

1. The Financial Services and the Treasury Bureau (FSTB) publishes this paper to consult the public on proposed legislative amendments to the Securities and Futures Ordinance (SFO). The proposed legislative amendments seek to give statutory backing to major listing requirements as recommended in the Consultation Conclusions on Proposals to Enhance the Regulation of Listing published by the FSTB in March 2004.
2. Details of the proposed amendments to the SFO are at **Appendix A**.
3. Respondents may submit their comments on or before **7 March 2005**, by any of the following methods -

By mail to: Financial Services and the Treasury Bureau
 (Attn. : Consultation Paper on Proposed Amendments to
 the SFO to Give Statutory Backing to Major Listing
 Requirements)
 18/F, Admiralty Centre Tower I,
 18 Harcourt Road,
 Admiralty,
 Hong Kong

By fax to: (852) 2861 1494

By email to: consult@fstb.gov.hk

4. Please note that the names of respondents and their comments may be posted on the website of the FSTB or referred to in other documents we publish. If you do not wish your name to be disclosed, please state so when making your submission.

CONTENTS

	<i>Page</i>
EXECUTIVE SUMMARY	1
CHAPTER 1 – INTRODUCTION	4
CHAPTER 2 – PROPOSED LEGISLATIVE AMENDMENTS	5
NEED FOR STATUTORY BACKING	5
PROPOSED LEGISLATIVE AMENDMENTS.....	6
PRIMARY TARGETS	13
Securities Issuers.....	14
Directors and Officers.....	15
SFC’S INVESTIGATIVE POWERS.....	15
SETTLEMENTS WITH PERSONS PROPOSED TO BE DISCIPLINED BY THE SFC.....	16
OVERALL LEGISLATIVE FRAMEWORK.....	16
CHAPTER 3 – FINING REGIME AND CHECKS AND BALANCES ON THE SFC	18
CIVIL FINES.....	18
Previous Legal Advice	18

Latest Legal Advice	19
Fining Guidelines.....	21
OVERALL SANCTIONING REGIME.....	21
CONCURRENT CIVIL REGIMES.....	24
TWO-TIERED SANCTIONING REGIME FOR THE MMT	26
FINING POWER.....	27
LEVEL OF FINES	28
Civil Fines Imposed by the SFC.....	28
Civil Fines Imposed by the MMT	29
Criminal Fines.....	29
Overall Fining Regime.....	30
CHECKS AND BALANCES ON THE SFC.....	30
CHAPTER 4 – SUMMARY OF ISSUES FOR CONSULTATION	33
APPENDICES	
Appendix A – Proposed Amendment to the Securities and Futures Ordinance (Proposals to Give Major Listing Requirements Statutory Backing)	A1
Appendix B – Checks and Balances on the Exercise of the Securities and Futures Commission’s Powers	A14

EXECUTIVE SUMMARY

1. The Administration conducted a public consultation on proposals to Enhance the Regulation of Listing in October 2003. A majority of the submissions agreed to promote compliance/enhance market quality by including major listing requirements in the statute, i.e. introducing statutory listing requirements.
2. Building on public support for introducing statutory listing requirements, we have proposed certain amendments to the SFO which aim to –
 - provide that the Securities and Futures Commission (SFC) may make rules to prescribe listing requirements and ongoing obligations of listed corporations under s.36 of the SFO;
 - extend the market misconduct regime in Parts XIII and XIV of the SFO to cover breaches of the statutory listing rules made by the SFC;
 - 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 civil fines¹, on the primary targets, i.e. issuers, directors and officers, for breaches of the statutory listing rules made by the SFC; and
 - empower the 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 rules made by the SFC under the amended Part IX of the SFO.
3. We would like to invite public views on the proposals which are reflected in the proposed amendments to the SFO prepared by the Administration at **Appendix A**.

¹ Officers will not be subject to civil fines to be imposed by the SFC or the MMT due to human rights concern. See paragraph 3.7 of this consultation paper for details.

4. As undertaken in the Consultation Conclusions on Proposals to Enhance the Regulation of Listing published in March 2004, we have explored whether the MMT could be empowered to impose financial penalties, as a new type of sanction, on well-defined groups of persons/entities for breaching certain statutory listing rules made by the SFC. Our findings indicate that –
 - both the MMT and the SFC may be empowered to impose civil fines on issuers and directors for breaches of statutory listing rules for regulatory purposes; and
 - the maximum level of civil fines that may be imposed by the MMT should be higher than that may be imposed by the SFC.
5. Under our proposal, the maximum level of civil fines that may be imposed by the MMT and the SFC on issuers and directors are HK\$8 million and HK\$5 million respectively. We would like to invite public comments on whether the proposed level of fines is sufficient to achieve the regulatory, as opposed to punitive, purposes of the fines.
6. Empowering both the SFC and the MMT to impose civil fines on issuers and directors would result in the following features in respect of the sanctioning regime to deal with breaches of statutory listing rules, namely –
 - Concurrent civil regimes: While both the SFC and the MMT may impose civil sanctions including civil fines on issuers and directors, the SFC's disciplinary regime would give the regulator an effective and flexible tool to deal with breaches in a timely manner. More severe breaches can be referred to the Department of Justice who will decide whether to bring criminal prosecution under Part XIV of the SFO, or to advise the Financial Secretary to institute the MMT proceedings. There is a provision preventing double jeopardy under the concurrent civil regimes, i.e. a person who has been disciplined by the SFC could not be subject to the MMT proceedings. But we also note that there may be questions about the necessity of empowering both the SFC and the MMT to impose the same types of civil sanctions on the primary targets, albeit of differing severity.

- Two-tiered sanctioning regime for the MMT: The proposed civil sanctions, civil fines on issuers and directors in particular, will empower the MMT to impose sanctions that are only restricted to specified groups of persons (i.e. issuers and directors) who have breached the statutory listing rules. These sanctions would not be applicable to other persons involved in the breach, or persons (including issuers and directors) who have committed other types of market misconduct such as insider dealing and market manipulation. Therefore, different groups of people committing different kinds of market misconduct would be treated differently under the same MMT regime.
7. In view of the concerns about concurrent civil regimes and the two-tiered sanctioning regime for the MMT, we would like to invite public views on whether the proposal for introducing civil sanctions, civil fines in particular, on the primary targets for breaches of the statutory listing rules should be pursued. Should the public support the proposal for introducing civil fines, we would like to invite public views on whether the SFC and the MMT should be empowered to impose civil fines concurrently (i.e. adopting the concurrent fining regimes), or whether the fining power should be confined to the MMT only.
 8. We would also like to seek public comments on whether additional checks and balances on the SFC, which may include the establishment of a committee to deal with the SFC's regulatory decisions relating to listing, are necessary.
 9. We shall consider the public comments carefully before we finalise our legislative proposals. We aim to introduce an amendment bill into the Legislative Council within the 2004/05 legislative year to amend the SFO.

CHAPTER 1 INTRODUCTION

- 1.1 As highlighted by the Financial Secretary in his Budget Speech in 2004, the Government has completed the consultation on enhancing the regulation of listing, and that there was general support for giving statutory backing to major requirements for listing. The relevant legislative amendments were expected to be introduced in early 2005.
- 1.2 This consultation paper takes forward the recommendation to give statutory backing to major listing requirements. The proposed legislative amendments set out at **Appendix A** are largely based on the recommendations outlined in the Consultation Conclusions on Proposals to Enhance the Regulation of Listing (Consultation Conclusions) published in March 2004². In the course of translating the recommendation into the form of proposed legislative provisions, we have identified a few specific issues which have not been discussed in detail in the broad framework laid down in the Consultation Conclusions. These issues will be discussed in Chapter III of this consultation paper.

² The full text of the Consultation Conclusions is available at the website of the Financial Services and the Treasury Bureau: <http://www.fstb.gov.hk/fsb>

CHAPTER 2 PROPOSED LEGISLATIVE AMENDMENTS

- 2.1 The securities and futures industry is one of the four pillars of our economy. Our policy objective is to maintain and enhance our competitiveness as a leading international financial centre and the premier capital formation centre for China. The Government attaches great importance to the listing functions to provide the important gatekeeping and ongoing supervisory services for the equity market, with a view to preserving and improving market quality.
- 2.2 In the light of the Report of the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure released in March 2003³ and public comments thereon, we have identified a number of issues that were critical for the better regulation of listing, and published in October 2003 the consultation paper on Proposals to Enhance the Regulation of Listing⁴. The submissions received during the consultation indicated an overwhelming support for introducing improvements, and a majority of the submissions agreed to promote compliance and enhance market quality by introducing statutory listing requirements.

NEED FOR STATUTORY BACKING

- 2.3 The lack of regulatory teeth in the Listing Rules administered by the Stock Exchange of Hong Kong Limited (SEHK) has been an issue of concern to the market as well as the general public. The dual filing system⁵ has rendered false or misleading disclosure by listing applicants in listing documents, or by listed issuers in complying with ongoing disclosure requirements, made knowingly or recklessly, an offence under the Securities and Futures Ordinances (SFO). It however does not

³ The full text of the Report is available at the Government's website: <http://www.info.gov.hk/info/expert/expertreport-e.htm>

⁴ The full text of the Consultation Paper is available at the website of the Financial Services and the Treasury Bureau: <http://www.fstb.gov.hk/fsb>

⁵ The dual filing system was introduced on 1 April 2003 under the Securities and Futures (Stock Market Listing) Rules made by the SFC under s.36 of the SFO. Copies of listing applications and public disclosure materials by listed companies are required to be filed with the SFC, in addition to the SEHK. The SFC has the powers to make comments and to object to a listing application. It can also exercise its statutory powers under s.384 of the SFO to take action against knowingly or recklessly false or misleading disclosure.

create any statutory liabilities for listing applicants or listed companies which breach other important listing requirements. With strong public support⁶, we recommend giving major listing requirements statutory backing by codifying these requirements in the statute in order to strengthen the enforcement regime and promote compliance.

2.4 The advantages of giving statutory backing to the more important listing requirements are as follows –

- to create a positive statutory obligation for compliance with these requirements;
- to allow more effective investigation of a suspected breach of these statutory requirements;
- to enable the imposition of a wide range of statutory sanctions in respect of any proven breach of these statutory requirements, sanctions which would be commensurate with the seriousness of the breach and therefore more effective; and
- to bring our regulatory regime into line with international standards and practices.

Details of our recommendations can be found in the Consultation Conclusions published in March 2004.

PROPOSED LEGISLATIVE AMENDMENTS

2.5 The main purposes of the proposal as reflected in the proposed legislative amendments at **Appendix A** of this paper are as follows -

(A) To provide that the SFC may make rules to prescribe listing requirements and ongoing obligations of listed corporations under s.36 of the SFO

2.6 S.36 of the current SFO already empowers the SFC to make statutory rules to govern listing after consultation with the SEHK and the Financial Secretary. Before making these rules, the SFC is also required to

⁶ See paragraph 5 of the Executive Summary of the Consultation Conclusions.

consult the public by virtue of s.398 of the SFO. The statutory rules made by the SFC may prescribe the requirements to be met before securities may be listed, and the procedures for dealing with applications for the listing of securities. The rules may also provide for cancellation of the listing of any specified securities. The rules made by the SFC are subsidiary legislation subject to negative vetting by the Legislative Council.

- 2.7 However, s.36 of the SFO does not specifically provide for power for the SFC to make rules on the requirements to be met by listed companies following the listing of their securities. Instead, s.36(1)(h) empowers the SFC to make rules regarding matters which may be prescribed by rules made by SEHK under s.23. In order to remove any possible doubt and to make the SFC's rule-making power more explicit, we propose to amend s.36 to provide legal certainty for the SFC's power to make rules to prescribe the statutory ongoing obligations for listed companies. The proposed amendments to s.36 of the SFO set out in paragraph A.1 at **Appendix A** aim to reflect the above proposal.
- 2.8 Under the current s.36 of the SFO, SFC may make rules to prescribe statutory listing requirements after consulting SEHK and the Financial Secretary. Before making such rules, SFC has the statutory duty under s.398 of the SFO to publish draft rules for public consultation. Under our proposal, these requirements concerning prior consultation would continue to apply to the rules made by the SFC under the amended s.36 of the SFO.
- 2.9 Apart from giving legal certainty to the SFC's power to make rules on the requirements for listed companies, the proposed amendments to s.36 of the SFO also seek to clarify the obligations of listed companies incorporated outside Hong Kong to comply with the statutory listing rules. The term "companies" is currently used in s.36(1)(e). According to Schedule 1 to the SFO, a "company" means a company as defined under the Companies Ordinance (Cap. 32) which means a company formed and registered under the Companies Ordinance, which in turn refers to a company incorporated in Hong Kong. The coverage of the term "company" is inadequate as far as the regulation of listing is concerned as some 80% of the issuers listed on the SEHK are incorporated overseas. In this context, the term "corporation" which is defined in Schedule 1 to the SFO as a company or other body corporate incorporated either in Hong Kong or elsewhere would be more appropriate. To ensure that the

statutory listing requirements laid down in the rules made by the SFC under s.36 of the SFO would be applicable to all companies listed on the SEHK regardless of the place of incorporation, we propose to adopt the term “corporation” instead of “company” in the new s.36 of the SFO.

2.10 As we can see from the current Securities and Futures (Stock Market Listing) Rules (SFSMLR) made under s.36 of the SFO, there are rules of a more procedural nature (such as those relating to the filing of documents), and a breach of which should not attract civil or criminal sanctions. In such cases, the SFC should specify in the rules that breaches of certain rules would not attract any sanctions.

(B) To extend the market misconduct regime in Parts XIII and XIV of the SFO to cover breaches of the statutory listing rules made by the SFC as mentioned in (A) above

2.11 The SFSMLR made under the SFO and came into effect on 1 April 2003 provide for the dual filing system. This dual filing system relies on criminal sanctions available under s.384 of the SFO for intentional or reckless provision of false or misleading information to the SFC or the Hong Kong Exchanges and Clearing Limited (HKEx). But the SFO does not provide for any statutory sanctions for breaches of rules made under s.36, nor does it empower the SFC to impose sanctions for breaches of these rules, including the SFSMLR.

2.12 We recognise that any breach of the important listing requirements would not only result in harm to shareholders and potential investors, but also tarnish the reputation of our equity market as a whole. Hence, we propose extending the market misconduct regime to cover breaches of statutory listing rules so that these breaches would also attract civil sanctions that may be imposed by the Market Misconduct Tribunal (MMT) under Part XIII of the SFO or criminal sanctions under Part XIV of the SFO. The proposed amendments to the SFO to reflect this proposal can be found in paragraphs A.13 and A.16 at **Appendix A**.

2.13 The MMT may impose a range of civil sanctions under Part XIII (s. 257) of the SFO, including –

- disgorgement of profits made or loss avoided, subject to compound interest thereon;

- disqualification of a person from being a director or otherwise involved in the management of a listed corporation for up to five years;
- a “cold shoulder” order on a person (i.e. the person is deprived of access to market facilities) for up to five years;
- a “cease and desist” order (i.e. an order not to breach any of the market misconduct provisions in Part XIII of the SFO again);
- a recommendation order that the person be disciplined by any body of which that person is a member; and
- payment of costs of the MMT inquiry and/or the SFC investigation.

Under our proposal, these civil sanctions will also be applicable to **any person** who has breached the statutory listing requirements.

2.14 Part XIV of the SFO provides for a range of sanctions that may be imposed under the criminal regime. These criminal sanctions include –

- on conviction on indictment to a fine of \$10 million and to imprisonment for 10 years; or
on summary conviction to a fine of \$1 million and to imprisonment for 3 years;
- disqualification of a person from being a director or otherwise involved in the management of a listed corporation for up to five years;
- a “cold shoulder” order on a person (i.e. the person is deprived of access to market facilities) for up to five years;
- a recommendation order that the person be disciplined by any body of which that person is a member; and
- payment of costs to the prosecutor under the Costs in Criminal Cases Ordinance (Cap. 492).

2.15 The current market misconduct regime as set out in Parts XIII and XIV of the SFO provides for a dual regime, i.e. parallel civil and criminal regimes, to deter market misconduct. Our policy intent is not to subject any person to the MMT inquiry under Part XIII and criminal prosecution under Part XIV of the SFO for the same market misconduct committed by

him. Therefore, the existing s.283 and s.307 of the SFO would also apply to breaches of statutory listing rules. Like the existing arrangement under the market misconduct regime, a person who has been acquitted or convicted of a breach of a statutory listing rule under Part XIV of the SFO cannot be made the subject of an MMT hearing in respect of the same conduct. Similarly, someone who is the subject of an MMT order or who has been exonerated at the end of an MMT inquiry into a suspected breach of a statutory listing rule under Part XIII cannot be prosecuted under Part XIV of the SFO in respect of the same conduct.

- (C) *To empower the MMT to impose, in addition to existing sanctions such as disqualification orders and disgorgement orders, new civil sanctions, namely public reprimands and civil fines, on issuers, directors and officers as appropriate (i.e. primary targets) for breaches of the statutory listing rules made by the SFC*

2.16 As mentioned in paragraph 2.22 of the Consultation Conclusions, we are advised by the SFC and the HKEx that for the regulatory regime to be effective, proportionate sanctions should be imposed directly on the primary targets, i.e. issuers, directors and officers, against any breaches of the statutory listing requirements. Apart from issuers (i.e. the corporations themselves), directors and officers are company insiders with a sufficient degree of participation in corporate decision-making and can reasonably be held responsible for disclosure made by the company. We therefore propose to empower the MMT to impose the following civil sanctions on these “primary targets” for breaches of the statutory listing requirements, in addition to the civil sanctions provided for in the current Part XIII of the SFO, namely –

- (1) public reprimands on issuers, directors and officers; and
- (2) civil fines of up to HK\$8 million on issuers and directors.

It should be noted that the SFO has already empowered the MMT to impose, among others, disqualification orders and disgorgement orders on persons who have committed market misconduct.

Proposed amendments to reflect the above proposal can be found in paragraph A.14 at **Appendix A**.

2.17 According to Leading Counsel⁷'s advice, the maximum amount of civil fines the MMT (and the SFC) may impose has to be set at a level that is regulatory but not punitive so that the proposed regime will remain civil for human rights purposes. We propose that the maximum level should be set at HK\$8 million, which is lower than the maximum amount of fines that may be imposed by the court under Part XIV of the SFO (i.e. HK\$10 million), but higher than that may be imposed by the SFC under our proposal (i.e. HK\$5 million). Details about the justifications for the MMT to impose civil fines, and the considerations that have to be taken into account in determining the maximum level of civil fines that may be imposed by the MMT are set out in paragraphs 3.4 – 3.8 in this consultation paper.

(D) To empower the 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 rules made by the SFC under the amended Part IX of the SFO

2.18 In response to market calls for a wider range of regulatory tools which would enable the SFC to take swift actions against breaches of statutory listing rules, we propose the SFC to be empowered to impose direct civil sanctions against breaches of the statutory listing rules by the primary targets without having to go through civil hearings by an MMT under Part XIII of the SFO, or criminal prosecution instituted by the SFC under s.388 of the SFO or by the Department of Justice under Part XIV of the SFO.

2.19 We propose that the SFC be empowered to impose the following civil sanctions directly on the primary targets –

(1) Public reprimands

The SFC may be empowered to issue public reprimands to the primary targets i.e. issuers, directors and officers.

(2) Disqualification orders

The SFC may be empowered to impose disqualification orders on directors and officers for breaches of statutory listing requirements.

⁷ See paragraph 3.4 in this consultation paper for background.

A disqualification order would debar a person from being a director or manager of a listed corporation for a period not exceeding a specified number of years. The proposed maximum duration of a disqualification order to be imposed by the SFC is three years, which is shorter than that may be imposed by the MMT.

(3) Civil Fines

The SFC may be empowered to impose civil fines on issuers and directors.⁸ The maximum amount of fines is proposed to be \$5 million which is lower than that may be imposed by the MMT. This is based on the premise that under the concurrent civil regimes, the SFC would be responsible for dealing with less serious cases, while more serious ones would be subject to the MMT proceedings. Further discussion on this issue can be found in paragraphs 3.4 – 3.8 of this consultation paper.

(4) Disgorgement orders

The SFC may be empowered to require “primary targets” to repay the amount of profit gained or loss avoided as a result of a breach of the statutory listing requirements.

Proposed amendments to reflect the above proposal can be found in paragraphs A.4 and A.7 at **Appendix A**.

2.20 The recommendations set out in the Consultation Conclusions issued in March 2004 did not provide for a “no double jeopardy” provision. According to paragraph 3.33 of the Consultation Conclusions, the SFC might take disciplinary actions such as reprimand and disqualification orders, **in addition** to civil sanctions imposed by the MMT or criminal prosecution. However, with the introduction of the power for the SFC to impose civil fines, it would be necessary to include a “no double jeopardy” provision.

⁸ While we may empower the SFC and the MMT to impose civil sanctions such as reprimands, disqualification orders or disgorgement orders on officers, legal advice indicates that imposing financial penalty on those people is more likely than not to lead a court to say that the group is so wide that it is not a regulated class, and so the fine is criminal in nature. Therefore, civil fines on officers cannot be pursued due to human rights concern. A more detailed discussion of this issue can be found in paragraph 3.7 of this consultation paper.

- 2.21 Having advised that both the MMT and the SFC may impose civil fines on issuers and directors, Leading Counsel indicated that the provision of concurrent civil regimes (i.e. the SFC disciplinary regime and the MMT regime) in respect of breaches of the statutory listing requirements would not breach human rights principles only if –
- (1) there is a provision preventing “double jeopardy” (i.e. powers to impose civil sanctions should not be exercised simultaneously by the SFC and the MMT); and
 - (2) there are sanctions of differing severity in the two regimes.
- 2.22 In view of Leading Counsel’s advice, we have included in paragraph A.12 at **Appendix A** a no “double jeopardy” provision. A person who has been considered for the SFC’s sanctions will not be subject to the MMT proceedings under Part XIII for the same misconduct. Equally, a person who has been referred to the MMT shall not be subject to the SFC’s sanctions for the same misconduct. We also propose that fines and disqualification orders that may be imposed by the SFC should be less severe than those imposed by the MMT, as reflected in paragraphs A.7 and A.14 at **Appendix A**.
- 2.23 The SFC’s sanctioning power is not new. The existing Part IX of the SFO already provides for a framework for the SFC to impose disciplinary sanctions on its regulated persons. We propose that the SFC’s imposition of civil sanctions on primary targets could be built on the existing Part IX of the SFO which provides for the procedural safeguards for fair hearing in respect of the discipline of licensed intermediaries and those involved in their management by the SFC. Proposed amendments to reflect the above proposal can be found in paragraph A.8 at **Appendix A**. Disciplinary sanctions imposed by the SFC would be appealable to the Securities and Futures Appeals Tribunal (SFAT)⁹. Proposed amendments to reflect the above proposal can be found in paragraph A.18 at **Appendix A**. This could provide effective checks and balances to ensure proper use of powers by the SFC.

PRIMARY TARGETS

2.24 As set out in paragraphs 2.16 and 2.19 of this consultation paper,

⁹ SFAT is a statutory tribunal with a jurisdiction to review specified decisions as set out in Schedule 8 to the SFO.

“issuers”, “directors” and “officers” will be made the “primary targets”, which will be subject to direct civil sanctions by the SFC, or reprimands issued and civil fines imposed by the MMT for breaching the statutory listing rules. We will elaborate further in the paragraphs below the definition of these terms, and the legal liabilities of these specified groups of persons.

Securities Issuers

- 2.25 Under our proposal, the term “issuer” covers both listing applicants and listed corporations. See paragraph A.17 at **Appendix A**. In other words, apart from those corporations already listed on the SEHK, the statutory listing rules to be made by the SFC will be applicable to listing applicants whose applications have yet to be granted by the SEHK, as well as applicants whose applications fail to secure the SEHK’s approval or are objected by the SFC. Bringing listing applicants into the regulatory net is consistent with the current s.36 of the SFO which empowers the SFC to make statutory listing rules to prescribe the requirements to be met before securities may be listed. Under the SFSMLR made under s.36, together with s.384 of the SFO, listing applicants, regardless of whether their listing applications are approved or not, may be prosecuted if they knowingly or recklessly provide false or misleading information in a statutory filing with the SFC.
- 2.26 As for corporations that have already been listed, the proposed definition of “securities issuer”, together with the proposed amendments to s.36 of the SFO which aim to give legal certainty to the SFC’s powers to prescribe the statutory ongoing obligations for listed corporations, will ensure that these corporations would be subject to the statutory listing rules.
- 2.27 Under the present proposal, the imposition of civil sanctions on securities issuers would not require the establishment of a mental element. This is based on the premise that failure to comply with the statutory listing rules (such as timely disclosure of price sensitive information) is a misconduct that speaks for itself and should be strictly outlawed. Drawing from the regulatory experience of the SFC, it is sometimes appropriate to infer a wrongful intention from acts, when such intention is suggested by circumstances, i.e. where the facts speak for themselves. Given that the issuers which are listed on the SEHK are primarily responsible for complying with the statutory listing rules, we believe it would be

appropriate to introduce the concept of “strict liability” in considering civil sanctions on issuers for breaching the statutory listing rules in the civil regimes. It should be noted that under the current proposal, the concept of strict liability would not apply in the criminal regime. In other words, offences of the issuers in criminal proceedings under Part XIV of the SFO requires that a mental element be established.

Directors and Officers

2.28 The existing Schedule 1 to the SFO defines an “officer” (in relation to a corporation) as a director, manager, or secretary of, or any other person involved in the management of, the corporation. This essentially covers both directors and officers. In addition, Schedule 1 to the SFO provides that a “director” includes a shadow director and any person occupying the position of director by whatever name called. We believe that the terms “director” and “officer” in the existing SFO embrace the concept of “directors” and “corporate officers” described in the Consultation Conclusions. We therefore propose to adopt these definitions for the purpose of introducing sanctions by the SFC and the MMT on these two groups of persons under the civil regimes.

2.29 We recognise that in most cases, it would be difficult to conclude that all directors or officers are involved in the breach of the statutory listing rules committed by the issuers. It would be unfair if the law should indiscriminately hold all directors and officers of an issuer liable for the breach committed by that issuer. We therefore propose to introduce the mens rea test for directors and officers in the civil regimes in addition to the criminal regime. These two groups of persons would only be subject to the SFC or the MMT sanctions if they are knowingly, intentionally or negligently concerned in the breach. Proposed legislative amendments to reflect our proposal can be found in A.4 and A.13 at **Appendix A**.

SFC’S INVESTIGATIVE POWERS

2.30 The existing s.179 empowers the SFC to require production of records and documents concerning listed corporations in specified circumstances. These include the circumstance where it appears to the Commission that there are circumstances suggesting that persons concerned in the process by which the corporation became listed (including that for making the securities of the corporation available to the public in the course of such process) have engaged, in relation to such process, in defalcation, fraud,

misfeasance or other misconduct.

- 2.31 To ensure that the SFC would have sufficient investigative powers to start an inquiry under s.179 of the SFO when it appears to the Commission that there is a breach of the statutory listing rules, including requirements for listings and ongoing obligations of listed corporations, we propose expanding the remit of s.179 by including a suspected breach of a statutory listing rule as one of the conditions for starting an inquiry under that section. The proposed legislative amendments to reflect the proposal can be found in A.2 at **Appendix A**.

SETTLEMENTS WITH PERSONS PROPOSED TO BE DISCIPLINED BY THE SFC

- 2.32 S.201 of the SFO has already empowered the SFC to settle disciplinary actions (such as disciplinary actions in respect of licensed persons) by agreement where it is appropriate to do so in the interest of the investing public or in the public interest. Paragraph A.10 at **Appendix A** seeks to extend the present arrangement to disciplinary actions relating to breaches of statutory listing rules. Settlement might be useful in cases where resources are limited but demands on the SFC to take enforcement actions are great. Where appropriate, settlement allows the SFC and the persons proposed to be disciplined to arrive at a satisfactory outcome quickly.

OVERALL LEGISLATIVE FRAMEWORK

- 2.33 To sum up, we recommend giving statutory backing to major listing requirements through a mix of primary and subsidiary legislation, supplemented with codes and guidelines -

- (1) **Primary legislation:** the market misconduct regime in Parts XIII and XIV of the SFO will be extended to cover breaches of statutory listing rules to be made by the SFC under the amended s.36 of the SFO. To enhance the effectiveness of the MMT regime in deterring this new type of market misconduct, the MMT will be empowered, in addition to the civil sanctions provided for in the current Part XIII of the SFO, to impose civil sanctions, namely public reprimands and civil fines on the specified group of primary targets for breaches of statutory listing rules. In addition, to address calls for swift action, the SFC will be empowered to

impose a range of civil sanctions following disciplinary procedures, namely public reprimands, disqualification orders, disgorgement orders and civil fines on the specified groups of primary targets as appropriate.

- (2) **Subsidiary legislation:** The SFC will make statutory rules under the amended s.36 of the SFO to codify the major listing requirements in the statute.
- (3) **Non-statutory codes and guidelines:** The SFC will introduce codes and guidelines under s.399 of the SFO to provide guidance in relation to the operation of the statutory listing rules to assist compliance. They are not part of the legislation but could provide users with helpful guidance.

2.34 The draft legislative provisions at **Appendix A** represent Government's proposals on how the primary legislation may be amended to introduce sanctions for breaches of major listing requirements. As for subsidiary legislation, the SFC would separately consult the public on their proposals concerning the statutory listing rules to be made by the Commission. For non-statutory codes and guidelines, subject to the passage of the relevant legislative amendments to the SFO and the subsidiary legislation to be made by the SFC, the SFC will introduce the necessary codes and guidelines in consultation with the market.

CHAPTER 3 FINING REGIME AND CHECKS AND BALANCES ON THE SFC

3.1 As discussed in Chapter 1, while the proposed legislative amendments set out in this paper are largely based on the recommendations laid down in the Consultation Conclusions, there are other proposals which represent further elaboration of the sanctioning regime recommended in the Consultation Conclusions. These new proposals are mainly associated with –

- (1) the design of a regime for the imposition of civil fines on the issuers and directors for breaches of the statutory listing rules; and
- (2) checks and balances on the SFC’s powers to impose civil sanctions on the primary targets.

These issues will be discussed in this Chapter.

CIVIL FINES

Previous Legal Advice

3.2 As pointed out in paragraphs 3.36 and 3.37 of the Consultation Conclusions, some submissions suggest that the SFC should be empowered to impose financial penalties on any person who is found to have breached the statutory listing requirements. This would give the regulator an effective and flexible tool to deter breaches of the statutory listing requirements. However, previous legal advice indicated that substantial financial penalties that went beyond their compensatory function and appeared to be punitive in nature may in certain cases turn the regime into a criminal one for human rights purposes, and hence required the incorporation of all safeguards necessary for a fair hearing in a criminal regime.

3.3 As an alternative, we have explored the possibility of empowering the SFC to impose financial penalties on the specific, well-defined primary targets, i.e. issuers, directors and officers. Previous legal advice indicated that, in the absence of full disciplinary relationship between the SFC and the “primary targets” similar to one that existed between the SFC and the licensed brokers, under which the SFC might suspend or

revoke their licence, the imposition of financial penalties by the SFC on the primary targets was likely to change the proposed regulatory regime into a criminal one for human rights purposes, thus necessitating the presence of procedural safeguards for criminal proceedings and defeating the purpose of swift penalties imposed by the regulator. That being the case, we undertook in the Consultation Conclusions to explore whether the MMT could be empowered to impose financial penalties, as a new type of sanctions on well-defined groups of persons/entities for breaching the statutory listing rules made by the SFC.

Latest Legal Advice

3.4 Subsequent to the issue of the Consultation Conclusions, we studied in detail the legal issues involving the proposal for empowering the MMT or the SFC to impose civil fines on the primary targets, and its intricate relationship with human rights concern. To keep ourselves abreast of developments in the jurisprudence elsewhere, we have sought advice from Leading Counsel in the United Kingdom before we prepare the proposed legislative amendments concerning the fining regime. In gist, advice from Leading Counsel indicates that the fines to be imposed by the SFC for breaches of the statutory listing rules would be civil in nature, if the following three safeguards are to be adopted –

- (1) Those subject to such sanctions are restricted to issuers and directors, and the sanctions are not to be imposed on other corporate officers.
- (2) The fines are only imposed for a regulatory purpose. The level of fines should be set proportionately to the breach, and to the gain made or loss avoided where this is identifiable; the purpose should be stated to be protective rather than penal. Guidelines should impose these principles.
- (3) There is a full right of appeal to a judicial body (i.e. SFAT) on the merits.

The above advice is also applicable to the MMT's powers to impose civil fines, except point (3) above as the MMT itself is a judicial body.

3.5 The above advice has been made having regard to jurisprudence of the European Court of Human Rights (ECtHR) and of the courts of the

United Kingdom. There were cases which suggest the following principle: Where the proceedings are regulatory, preventive or compensatory, the proceedings are unlikely to be “criminal”, even though a substantial fine is imposed. Specifically, the ECtHR has found that the imposition of a financial penalty did not involve a “criminal charge” where the proceedings were of a regulatory or disciplinary nature involving rules applicable to a limited class.

- 3.6 On the notion that in the absence of a full disciplinary relationship between the SFC and the primary targets, the imposition of financial penalties by the SFC on the “primary targets” may run the risk of changing the proposed regulatory regime into a criminal one for human rights purposes, the advice stated that some of the cases where the ECtHR and the English courts have held financial sanctions to be civil, rather than criminal, lacked any such relationship.
- 3.7 As for the proposal for empowering the SFC or the MMT to impose fines on officers, the same piece of advice pointed out that this may turn the regime into a criminal one because of the width of the term “officers” and the risk that it may be said that the power is therefore one which applies to people generally rather than being a specific measure for regulating those who operate in the market. According to the advice, the inclusion of all persons involved with management is to run a very substantial risk since it broadens very substantially the class of those affected.
- 3.8 In conclusion, fines to be imposed by the **SFC** and the **MMT** on **issuers** and **directors** (but not officers) for breach of the statutory listing rules would be regarded as civil rather than criminal for human rights purposes based on the following principles –
 - (1) The proceedings will only apply to a limited class of persons and not to the population as a whole. Although issuers and directors are not members of a distinct profession, they are nevertheless clearly distinguishable from the general public in that they are subject to regulation because of the position they hold in the market and the need to regulate their conduct to protect consumers and to protect the reputation of the market.
 - (2) The purpose of the proceedings is regulatory – that is to maintain high standards in the market so as to protect consumers, and promote the reputation of the Hong Kong financial market – and

not to punish.

- (3) There is no power to imprison (other than if the subject ignores a fine which is made enforceable by a court order) and an adverse decision is not placed on the individual's criminal record.

3.9 In the light of the latest legal advice, we have incorporated the powers for the SFC and the MMT to impose civil fines on issuers and directors for breaches of the statutory listing rules in the proposed legislative amendments at **Appendix A**.

Fining Guidelines

- 3.10 According to the advice, the level of the fine must be set proportionately to the breach, and to the gain made or the loss avoided where this is identifiable. There may legitimately be an element of deterrence, so as to protect consumers and the market by preventing wrongdoing, so long as any deterrent element of the fines is kept at a moderate level. There should be guidelines setting out the preventive and regulatory purpose of punishment, recognising proportionality to gains made and losses avoided, recognising an element of deterrence, but prohibiting pure punishment.
- 3.11 In the light of the legal advice concerning the making of fining guidelines, we have proposed in paragraphs A.9 and A.14 at **Appendix A** the factors that need to be considered before the SFC and the MMT may impose civil fines on issuers and directors. The purpose of these provisions is to ensure regulatory (as opposed to punitive) and hence civil nature of the fines to be imposed by the SFC and the MMT.

OVERALL SANCTIONING REGIME

3.12 The sanctions, together with the appeal mechanisms, embodied in the draft legislative provisions at **Appendix A** are summarised below –

	Civil Regime		Criminal Regime
	SFC	MMT	
Sanctions	<u>Issuers</u> <ul style="list-style-type: none">• reprimand• civil fine up to \$5 million• disgorgement	<u>Any person found to have breached or assisted in breaching the</u>	<u>Any person found to have breached the statutory listing rules or aided/abetted in the breach</u>

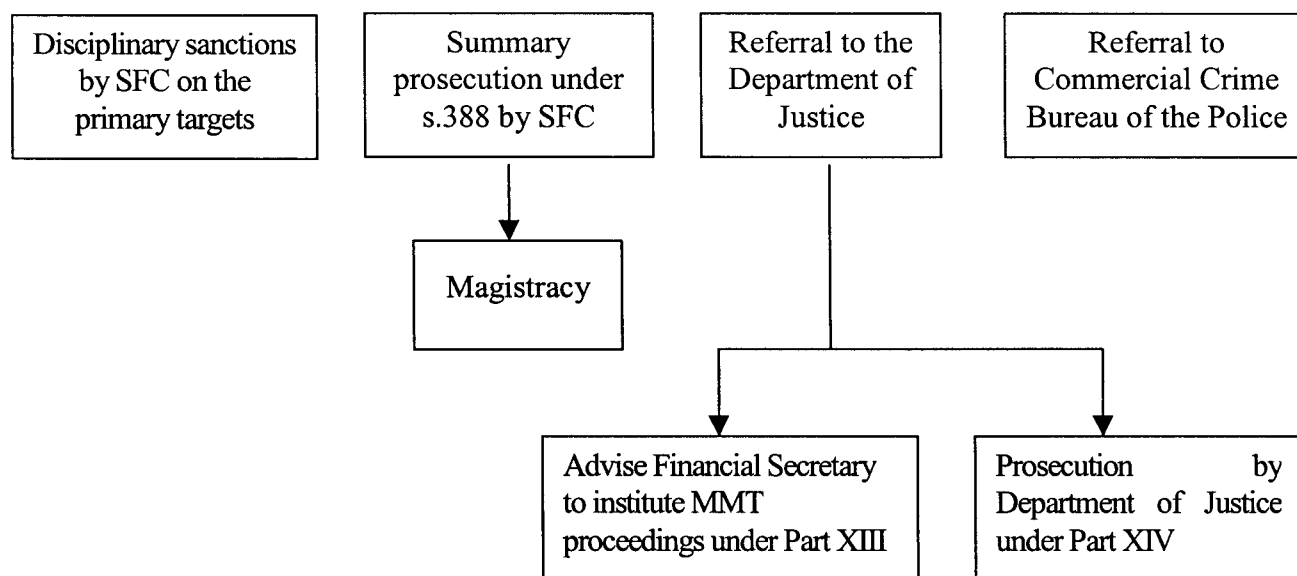
	<p>of profit or loss avoided</p> <p><u>Directors</u></p> <ul style="list-style-type: none"> • reprimand • disqualification orders • civil fine up to \$5 million • disgorgement of profit or loss avoided <p><u>Officers</u></p> <ul style="list-style-type: none"> • reprimand • disqualification orders • disgorgement of profit or loss avoided 	<p><u>statutory listing rules</u></p> <ul style="list-style-type: none"> • disgorgement of profit or loss avoided • disqualification order • “cold shoulder” order • “cease and desist” order • recommendation order for discipline by professional bodies • payment for the MMT’s enquiry costs and/or the SFC’s investigation costs <p>In addition to the above:</p> <p><u>Issuers</u></p> <ul style="list-style-type: none"> • reprimand • civil fine up to \$8 million <p><u>Directors</u></p> <ul style="list-style-type: none"> • reprimand • civil fine up to \$8 million <p><u>Officers</u></p> <ul style="list-style-type: none"> • reprimand 	<ul style="list-style-type: none"> • disqualification order • “cold shoulder” order • recommendations order for discipline by professional bodies • payment of costs to the prosecutor under the Costs in Criminal Cases Ordinance (Cap.492) • fine up to \$10 million • imprisonment up to 10 years
Appeals to	SFAT	Court of Appeal	Court of Appeal

3.13 The proposed sanctions and appeal mechanism set out in the table above follows the three-pronged approach as recommended in the Consultation Conclusions issued in March 2004, and incorporates the following new features –

- (a) powers for the SFC to impose civil fines on issuers and directors;
- (b) powers for the MMT to issue reprimands to issuers, directors and officers and to impose civil fines on issuers and directors; and
- (c) quantum of sanctions¹⁰ – while both the SFC and the MMT may impose disqualification orders and/or civil fines, the maximum level of fines that may be imposed by the MMT is higher than that by the SFC. By the same token, the maximum duration of a disqualification order that may be imposed by the MMT is longer than that may be imposed by the SFC.

These new features would give rise to issues concerning concurrent civil regimes and two-tier sanctioning regime for the MMT. These issues will be discussed in paragraphs 3.15-3.21 in this consultation paper.

3.14 Under the proposal, possible enforcement actions that may be taken by the SFC following its investigation into suspected breach of the statutory listing rules are summarised below –



¹⁰ The justifications for providing quantum of sanctions can be found in paragraph 3.15(2) of this consultation paper.

CONCURRENT CIVIL REGIMES

- 3.15 The three-pronged approach set out in the table on pages 21 and 22 embodies concurrent civil regimes (i.e. the SFC disciplinary regime and the MMT proceedings) to deal with breaches of the statutory listing rules. According to legal advice, maintaining the two civil regimes, including the powers for the SFC and the MMT to impose civil fines, to apply concurrently to breaches of the statutory listing rules would not breach human rights principles if -
- (1) there is a provision preventing double jeopardy, i.e. a person who has been disciplined by the SFC could not be subject to the MMT proceedings; and
 - (2) there is a justification for distinguishing between the cases which are dealt with by the SFC and the cases which are heard by the MMT so that a person cannot complain that his case has been arbitrarily assigned to one or the other. On the basis that the perceived gravity of the alleged breaches could be the justification for the distinction, sanctions of differing severity in the two regimes should be provided for.
- 3.16 The concurrent civil regimes provide an appropriate range of sanctions to deal with breaches. The SFC's disciplinary regime gives the regulator an effective and flexible tool to deal with breaches of statutory listing rules in a timely manner. It allows the SFC to impose direct civil sanctions swiftly on the specific targets who can reasonably be held responsible for disclosure made by the company without having to go through civil hearing by an MMT under Part XIII of the SFO, or criminal prosecution under Part XIV of the SFO. For breaches of more severe nature and/or involving other relevant parties such as substantial shareholders and professional advisers, the SFC may refer such cases to the Department of Justice who will decide whether to bring criminal prosecution under Part XIV of the SFO. If the Department of Justice takes the view that prosecution is not justified, he/she may advise the Financial Secretary to consider a third option, i.e. instituting civil proceedings before the MMT under Part XIII of the SFO.
- 3.17 Given that breaches of statutory listing rules may range from relatively minor technical breaches to more severe market misconduct that seriously undermine investor interest and the reputation of the market, the

flexibility provided by the concurrent civil regimes (i.e. the SFC regime or the MMT regime) and the criminal route under Part XIV of the SFO would be particularly important. This proposed three-pronged approach which embraces concurrent civil regimes provides a swift and direct avenue available in the SFC's disciplinary regime to deal with relatively minor breaches, without losing the more effective enforcement teeth against breaches of more serious nature provided by the MMT proceedings and the criminal route.

- 3.18 However, there may be questions about the necessity of empowering both the SFC and the MMT to impose the same types of civil sanctions (i.e. reprimands, disqualification orders, disgorgement orders and civil fines) on the primary targets, albeit of differing severity. Under our proposal, the SFC's decisions to impose these civil sanctions on the primary targets may be challenged before the SFAT which has the power to review the merits of any case before it. The composition of the SFAT is on par with that of the MMT – both tribunals are chaired by a judge at the Court of First Instance level. In this context, there may not be a strong justification for introducing concurrent civil regimes in respect of the imposition of reprimand, disqualification orders, disgorgement orders and civil fines on the primary targets.
- 3.19 In fact, one may argue that the proposal for concurrent fining regimes may compromise the effectiveness of the original proposal for a three-pronged approach as recommended in the Consultation Conclusions. According to paragraph 3.33 of the Consultation Conclusions, a primary target found in breach of a statutory listing rules might be subject to a direct reprimand or disqualification order by the SFC **and** civil sanctions imposed by the MMT. In other words, a primary target sanctioned by the SFC might also be subject to the MMT proceedings. However, with the introduction of the concurrent fining regimes, it would be, according to Leading Counsel's advice, necessary to introduce a provision preventing double jeopardy, i.e. a person who has been disciplined by the SFC could not be subject to the MMT proceedings (see paragraph 3.15 of this consultation paper). Therefore, the proposal for empowering the SFC to impose civil fines would mean that the SFC's civil sanctions would pre-empt an MMT inquiry. That being the case, the possibility of subjecting a primary target to both the SFC's civil sanctions and an MMT inquiry for the same misconduct would be lost should the SFC be empowered to impose civil fines.

TWO-TIERED SANCTIONING REGIME FOR THE MMT

3.20 Empowering the MMT to impose civil sanctions, the most notable one being a civil fine on issuers and directors, on the primary targets (as discussed in paragraph 2.16 above) would create a two-tiered regime for the MMT sanctions in respect of breaches of the statutory listing rules –

	Sanctions	Applicable to
1 st Tier	<ul style="list-style-type: none"> • Reprimand 	<ul style="list-style-type: none"> • Issuers • Directors • officers
	<ul style="list-style-type: none"> • Civil fines of up to HK\$8 million 	<ul style="list-style-type: none"> • Issuers • Directors
2 nd Tier	<ul style="list-style-type: none"> • Existing sanctions under s.257 of the SFO – <ul style="list-style-type: none"> (a) disqualification order (b) disgorgement order (c) “cold shoulder” order (d) “cease and desist” order (e) referral order (f) cost order 	<ul style="list-style-type: none"> • All persons, including issuers, directors and officers

3.21 Such a two-tiered sanctioning regime has the advantage of differentiating the primary targets who are directly responsible for compliance with statutory listing rules and those who are not. The introduction of heavier sanctions against the primary targets represents a more targeted approach in dealing with breaches of statutory listing rules. This can enhance the effectiveness and flexibility of the MMT regime and hence protection for the investing public.

3.22 However, such a two-tiered sanctioning regime may give rise to the following concerns –

- (1) This regime may raise the question of why different groups of persons should be punished in different ways for the same conduct by the same tribunal and under the same civil proceedings. Although the primary responsibility of complying with the listing rules should fall on the primary targets, it would be difficult to conclude that the primary targets would be more culpable than others in all cases of breaches of the statutory listing rules. Given the

variety of listing rules that may be enshrined in the statute, the roles of the primary targets and other persons, and hence their relative responsibilities, may vary from one case to another. The two-tiered sanctioning regime may compromise the flexibility of the MMT in determining the sanctions on the primary targets and other persons on the basis of the seriousness of the misconduct of each person, regardless of the fact that whether he/she is a primary target or not.

- (2) One may also raise doubt about the fairness or consistency of treatment under the MMT regime. The design of the two-tiered sanctioning regime may be perceived as treating different groups of persons in different ways for the same misconduct.
- (3) The fact that the two-tiered sanctioning regime will only be applicable to cases involving breaches of the statutory listing rules but not the other six types of market misconduct (such as insider dealing) may have the disadvantage of complicating the whole MMT regime, though the complication may well be justified. One must recognise that the nature of misconduct under the listing regime is different from that of the other six types of market misconduct. Under the listing regime, there are specific and well-defined groups of persons (i.e. primary targets) who have the positive obligation for complying with the statutory listing rules prescribed in the law. This is different from the other six types of market misconduct where the elements of “primary targets” and “position obligation” cannot be readily identified.

FINING POWER

3.23 As demonstrated in the discussion in paragraphs 3.16 and 3.17 above, empowering the SFC and the MMT to impose civil sanctions, civil fines in particular, provides a spectrum of enforcement response which will facilitate a more calibrated approach towards enforcement. But this approach is not free from doubt. The powers for the SFC and the MMT to impose civil sanctions, civil fines in particular, will bring about complications arising from concurrent civil regimes (as discussed in paragraphs 3.18 and 3.19 above) and a two-tiered MMT regime (as discussed in paragraph 3.22 above). A wide spectrum of enforcement response may also introduce uncertainty. It may give rise to questions about the criteria adopted by the regulator in determining whether a case should attract civil sanctions by the SFC or prosecution by the SFC at

magistracy, or referral to the Department of Justice for prosecution under Part XIV of the SFO or recommendation to the Financial Secretary to institute the MMT proceedings.

3.24 On the basis of the concerns arising from the current civil regimes and the two-tiered sanctioning regime for the MMT mentioned in paragraph 3.22, we would like to invite public views on whether the proposal for introducing civil fines on issuers and directors for breaches of the statutory listing rules should be pursued. Should the public support the proposal for introducing civil fines, we would like to invite public views on whether the SFC and the MMT should be empowered to impose civil fines concurrently (i.e. adopting the concurrent fining regimes), or whether the fining power should be confined to the MMT only. Possible options include –

- (1) The present proposal, i.e. both the SFC and the MMT should be empowered to impose civil fines, but of differing severity.
- (2) The power to impose civil fines would be conferred on the MMT only, while the SFC would be empowered to issue reprimands and impose disqualification orders and disgorgement orders on the primary targets. Under this proposal, the MMT would still adopt a two-tiered sanctioning regime, while the complications arising from concurrent **fining** regimes can be avoided.

Public views on the relative tenability of each of the above option are welcome.

LEVEL OF FINES

3.25 The proposed legislative provisions at **Appendix A** has been prepared on the basis of concurrent civil regimes and a two-tier sanctioning regime for the MMT. We set out below the level of fines that may be imposed for breaches of statutory listing rules under our proposal.

Civil Fines Imposed by the SFC

3.26 Paragraph A.7 at **Appendix A** proposes a new power for the SFC to impose civil fines on issuers and directors of up to HK\$ 5 million for breaches of the statutory listing requirements. The fines may be imposed alone or in addition to other sanctions including reprimands,

disqualification orders and disgorgement orders. According to the proposed legislative amendments in paragraph A.12 at **Appendix A**, a person who has been subject to the SFC's disciplinary procedure will not be subject to the MMT proceedings for the same misconduct. This proposed arrangement is consistent with Leading Counsel's advice that there should be, among others, a provision preventing "double jeopardy" under the SFC's disciplinary regime and the MMT proceedings. More details about the advice can be found in paragraph 3.15(1) in this consultation paper.

- 3.27 In line with advice from Leading Counsel, we have set out in paragraph A.9 factors to be considered by the SFC when considering the level of the fine to be imposed on an issuer or a director. The SFC may issue guidelines under s.399 of the SFO to set out in detail the manner in which it proposes to exercise the power to impose fines.

Civil Fines Imposed by the MMT

- 3.28 As discussed in paragraph 3.9 above, the MMT may also impose civil fines on issuers and directors. Paragraph A.14 at **Appendix A** proposes that the maximum level of civil fines that may be imposed by the MMT would be HK\$8 million. Empowering the MMT to impose heavier civil fines than that may be imposed by the SFC is consistent with our proposal for distinguishing between the cases handled by the SFC and the cases heard by the MMT on the basis of the perceived gravity of the alleged breaches. A more detailed discussion about this distinction can be found in paragraph 3.15(2) of this consultation paper.

- 3.29 We have also set out in paragraph A.14 at **Appendix A** the proposed factors to be considered by the MMT when considering the level of a fine to be imposed on an issuer or a director.

Criminal Fines

- 3.30 As for the criminal regime, the level of fines to be imposed is proposed to be in line with the maximum level of fines as provided for in Part XIV of the SFO, i.e. HK\$10 million. The fine provided for in the criminal regime for all persons who are found to have breached the statutory listing rules (including the primary targets), together with other sanctions including imprisonment of up to 10 years, appears to be adequately severe to deter breaches. Therefore, we do not propose any amendments

to the sanctions under the criminal regime.

Overall Fining Regime

- 3.31 We would like to invite public comments on whether the proposed level of fines to be imposed by the SFC (i.e. HK\$5 million) and the MMT (i.e. HK\$8 million) are sufficient to achieve the regulatory, as opposed to punitive, purposes of the fines. (See paragraph 3.4(2) of this consultation paper for details about the regulatory purposes of civil fines). In considering the appropriate level of the fines, we should have regard to the fact that under our proposal, the SFC may impose a disgorgement order in addition to a civil fine on an issuer or a director for breaching the statutory listing rules. The disgorgement order would in effect enable the SFC to impose fines proportionate to the profit made or loss avoided where this is identifiable.

CHECKS AND BALANCES ON THE SFC

- 3.32 The proposed legislative amendments would confer onto the SFC new responsibilities and powers to enforce major listing requirements, and to impose civil sanctions on issuers, directors and officers for breaches of these requirements. Accordingly, care has been taken to ensure that there are adequate checks and balances on the SFC's powers in this regard. Apart from the general checks and balances set out at **Appendix B**, we would like to highlight three notable examples of safeguards that are particularly relevant to the SFC's regulation of listing –

(1) Disciplinary decision-making process

The proposed legislative amendments provide for a fair and transparent decision-making process, based on the process laid down in the current Part IX of the SFO. In particular, the SFC may impose a disciplinary sanction only after giving the person on whom the sanction is proposed to be imposed an opportunity of being heard. The SFC must also issue to the person who is the subject of disciplinary decisions, the decisions in writing together with a written statement of the reasons for the decisions. These procedural requirements are embodied in the proposed legislative amendments in paragraph A.8 at **Appendix A**.

(2) Right to Appeal to the SFAT

Paragraph A.18 at **Appendix A** proposes the right to appeal against all types of the SFC's disciplinary decisions against issuers, directors and officers. These appeals will be heard by the SFAT chaired by a judge, and are full merits reviews where the SFAT may affirm, vary or substitute the SFC's decisions.

(3) Practitioners' input

The Dual Filing Advisory Group is a standing committee established by the SFC under section 8 of the Securities and Futures Ordinance. The Group's members include investors as well as market practitioners, such as fund managers, corporate finance advisers, legal advisers and accountants. Since its establishment in May 2003, the Group has provided valuable advice to the SFC on treatment of cases under the Dual Filing regime and the relevant regulatory provisions, as well as on related policy issues.

The SFC will consider how the terms of reference of this committee should be adjusted to provide practitioners' input to the SFC's process of administering and enforcing the statutory listing rules.

- 3.33 Apart from the checks and balances at **Appendix B** and those highlighted in paragraph 3.32 above, other options to strengthen the existing checks and balances may also be pursued to ensure proper exercise of the SFC's powers. It has been suggested that the SFC's disciplinary decisions relating to the regulation of listing be delegated to a committee set up under s.8 of the SFO which provides that the SFC may establish committees. The committee may comprise members of the Commission, including executive and non-executive directors, or even market practitioners and investor representatives. The Regulatory Decisions Committee (RDC) set up by the board of the UK Financial Services Authority can provide useful reference. The board appointed the RDC chairman and members, who represent the public interest and are drawn from practitioners and non-practitioners. The RDC takes those enforcement, authorisation and supervisory decisions that are of material significance for the firms and individuals concerned.

3.34 Given that the proposed legislative amendments set out in **Appendix A** would confer on the SFC a range of new functions and powers in the regulation of listing, we would like to invite public views on whether additional checks and balances, which may include the establishment of a committee to deal with the SFC's regulatory decisions relating to listing, are necessary.

CHAPTER 4 SUMMARY OF ISSUES FOR CONSULTATION

- 4.1 The Government is committed to upgrading the quality and hence the competitiveness of our equity market. With this in mind, we recommended in the Consultation Conclusions specific proposals on how major listing requirements would be statutorily backed, i.e. to extend the market misconduct regime to cover breaches of statutory listing rules, and to empower the SFC to impose civil sanctions on the primary targets. The legislative proposals set out in the paper have been developed on the basis of the recommendations in the Consultation Conclusions issued in March 2004. We have also highlighted in Chapter III the more important issues on the legislative front that have not been elaborated in the Consultation Conclusions, and discussed the issue of checks and balances on the exercise of the SFC's powers to impose sanctions on the primary targets.
- 4.2 We summarise here the matters on which this consultation exercise seeks to collect public views –
- the proposals as reflected in the proposed amendments to the SFO prepared by the Administration (**Appendix A**);
 - whether the proposal for introducing civil fines on issuers and directors for breaches of the statutory listing rules should be pursued. Should the public support the proposal for introducing civil fines, we would like to invite public views on whether the SFC and the MMT should be empowered to impose civil fines concurrently (i.e. adopting the concurrent fining regimes), or whether the fining power should be confined to the MMT only (paragraph 3.24);
 - whether the proposed level of fines to be imposed by the SFC (i.e. HK\$ 5 million) and the MMT (i.e. HK\$ 8 million) is sufficient to achieve the regulatory, as opposed to punitive, purposes of the fines. (paragraph 3.31); and
 - whether additional checks and balances, which may include the establishment of a committee to deal with the SFC's regulatory decisions relating to listing, are necessary (paragraph 3.33).

APPENDICES

**PROPOSED AMENDMENTS TO THE SECURITIES AND FUTURES ORDINANCE
(Proposals to Give Major Listing Requirements Statutory Backing)**

A.1 Securities and Futures Commission (SFC)'s Powers to Make Rules

Section 36(1) of the Securities and Futures Ordinance (Cap. 571) is amended -

- (a) in paragraph (a), by adding -
 - "(ia) prescribing the requirements to be complied with by persons concerned in the listing of securities;"
- (b) by adding -
 - "(aa) prescribing the requirements to be complied with by any specified persons or class of persons in relation to securities which are listed or accepted for listing;"
- (c) in paragraph (e), by repealing "companies" and substituting "corporations";
- (d) by adding -
 - "(i) prescribing any requirement prescribed by rules made under any other paragraph of this subsection as relevant listing requirement for the purposes of the definition of "relevant listing requirement" in section 1 of Part 1 of Schedule 1."

A.2 SFC's Powers to Require the Production of Records and Documents Concerning Listed Corporations, etc.

Section 179 is amended -

- (a) in subsection (1) -
 - (i) by adding -
 - "(ca) it appears to the Commission that there are circumstances suggesting that at any relevant time there has been a contravention of any relevant listing requirement;"
 - (ii) in paragraph (f), by adding "(ca)," after "(c),".

A.3 SFC's Powers of Investigations

Section 182(1)(e) is amended -

- (a) in subparagraph (i), by repealing "or" at the end;

- (b) by adding after subparagraph (i) -
 "(ia) for the purpose of considering whether to exercise any power under section 197A, has reason to inquire whether any person is or was at any time guilty of misconduct as a securities issuer or a director or other officer of a securities issuer as described in section 197A(1) or (2); or".

A.4 SFC's Disciplinary Powers to Impose Civil Sanctions on the Primary Targets

Section 193 is amended -

- (a) in subsection (1), by repealing "this Part" and substituting "Division 2";
- (b) in subsection (2) -
- (i) by repealing "this Part" and substituting "Division 2";
 - (ii) by repealing "an intermediary" and substituting "a person";
 - (iii) by adding "as an intermediary" after "subsection (1)";
 - (iv) in paragraph (a), by repealing "in the case of" and substituting "where the person is or was (as the case may be)";
 - (v) in paragraph (b), by repealing "in the case of" and substituting "where the person is or was (as the case may be)";
- (c) by adding -
- "(2A) In Division 2A, unless the context otherwise requires -
 "misconduct" (失當行爲) means a contravention of any relevant listing requirement, and "guilty of misconduct" (犯失當行爲) shall be construed accordingly.
 - (2B) In Division 2A, where a person is, or was at any time, guilty of misconduct as a securities issuer as a result of its contravention of any relevant listing requirement, the contravention shall also be regarded as misconduct on the part of any other person who is or was (as the case may be) knowingly, recklessly or negligently concerned in the contravention as an officer of the first-mentioned person, and "guilty of misconduct" shall also be construed accordingly."

A.5 Amendment of heading in Part IX

The heading of Division 2 is amended by repealing "Discipline" and substituting "Disciplinary action in respect of licensed persons and registered institutions, etc."

A.6 Division added to Part IX

The following is added -

"Division 2A - Disciplinary action in respect of securities issuers, etc.

A.7 SFC's Powers to Impose Civil Sanctions

The following sanction is added -

197A. Disciplinary action in respect of securities issuers, etc.

(1) Subject to section 198, where a person is, or was at any time, guilty of misconduct as a securities issuer or an officer of a securities issuer, the Commission may exercise such of the following powers as it considers appropriate in the circumstances of the case -

- (a) publicly reprimand the person;
- (b) in the case of the person being guilty of misconduct as an officer of a securities issuer, order that the person shall not, without the leave of the Court of First Instance, be or continue to be a director, liquidator, or receiver or manager of the property or business, of a listed corporation or any other specified corporation or in any way, whether directly or indirectly, be concerned or take part in the management of a listed corporation or any other specified corporation for such period (not exceeding 3 years) as the Commission may specify;
- (c) order that the person pay an amount not exceeding the amount of any profit gained or loss

avoided by the person as a result of the misconduct.

(2) Subject to sections 198 and 199, where a person is, or was at any time, guilty of misconduct as a securities issuer or a director of a securities issuer, the Commission may, separately or in addition to any power exercisable under subsection (1), order the person to pay a pecuniary penalty not exceeding \$5,000,000.

(3) Where the Commission makes an order under subsection (1)(b), the Commission may specify a corporation by name or by reference to a relationship with any other corporation.

(4) Where the Commission makes an order under subsection (1)(b), the order shall be filed by the Commission with the Registrar of Companies as soon as reasonably practicable after it is made.

(5) A person ordered to make any payment under subsection (1)(c) or (2) shall make the payment to the Commission within 30 days, or such further period as the Commission may specify by notice under section 198(3), after the order has taken effect as a specified decision under section 232.

(6) The Court of First Instance may, on an application of the Commission made in the manner prescribed by rules made under section 397 for the purposes of this subsection, register an order made under subsection (1)(c) or (2) in the Court of First Instance and the order shall, on registration, be regarded for all purposes as an order of the Court of First Instance made within the civil jurisdiction of the Court of First Instance for the payment of money.

(7) Any money paid to or recovered by the Commission pursuant to an order made under subsection (1)(c) or (2) shall be paid by the Commission into the general revenue."

A.8 Procedural requirements in respect of SFC's exercise of disciplinary powers

Section 198 is amended -

- (a) in subsection (1), by repealing "or 197(1)(a) or (b) or (2)" and substituting ", 197(1)(a) or (b) or (2) or 197A(1) or (2)";

- (b) in subsection (3) -
 - (i) by repealing "or 197(1) or (2)" and substituting ", 197(1) or (2) or 197A(1) or (2)";
 - (ii) in paragraph (c), by adding ", or of any other order," after "prohibition";
 - (iii) in paragraph (e), by adding ", or of any payment to be required to be made," after "imposed".

A.9 Guidelines for performance of SFC's functions to take Disciplinary Actions

Section 199 is amended -

- (a) in subsection (1), by repealing "or 196(2)" and substituting ", 196(2) or 197A(2)";
- (b) in subsection (2), by repealing "under subsection (1) shall include the following as factors that the Commission shall take into account in performing any of its functions under section 194(2) or 196(2)" and substituting "by it under subsection (1) to indicate the manner in which it proposes to perform any of its functions under section 194(2) or 196(2) shall include the following as factors that it shall take into account in performing such functions";
- (c) by adding -
 - "(2A) Guidelines published by the Commission under subsection (1) to indicate the manner in which it proposes to perform any of its functions under section 197A(2) shall contain provisions to the effect that, in performing such functions, the Commission -
 - (a) shall only order the payment of a pecuniary penalty which is, in the circumstances of the case, proportionate and reasonable in relation to the conduct of the person; and
 - (b) in determining whether any pecuniary penalty is proportionate and reasonable within the meaning of paragraph (a), may, in addition to any other matter that it may consider relevant, take into account -
 - (i) the seriousness of the conduct of the person as

- determined with reference to the nature of the relevant listing requirement in question;
- (ii) whether the conduct was intentional, reckless or negligent;
 - (iii) whether the conduct may have damaged the integrity of the securities and futures market;
 - (iv) whether the conduct may have damaged the interest of the investing public; and
 - (v) whether the conduct resulted in a benefit to the person or any other person."

A.10 SFC's Power to Enter into Settlement with Persons Proposed to be Disciplined

Section 201 is amended -

- (a) in subsection (1), by repealing "or 197(1) or (2)" and substituting ", 197(1) or (2) or 197A(1) or (2)";
- (b) in subsection (3), by repealing "or 197(1)(a) or (b) or (2)" and substituting ", 197(1)(a) or (b) or (2) or 197A(1) or (2)";
- (c) in subsection (4) -
 - (i) by repealing "section 198(2) and (3) as if section 198(2) and (3)" and substituting "the provisions of section 198(3) and, where the power the exercise of which has been contemplated is that under the sections specified in section 198(2), of section 198(2), as if those provisions";
 - (ii) by repealing "also applies" and substituting "also apply".

A.11 Publication of SFC's Decisions to Take Disciplinary Actions against the Primary Targets

The following is added -

"203A. Commission to maintain register showing exercise of powers under section 197A

(1) The Commission shall maintain a register in such form as it considers appropriate to show, in relation to any exercise of power under section 197A(1) or (2), the particulars specified in subsection (2).

(2) The particulars specified for the purposes of subsection (1) are -

(a) where the exercise of power is in respect of the misconduct on the part of any person as a securities issuer -

- (i) the name and business address of the person;
- (ii) the particulars of the misconduct;
- (iii) the particulars of the exercise of power; and
- (iv) such other particulars as are prescribed by rules made under section 397 for the purposes of this subsection; or

(b) where the exercise of power is in respect of the misconduct on the part of any person as a director or other officer of a securities issuer -

- (i) the name and business address of the person;
- (ii) the name and business address of the securities issuer;
- (iii) the particulars of the misconduct;
- (iv) the particulars of the exercise of power; and
- (v) such other particulars as are prescribed by rules made under section 397 for the purposes of this subsection.

(3) The register may be maintained -

(a) in a documentary form; or

(b) by recording the information required under subsection (2) otherwise than in a documentary form, so long as the information is capable of being reproduced in a legible form.

(4) For the purpose of enabling any member of the public to ascertain the identity of any person in respect of whose misconduct any power has been exercised under section 197A(1) or (2) and the particulars of the misconduct and the exercise of power, the register shall be made available for public inspection at all reasonable times.

(5) At all reasonable times, a member of the public may -

- (a) inspect the register or, where the register is maintained otherwise than in a documentary form, a reproduction of the information or the relevant part of it in a legible form; and
- (b) obtain a copy of an entry in or extract of the register on payment of the prescribed fee.

(6) A document purporting to be -

- (a) a copy of an entry in or extract of the register; and
- (b) certified by an authorized officer of the Commission as a true copy of the entry or extract referred to in paragraph (a),

shall be admissible as evidence of its contents in any legal proceedings.

(7) Without derogating from the other provisions of this section, the Commission shall, in addition, cause the register to be available to the public in the form of an on-line record.

A.12 No Double Jeopardy in respect of SFC's Disciplinary Actions

The following is added -

203B. No further disciplinary action under section 197A after proceedings in respect of same conduct

Notwithstanding anything in this Part, no power may be exercised under or pursuant to this Part to determine whether to exercise any power in respect of any person under section 197A in respect of any conduct -

- (a) if -
 - (i) proceedings have previously been instituted against the

person under section 252 in respect of the same conduct; and

- (ii) (A) those proceedings remain pending; or
- (B) by reason of the previous institution of those proceedings, no proceedings may again be lawfully instituted against that person under section 252 in respect of the same conduct; or

(b) if -

- (i) criminal proceedings have previously been instituted against the person under Part XIV in respect of the same conduct; and
- (ii) (A) those criminal proceedings remain pending; or
- (B) by reason of the previous institution of those criminal proceedings, no criminal proceedings may again be lawfully instituted against that person under Part XIV in respect of the same conduct."

A.13 Extending the Market Misconduct Tribunal (MMT) Regime to Cover Beaches of Statutory Listing Rules

Section 245(1) is amended -

(a) in the definition of "market misconduct" -

by adding -

"(g) breach of listing requirement."

(b) by adding -

"breach of listing requirement" means breach of listing requirement within the meaning of section 278A;".

The following is added -

"278A. Breach of listing requirement

Breach of listing requirement takes place when -

- (a) a person as a securities issuer contravenes any relevant listing requirement; or

- (b) a person as an officer of a securities issuer is knowingly, recklessly or negligently concerned in the contravention by the securities issuer of any relevant listing requirement."

A.14 MMT's Powers to Impose Civil Sanctions on Primary Targets

Section 257 is amended -

- (a) by adding -

"(1A) Subject to subsection (3), at the conclusion of any proceedings instituted under section 252, where the Tribunal determines pursuant to section 252(3)(a) that market misconduct has taken place by reason of a breach of listing requirement, the Tribunal may, separately or in addition to any power exercisable under subsection (1), make one or more of the following orders in respect of a person who has by virtue of section 252(4)(a) been identified as having engaged in the market misconduct pursuant to section 252(3)(b) -

- (a) an order for public reprimand of the person;
- (b) where the person has perpetrated the conduct which constitutes the market misconduct as a securities issuer or a director of a securities issuer, an order that the person pay to the Government a pecuniary penalty not exceeding \$8,000,000.";

- (b) in subsection (2), by adding "or (1A)(a)" after "subsection (1)";

- (c) by adding -

"(2A) When making any order in respect of a person under subsection (1A)(b), the Tribunal shall only order the payment of a pecuniary penalty which is, in the circumstances of the case, proportionate and reasonable in relation to the conduct of the person.

(2B) For the purposes of subsection (2A), the Tribunal may, in addition to any other matter that it may consider relevant, take into account -

- (a) the seriousness of the conduct of the person as determined with reference to the nature of the relevant listing requirement in question;
- (b) whether the conduct was intentional, reckless or negligent;
- (c) whether the conduct may have damaged the integrity of the securities and futures market;

- (d) whether the conduct may have damaged the interest of the investing public;
- (e) whether the conduct resulted in a benefit to the person or any other person; and
- (f) any conduct by the person which -
 - (i) previously resulted in the person being convicted of an offence in Hong Kong;
 - (ii) previously resulted in the person being identified by the Tribunal as having engaged in any market misconduct pursuant to section 252(3)(b); or
 - (iii) previously resulted in the person being identified as an insider dealer in a determination under section 16(3), or in a written report prepared and issued under section 22(1), of the repealed Securities (Insider Dealing) Ordinance.";

(d) in subsections (3), (7) and (8), by adding "or (1A)" after "subsection (1)".

A.15 No further MMT proceedings after exercise of power under Part IX or criminal proceedings under Part XIV

Section 283 is amended by repealing everything after "any conduct" and substituting -

"-

- (a) if -
 - (i) any power has previously been exercised under or pursuant to Part IX to determine whether to exercise any power in respect of the person under section 197A in respect of the same conduct; and
 - (ii) (A) the exercise of power under section 197A remains pending; or
 - (B) by reason of the previous exercise of power under or pursuant to Part IX, no power may again be lawfully exercised under or pursuant to that Part to determine whether to exercise any power in respect of the person under section 197A in

respect of the same
conduct; or

- (b) if -
 - (i) criminal proceedings have previously been instituted against the person under Part XIV in respect of the same conduct; and
 - (ii) (A) those criminal proceedings remain pending; or
(B) by reason of the previous institution of those criminal proceedings, no criminal proceedings may again be lawfully instituted against that person under Part XIV in respect of the same conduct."

A.16 Extending the Criminal Regime Under Part XIV to Cover Breaches of Statutory Listing Rules

The following is added -

"299A. Offence of breach of listing requirement

- (1) A person shall not -
 - (a) as a securities issuer contravene any relevant listing requirement; or
 - (b) as an officer of a securities issuer be knowingly or recklessly concerned in the contravention by the securities issuer of any relevant listing requirement.
- (2) A person who contravenes subsection (1) commits an offence."

A.17 Definitions

Section 1 of Part 1 of Schedule 1 is amended -

- (a) in the definition of "shadow director", by adding "or a majority of the directors" after "directors" where it twice appears;
- (b) by adding -
 - "securities issuer" means a listed corporation or a listing applicant;
 - "listing applicant" means a corporation by or on behalf of which an application for the listing of any securities issued or to be issued by the corporation has been made to a

recognized exchange company, whether or not [, as a result of the application,] the recognized exchange company has agreed to allow, subject to the requirements of this Ordinance, dealings in those securities to take place on a recognized stock market operated by the recognized exchange company;

"relevant listing requirement" means any requirement prescribed by rules made under section 36(1)(i) of this Ordinance as relevant listing requirement for the purposes of this definition;"

**A.18 SFC's Decisions to Sanction the Primary Targets
Appealable to the Securities and Futures Appeals Tribunal**

Division 1 of Part 2 of Schedule 8 is amended by adding -

- | | |
|--|--|
| "59A. Section 197A(1)(a),
(b) or (c) of this
Ordinance | Exercise of power to
publicly reprimand a person,
or to make an order in
respect of a person. |
| 59B. Section 197A(2) of
this Ordinance | Order to pay a pecuniary
penalty." |

Checks and Balances on the Exercise of the Securities and Futures Commission's Powers

Since the establishment of the Securities and Futures Commission (SFC) in 1989, care has been taken to ensure that the SFC has the necessary powers to carry out its regulatory objectives effectively, and that such powers are checked by sufficient safeguards.

The Securities and Futures Ordinance (SFO), which commenced operation on 1 April 2003, sets out clearly the regulatory objectives of the SFC. Various checks and balances on SFC's powers have been incorporated in the SFO, together with some enhanced features –

- (i) the Chief Executive appoints all directors of the SFC, the majority of whom must be non-executive. Certain key functions¹ of the SFC could only be exercised pursuant to decisions taken at meetings of the full SFC;
- (ii) the SFC must consult the public in exercising its rule-making power;
- (iii) an independent non-statutory panel, the Process Review Panel (PRP), was established by the Chief Executive to review the SFC's internal operating procedures, including those for ensuring consistency and fairness;
- (iv) an independent Securities and Futures Appeals Tribunal (SFAT), chaired by a full-time judge, was established under the SFO, replacing the part-time Securities and Futures Appeals Panel. A wider range of SFC's decisions are subject to review by the SFAT on the full merits of a case;
- (v) members of the public who are aggrieved by the SFC's decisions in the performance of its functions may apply for judicial review;
- (vi) complaints against the actions of the SFC or any of its staff may be lodged with the Office of the Ombudsman;
- (vii) as a public body, under the Prevention of Bribery Ordinance SFC's practices and procedures are subject to review by the Independent Commission Against Corruption (ICAC);

¹ Functions as specified in Part 2 of Schedule 2 of the SFO.

- (viii) the Chief Executive approves estimates of the SFC's income and expenditure, and the Financial Secretary shall cause the approved estimates to be laid before the Legislative Council. Indeed in the past, it has been a practice for the SFC Chairman and senior management to attend the Financial Affairs Panel meetings in relation to its budget and other major initiatives;
- (ix) the SFC is required to submit its annual report and financial statements to the Financial Secretary who shall cause a copy to be laid before the Legislative Council;
- (x) the Director of Audit may examine the records of the SFC;
- (xi) the Chief Executive may give the SFC directions regarding the performance of its duties and functions; and
- (xii) the SFC must furnish such information to the Financial Secretary as he may specify.