

Securities and Futures Commission Proposes Amendments to the Securities and Futures Ordinance to Strengthen Enforcement

24 June 2022

SUMMARY

On 10 June 2022, the Securities and Futures Commission (the “SFC”) launched a two-month consultation (“Consultation”) on proposed enforcement-related amendments to the Securities and Futures Ordinance (the “SFO”). The public has until 12 August 2022 to submit their comments on the Consultation before an amended bill is introduced into the Legislative Council.

The Consultation includes various proposals, although the key ones that are probably of most interest concern a proposed extension of the SFC’s powers to apply for injunctions and other orders under section 213 of the SFO, and a proposal to widen the territorial scope of the insider dealing provisions of the SFO. These are reviewed in more detail below. If ultimately enacted, they will provide an important broadening of the SFC’s powers in the fulfilment of its enforcement duties.

PROPOSED AMENDMENTS TO SECTION 213 OF THE SFO

Current Regime

Section 213 of the SFO enables the SFC to apply to the Court of First Instance for various orders including injunctions and the payment of damages, where there has been, amongst other things, a breach of the relevant provisions¹. However, the SFC’s powers under the current regime are limited. In particular, the SFC does not currently have the power to apply to the Court of First Instance for an order under section 213 where a regulated person or institution has been found guilty of misconduct or has been found not to be a fit and proper person, irrespective of how serious the misconduct has been. In these circumstances, the SFC is currently only able to take disciplinary actions against the regulated person or institution under section 194 or 196 of the SFO, with no

¹ Under the current regime, the basis for an application under section 213 includes breaches of the SFO, and breaches of any of the terms and conditions of any license or registration under the SFO.

ability to seek any form of injunction or damages in favour of any person who has suffered losses as a result of the misconduct of the regulated person or institution.

The SFC's Proposed Amendments

The Consultation contains proposed amendments to the SFO in order to fill this important gap, so as to better “*protect investors and the interests of clients of regulated persons*”.

For these purposes, the Consultation proposes that section 213 be extended in two respects: first, to enable the SFC to apply for injunctions and other relevant orders under section 213 where it has exercised its disciplinary powers against a regulated person under section 194(1), 194(2), 196(1) or 196(2) of the SFO; and second, to include an additional provision empowering the Court of First Instance to make an order to restore the parties to any transaction to the position in which they were before the transaction was entered into where the SFC has exercised its powers under section 194 or section 196 in respect of a regulated person.

The second of these proposed amendments, in particular, provides an important weapon in the SFC's armory against regulated persons when a breach of section 194 or 196 has been established. Whilst to date the SFC has found other ‘indirect’ means of securing compensation to be paid to investors who have suffered as a result of such breaches (with such payments often forming part of remediation agreements), this proposed amendment would provide the SFC with a direct route to secure the payment of compensation in circumstances where agreement cannot be reached voluntarily for such compensation to be paid. This not only benefits investors, but would also no doubt act as a further deterrent to regulated persons from failing to adhere to the highest standards expected of them by the SFC.

AMENDMENTS TO INSIDER DEALING PROVISIONS OF THE SFO

Current Regime

The Consultation has recommended two areas in particular where the current insider dealing regime needs to be amended in order to extend its jurisdictional reach.

First, at present, the civil and criminal regimes of the SFO prohibit insider dealing with respect to the “listed securities” of a listed corporation or their derivatives. This covers securities either listed only on The Stock Exchange of Hong Kong Limited or their derivatives (“Hong Kong Listed Securities”) or listed dually in Hong Kong and another jurisdiction. However, importantly, it does not cover securities listed solely out of Hong Kong. The Consultation seeks to address this lacuna.

The SFC actually encountered this loophole in *The Securities and Futures Commission v Young Bik Fung & Ors* [2019] HKC 254. This case involved insider dealing activities concerning the shares of a bank listed outside Hong Kong. As such, the SFC was not able to rely on the insider dealing provisions under the SFO because the shares concerned were not listed on a recognised stock market in Hong Kong. Instead, the SFC had to rely on section 300 of the SFO, which required it to prove the commission of an offence involving fraud and/or deception. Whilst the SFC was ultimately successful in that case, the fact remains that section 300 was not originally intended to address issues of insider dealing and, from the SFC's perspective at least, it contains a higher burden to establish an offence. Indeed, the SFC would not be able to pursue any action under section 300 where there is insufficient evidence to establish fraud and/or deception, which is not required to be established under the insider dealing provisions.

Second, there is currently no express provision in the SFO to cover insider dealing in Hong Kong Listed Securities where the acts of insider dealing have taken place outside of Hong Kong. In this regard, according to the SFC's statistics, between 2017 and 2021, approximately 61% of insider dealing cases handled by the SFC concerned insider dealing occurring outside of Hong Kong in respect of Hong Kong Listed Securities. As such, the SFC sees this lack of jurisdictional reach as an important loophole in its fight against those who engage in insider dealing.

The SFC's Proposed Amendments

In light of these lacunas, the Consultation has proposed two amendments to address the "limited coverage" and "statutory gap", and to align the SFO with the insider dealing laws in other common law jurisdictions.

The first proposed amendment seeks to extend the definition of "listed" in section 245(2) and section 285(2) of the SFO to include overseas-listed securities or their derivatives, thereby removing the need to rely on section 300 of the SFO for cases involving such securities moving forward. The second proposed amendment seeks to introduce a new section in the SFO to expand the territorial scope of the insider dealing regimes so that it covers any acts of insider dealing, whether inside or outside of Hong Kong, involving Hong Kong Listed Securities.

Given the SFC's laser focus on punishing those who engage in insider dealing and the increasingly sophisticated and international nature in which insider dealing is carried out, it is unsurprising that the SFC is seeking to broaden its powers by extending the jurisdictional reach of the regime. If and when these amendments come into force, the message is clear to those who do engage in insider dealing that there will be few safe havens for them away from the SFC's reach.

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Please do not hesitate to contact us with any questions.

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