

SFC PROPOSES TO EXPAND ITS ENFORCEMENT POWERS

SFC'S CONSULTATION ON PROPOSED AMENDMENTS TO THE SECURITIES AND FUTURES ORDINANCE

Summary

On 10 June 2022, the Securities and Futures Commission (the **SFC**) published a consultation paper inviting comments on certain proposed amendments (the **Proposed Amendments**) to the Securities and Futures Ordinance (the **SFO**).

The Proposed Amendments concern three aspects in the current legislation, namely (1) the power of the SFC to apply to the Court of First Instance for reliefs under section 213 of the SFO, (2) the exemption to section 103(1) of the SFO in relation to the prohibition on the issue of advertisements in respect of securities or structured products or interests in collective investment scheme, and (3) the insider dealing regime. The primary objective of the Proposed Amendments is to enable the SFC to better protect the interests of the investing public and uphold the reputation of Hong Kong's financial markets through more effective enforcement action.

The consultation period will end on 12 August 2022.

Expanding SFC's powers to apply for reliefs under section 213

The SFO currently enables the SFC to apply to the Court of First Instance (the **CFI**) for various orders under section 213 of the SFO so as to provide remedies for persons affected by a contravention of one of the relevant provisions, requirements or conditions under or imposed pursuant to the SFO (including but not limited to the provisions of the SFO and its subsidiary legislation).

The orders available under section 213 include:

- an injunction restraining or prohibiting the contravention or dealing in a specified property;
- an order requiring a person to take steps to restore the parties to any transaction to the position in which they were before the transaction was entered into;
- an order appointing an administrator;
- an order declaring that a contract is void or voidable;

- an order directing a person to do or refrain from doing any act to ensure compliance with any other court order made; and
- an order requiring the wrongdoer to pay damages to any other person.

The SFO currently does not allow the SFC to apply for the orders under section 213 against a regulated person who is found guilty of misconduct or who, in the SFC's opinion, is not a fit and proper person to remain the same type of regulated person under sections 194 and 196 of the SFO respectively, unless the conduct which gave rise to the finding also constituted a contravention of one of the relevant provisions, requirements or conditions described in section 213. This means that a breach of the SFC's codes and guidelines (e.g. the Code of Conduct for Persons Licensed by or Registered with the SFC (the **Code of Conduct**)) by a regulated person in itself cannot currently give rise to a cause of action under section 213, even if the misconduct concerned is serious and might have led to investors' loss.

The SFC now proposes to amend section 213 to expand the basis on which the SFC may apply to the CFI for remedial and other orders after having exercised any of its powers under section 194 or 196 against a regulated person.

The proposed expansion would mean that the SFC may be able to seek the orders under section 213 against an intermediary for a breach of the Code of Conduct (e.g. Paragraph 17 in relation to sponsors' conduct and Paragraph 21 in relation to the standards of conduct expected of a licensed or registered person engaged in bookbuilding or placing activities which will become effective on 5 August 2022). In particular, such a breach will give the SFC a cause of action to seek damages in addition to any pecuniary penalty that the SFC may impose on the intermediary under section 194 or 196.

Broadening the scope of insider dealing provisions

The current insider dealing provisions under the SFO (sections 270 and 291) only apply when the securities/ derivatives concerned are either listed in Hong Kong or

dually-listed in Hong Kong and another jurisdiction. As such, the current regime does not apply to insider dealing perpetrated in Hong Kong with respect to securities/ derivatives listed overseas.

The existing insider dealing provisions do not expressly cover insider dealing with respect to securities/ derivatives listed in Hong Kong which is perpetrated outside of Hong Kong.

The SFC now proposes to expand the scope of the insider dealing provisions of the SFO to expressly cover the above scenarios.

Whilst the SFC was successful in using section 300 of the SFO to pursue a case involving insider dealing of securities listed on a foreign stock exchange¹, the SFC recognises that section 300 is designed to cover acts of fraud or deception involving transactions between specified persons and is not designed to deal with the mischief of insider dealing against the market as a whole. This conceptual difference affects the nature of relief that can be sought and the calculation of the amounts payable by the wrongdoers. In a section 213 action based on a contravention of section 300, the wrongdoer would only be ordered to return the profits from the illicit trades to the victim who has been defrauded. However, if a case were to be brought under the insider dealing regime, the wrongdoer could be asked to restore all aggrieved investors affected by the illicit trades to the position they were in before they entered into the relevant transactions. Further, the elements required to be proved under section 300 are also different from those required to establish the offence of insider dealing under section 291. Fraud and/or deception is required to be established for a section 300 offence but is not under section 291.

As regards cases of insider dealing with respect to Hong Kong-listed securities or their derivatives where the acts which give rise to a contravention of section 270 or 291 have taken place outside Hong Kong, the SFC currently deals with them by applying the common law test of territorial jurisdiction to determine whether a substantial measure of the activities of the crime have taken place within Hong Kong, which is highly fact-sensitive.

It is notable that between 2017 and 2021, approximately 61% of the insider dealing cases handled by the SFC concerned insider dealing of Hong Kong-listed securities perpetrated outside of Hong Kong. It therefore appears that there is a real need to expand the insider dealing regime to cover such wrongdoing so that Hong Kong markets and investors can be better protected. This proposed expansion will also bring Hong Kong in line with other major common law jurisdictions (e.g. Australia, Singapore and the UK) and is also consistent with other market misconduct provisions in the SFO (e.g. false trading, price rigging and stock market manipulation).

Exemption to the offence of issuing advertisements in certain cases

The SFO currently prohibits the issuance of an advertisement, invitation or document of investment products unless authorised by the SFC. One of the exceptions is that advertisements, invitation or document of investment products which are or are intended to be sold only to professional investors (PIs) do not require such authorisation (the **PI Exemption**)².

It has been decided by the Court of Final Appeal³ (the **CFA Judgment**) that the PI Exemption applies to any advertisement having some connection or relation to investment products that are or are intended to be disposed of only to PIs. The position following the CFA Judgment is that it is not illegal to issue an advertisement of investment products to the general public even if it is for sale only to PIs.

To better protect the interests of the investing public, the SFC now proposes to amend section 103(3)(k) so that it will be clear that an advertisement of investment products which is intended to be sold only to PIs must not be issued to the public without the SFC's authorisation.

Next steps

The SFC will publish a consultation conclusions paper after all comments received during the consultation period have been considered. Subject to the comments received, an amendment bill will be introduced into the Legislative Council.

¹ *Securities and Futures Commission v Young Bik Fung & Ors* [2019] HKC 254

² Section 103(3)(k) of the SFO

³ *Securities and Futures Commission v Pacific Sun Advisors Ltd and another* [2015] 2 HKC 595

CONTACTS



WYNNE MOK
PARTNER
T: +852 2901 7201
E: wynne.mok@slaughterandmay.com



JASON CHENG
ASSOCIATE
T: +852 2901 7211
E: jason.cheng@slaughterandmay.com



AUDREY LI
ASSOCIATE
T: +852 2901 7209
E: audrey.li@slaughterandmay.com

London
T +44 (0)20 7600 1200
F +44 (0)20 7090 5000

Brussels
T +32 (0)2 737 94 00
F +32 (0)2 737 94 01

Hong Kong
T +852 2521 0551
F +852 2845 2125

Beijing
T +86 10 5965 0600
F +86 10 5965 0650

Published to provide general information and not as legal advice. © Slaughter and May, 2022.
For further information, please speak to your usual Slaughter and May contact.

www.slaughterandmay.com