst the financial markets in Singapore are not, currently, as important as those of Hong Kong, UK or US, it is Hong Kong's main regional competitor in respect of financial markets. Consequently, we consider Singapore a relevant comparative jurisdiction. We are advised by Singapore counsel that the position in Singapore is as follows:

- Under section 31 of the Securities Industry Act ("SIA"), Chapter 289 of Singapore, it is an offence, in connection with an application for a licence or renewal of a licence, to wilfully make a false or misleading statement or wilfully omit any matter or thing without which the application is misleading, in each case in a material respect (emphasis added).
- Under section 109 of the SIA, it is also an offence if a person with intent to deceive, makes or furnishes or knowingly and wilfully authorises or permits the making or furnishing of any false or misleading statement or report to MAS, a securities exchange or any officers thereof (emphasis added).

3.2 Table summarising international position

	HK(Bill)	US	UK	Aus	Sing.
knowingly	□	□	□	□	□[4]
recklessly (NB. proposed)	□	?[1]	□	□	
w/o + ve belief	□				
complete	□				
pursuant to statutory requirement	□	□	□	□	□
informal	□	□		□	□[4]
written	□	□	□	□	□
oral	□	□	□	?[2]	□
Exchs	□			?[3]	□

[1] the legislation stipulates that the offence is committed "knowingly and wilfully" and we do not agree that judicial interpretation has extended this so far as "recklessness" as this notion might be understood in Hong Kong (at least in the context of a criminal prosecution)

[2] not if information being submitted to ASIC

[3] not securities clearing houses

[4] but only if "with intent to deceive"

It remains our view that the Hong Kong legislation goes further than the equivalent legislation in US, UK and Singapore. SFC/FSB have suggested that the equivalent legislation in Australia goes further. However, as noted by SFC/FSB, only certain aspects of this legislation are broader, e.g. in some instances only documentary information is targeted. Why is it thought that the Hong Kong legislation needs to be the most draconian?

4 The "chilling" effect

The SFC/FSB paper states that the Australian legislation has not had the effect of "chilling" the relationship between market participants and regulators in Australia. It is difficult for us to comment on this assertion. However, as we have previously related, the view of the Group is that the current proposed legislation would have a negative effect on relations between regulators and market participants in Hong Kong.

SFC/FSB appear to be of the view that the Group's view is overstated on two grounds:

4.1 "There will be no harmful effect to communication with a regulator if persons are inhibited from knowingly or recklessly lying or telling half-truths. If anything, the integrity of communication will be improved (see paragraph 2.3)."

4.2 We understand that SFC/FSB have expressed some doubt as to whether true "informal" communication actually takes place between market participants and the regulators ["It is the experience of the SFC at least that many important communications, even if "informal" or voluntary are vetted by lawyers before being made or made with lawyers present" (see paragraph 23)].

We shall deal with these points in turn.

4.3 (see 4.1 above) If it is accepted that the free (and prompt) flow of information between regulators and market participants is something that should be encouraged, the obvious response here is to say that there will be a "harmful effect to communication" if market participants simply decide not to volunteer information to regulators in the light of possible criminal liability or do so less promptly (once it has been subjected to rigorous examination by Counsel (internal or external)). The clues as to why this might happen might be found in the SFC/FSB paper. As you are aware, in our previous paper, the Group posited various scenarios in which criminal liability might arise notwithstanding the apparent innocuousness of the given circumstances. In response SFC/FSB have provided the following insights as to how the new legislation might be deployed:

- **Scenario 2 -** "they most likely could not be held criminally liable"
- **Scenario 3 -** "criminal liability would most likely only arise if there were a material omission …"
- **Scenario 4 -** "most unlikely in these circumstances that a court would hold a person criminally liable"

One might note the difficulties that the draftsmen of the Bill have in stating definitively whether criminal liability would arise or not. These comments demonstrate that a finding of criminal liability (even in innocuous circumstances) would become dependent upon prosecutorial discretion, the vagaries of jury trial and/or the attitude adopted by the judge or magistrate. Financial institutions (particularly the legal and compliance functions) are not prepared to take the risk of incurring criminal liability (even if small). The SFC/FSB paper gives us little comfort in respect of the increased "lawyerisation" that we anticipated in our previous paper.

4.4 (see 4.2 above) At very short notice, the Group has generated the following list of examples of recent information requests from regulators/instances when information might be volunteered to the regulators:

- see Scenario 1 in our previous paper (NB. not addressed in SFC/FSB paper)
- recent requests for feedback on the impact of C5.4 in the Code of Conduct / Client Identity Rule Policy
- the annual questionnaire for fund managers
- liaison with SFC Investment Products Division (re. advertising materials, prospectuses etc.) - the majority of such discussions are conducted over the telephone.
- recent enquiry about Chinese Wall arrangements
- recent questionnaire from the SFC to brokers on the use of online facilities for trading purposes
- requests by the SFC for research reports

If responses to such requests might attract criminal liability, why would any financial institution wish to respond?

5 Miscellaneous points

5.1 We note that the paper is drafted in terms that suggest that certain drafting concessions have already been made (we also note that such concessions remain subject to approval): (i) the replacement of "complete" and "incomplete" with "false or misleading, including misleading by omission"; and (ii) the replacement of the notion of a lack of belief with "recklessness". The first amendment noted above is welcomed although we would question the need for the replacement phrase. It is accepted common law that something can be misleading by omission. The second amendment is an improvement but is by no means a solution to the problems identified by the Group and strays some way from the stated objective of eradicating lies to the regulators.

We note the explanation of recklessness in paragraph 40 of the SFC/FSB submission. We would welcome further details on to the source of this explanation. We had anticipated that "recklessness" would be interpreted as meaning the taking of an unjustifiable risk, or acting with careless disregard. What this would mean in context is difficult to ascertain. Would a financial adviser or lawyer or accountant be taking an unjustifiable risk in simply passing on information received directly from a client without first reading it? Context is, of course, everything but one might at least anticipate an increased reluctance to play the role of intermediary if merely acting as a conduit might attract criminal liability.

The Group has expressed concern that such drafting is motivated by problems encountered by the regulators when seeking information from Hong Kong companies. The effect of the legislation (in apparently targeting the provider (but see below) rather than generator of information) is to cast the intermediary as "policeman" by ensuring that the intermediary has a personal interest in the accuracy of any disclosure. This is a role that the Group or any adviser is unwilling to accept.

5.2 (see para. 40 of SFC/FSB paper) - It appears that SFC/FSB intend that the proposed legislation should impose criminal liability not only on the direct provider of information but also on persons who provide information "indirectly". If this is indeed what the legislature intended then the drafting should make this fact clear (see US, Australia, Singapore). The Group believes that the proposed legislation would benefit from greater precision in terms of identifying the persons who might be culpable.

6 Conclusion

As this paper and our previous paper have indicated, the Group has some serious reservations about the Bill as currently drafted. The amendments recognised but not yet implemented by SFC/FSB are a step in the right direction but do not go far enough. The Group is concerned, however, at the pace with which this legislation is being pushed through. Many elements of the Bill merit further debate and yet the Group notes that tomorrow's meeting is the last scheduled meeting of the Bills Committee. The Group strongly believes that further consultation is necessary.

As noted previously, this paper has been produced at speed. The Group has not had an opportunity to discuss further drafting “solutions”. Further consultation would afford time and scope for such solutions to be explored.

30 May 2000