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54/F, One Island East
18 Westlands Road, Quarry Bay
Hong Kong

12 August 2022

Dear Sirs

Consultation Paper on Proposed Amendments to Enforcement-related Provisions of the Securities and Futures Ordinance (Cap 571) ("SFO") issued on 10 June 2022 (the "Consultation Paper")

We welcome the opportunity to comment on the Consultation Paper.

We set out below responses to the proposals and questions in the Consultation Paper, incorporating both Clifford Chance's views, as well as those of our clients[1], who have participated in the preparation of this response. Unless otherwise stated, in this response we adopt the definitions and abbreviations used in the Consultation Paper.

[1] We are extremely grateful to our clients who contributed to this response, for sharing their valuable time, experience and insights.

Part 1 – Amendments to section 213 of the SFO to expand the basis on which the SFC may apply for remedial and other orders against a regulated person

1. *Do you agree with: (i) the proposal to amend section 213 of the SFO 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 of the SFO against a regulated person, and; (ii) the proposed consequential amendments to section 213(1), (2), (7) and (11)? Please explain your view.*

Answer to Question 1(i)

Introduction and executive summary of comments

1.1. We appreciate the Commission's stated reasons for the proposal to amend section 213, and in particular, recognise the stated imperative of giving the Commission more effective means to protect investors and the interests of clients of regulated persons. That said, we respectfully note that there is currently a lack of clarity in the Consultation Paper as to:

1.1.1. the requisite nature and seriousness of the misconduct in question, which will give rise to an application for investor compensation;

1.1.2. the potential liability of individual responsible officers ("ROs") and managers in charge ("MICs");

1.1.3. how the Commission will ensure substantive and procedural fairness if the enhanced enforcement powers it seeks are implemented.

1.2. We expand below on the reasons why further and more explicit guidance from the Commission is important, and also make suggestions on the matters which such guidance might take into account.

1.3. ***Nature and seriousness of misconduct***. We note that the proposed changes appear to target "*serious*" misconduct[2]. However, the Consultation Paper does not specify what forms of misconduct the Commission is targeting, or the factors the Commission will take into consideration in determining the "*seriousness*" of the misconduct in question, beyond noting that the relevant person will have to be "*guilty of misconduct or not be*

[2] Paragraph 9 of the Consultation Paper: "*This means that a breach of the SFC's codes and guidelines..., however serious, cannot currently give rise to a cause of action under section 213...*".

a fit and proper person to remain a regulated person under section 194 or 196, respectively".

1.4. This leads to a lack of certainty as to the circumstances in which the Commission will seek to obtain orders from the CFI in connection with the proposed expansion of section 213, in turn creating difficulties for regulated persons in anticipating and assessing the risk that they may become liable for investor compensation. Regulated persons need to understand their potential exposure in order to assess their legal position and decide the course of action to take and manage risks.

1.5. This lack of certainty is particularly exacerbated by (i) the relatively broad drafting of section 213; (ii) the wide range of code, standard and guideline breaches that can lead to a finding of "*misconduct*" under section 194 or 196; and (iii) the lack of explicit guidance[3] around what "*unfairly prejudice any person*" means, in terms of the test the CFI should apply in making its determination.

1.6. In connection with the Commission's stated objective of front-loaded regulation, we and our clients very much welcome further clarification and/or illustrations from the Commission as to the type of conduct the Commission seeks to deter with its proposed expanded enforcement powers, and further guidance on how the Commission intends to wield such powers.

1.7. In this regard, we consider that the following may be of assistance in enhancing clarity and predictability, with respect to how the Commission's proposed enhanced powers can be implemented in practice:

1.7.1. The expanded section 213 relief may only be granted if the misconduct or unfitness is dishonest and/or wilful.

1.7.2. Where restitutionary relief is sought, there should be no element of windfall.

1.7.3. Where damages are sought, the common law tests of foreseeability / remoteness and causation should be applied.

1.8. ***Substantive and procedural fairness***. The Commission will no doubt appreciate that any change should not impinge on or in any way prejudice substantive or procedural fairness. We and our clients very much welcome further clarity from the Commission

[3] In this regard, we note that while there is case authority on what this means in practice (see paragraph 1.12 below), there is no indication as to how this test will be applied, notably in the context of the proposed expanded scope of section 213.

in terms of how it will ensure that substantive and procedural fairness will not at any time be adversely affected.

1.9. In this regard, we consider that the following may be of assistance in protecting procedural fairness, should the Commission be granted the additional powers sought:

1.9.1. The CFI should consider any disciplinary sanction already imposed under section 194 or 196 (or other sanction by relevant local or foreign regulatory regimes) and determine whether granting further remedial relief would be disproportionate or otherwise unduly onerous, burdensome or excessive. Alternatively, in a case where the Commission seeks investor compensation under the proposed expanded section 213, it should consider suspending in particular any pecuniary penalty imposed under section 194 or 196, until the issue of investor compensation is resolved.

1.9.2. It be made clear that the CFI must make its own assessment and not rely on the Commission's opinion, including as set out in the Commission's statement of disciplinary action, if no Securities and Futures Appeals Tribunal ("**SFAT**") proceedings or Court of Appeal appeals are commenced.

1.9.3. The Commission should only be entitled to apply for interim relief, and the CFI should not grant any final relief (including investor compensation), pending any determination to be made by the SFAT and/or the Court of Appeal with respect to a finding by the Commission for section 194 or 196 disciplinary action.

Nature and seriousness of misconduct

Why we consider an additional test of dishonesty and/or wilfulness would be of assistance

1.10. The stated aim is for section 213 remedial orders, in particular, investor compensation in the form of restoration orders and damages, to be made available for Code of Conduct[4] and other standards and guidance breaches by regulated persons.[5] The types of misconduct and unfitness that will be engaged by the proposed change are broad. Examples where dishonesty and/or wilfulness may be involved are:

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4 Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the "**Code of Conduct**").

5 Section 213 currently only covers, *inter alia*, contraventions of a provision of the SFO or other relevant provisions including specified companies' legislation provisions on prospectuses and buying back of own shares, as well as anti-money laundering legislation provisions.

1.10.1. Mis-selling.

1.10.2. False or misleading financial statements or other window-dressing outside the IPO context.

1.10.3. Trades or transactions without the requisite client authorisation or employee personal trades without employer approval.

1.10.4. Misfeasance and/or deliberate concealment of poor performance or mistakes.

1.11. On the other hand, many Code of Conduct, standards and guidance breaches do not involve dishonestly or wilfulness or are technical in nature, including for example inadvertent conflicts of interests that arise due to employee oversight, or inadvertent delays in reporting to the Commission.

1.12. The addition of a dishonesty and/or wilfulness test is appropriate because currently, for a remedial or other order to be made under section 213, the CFI is required to satisfy itself "*so far as it can reasonably do so*" that the order is desirable and will not unfairly prejudice any person (see subsection (4)). The desirability of a section 213 order has been described as the order having some utility or serving some purpose within the contemplation of the SFO.[6] Desirability and fairness have also been referred to as highly general concepts which do not lend themselves to definition or precise exposition such that a fairly broad-brush approach has to be adopted where necessary.[7] The generality of such concept means that there is much discretion and no certainty. The addition of the dishonesty and/or wilfulness test will go some way in providing certainty.

1.13. Furthermore, this concept was applied (with approval of the court) in the *Qunxing Paper* case, where section 213 relief was ordered including for the reason that the misconduct was knowing with a high degree of culpability.[8]

1.14. Relatedly, sections 194 and 196 are expansive, in the sense that they are triggered by misconduct, which is defined widely in section 193(1)(d) to include not only contravention of a SFO provision, but also an act or omission relating to the carrying on of a regulated activity which, in the opinion of the Commission, is or is likely to be

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6 See *SFC v A* [2008] 1 HKC 89 at [26] citing *Australian Securities and Investments Commission v Mauer-Swisse Securities Limited and Another* (2002) 42 ACSR 605 at 607 per Palmer J.

7 See *SFC v Qunxing Paper Holdings Co Ltd and Others* [2018] 1 HKLRD 1060 at [57], which was applied in *SFC v Unknown Persons trading as Cardell Limited* [2019] 1 HKLRD 702.

8 See *SFC v Qunxing Paper Holdings Co Ltd and Others* [2018] 1 HKLRD 1060 at [64]-[68].

prejudicial to the interest of the investing public or to the public interest. Section 193(3) further provides that for the purpose of this definition of misconduct, the Commission shall not form an opinion of prejudice to the interest of the investing public or to the public interest unless it has regard to applicable codes and guidelines. Sections 194 and 196 are also engaged when in the opinion of the Commission, a regulated person is not fit and proper. Fitness and properness is a very broad concept, covering not just a licensed person's ability to carry on the regulated activity competently, honestly and fairly, and going to his or her reputation, character, reliability and financial integrity, but also negligence and carelessness.

1.15. The addition of the dishonesty and/or wilfulness analysis also ensures that there is compliance with sections 169 and 399. Both provide that a failure to comply with codes and guidelines shall not *by itself* create liability to judicial or other proceedings, which would include section 213 proceedings. Something more such as the inclusion of the dishonesty and/or wilfulness test is required.

Further clarity is in particular important for individuals

1.16. With respect to individual ROs or MICs, supervisory failures, particularly those relating to technical breaches, are often inadvertent, for example, due to breaches by team members and not any intentional misconduct on the part of the individual RO or MIC in question.

1.17. In such circumstances, we query whether it is appropriate for an RO or MIC to be made personally liable for investor compensation, or indeed to have the spectre of very significant investor compensation hanging over them, in circumstances where they may well already be subject to investigation by the Commission, which in itself can have significant impact on careers and livelihoods.

1.18. It should accordingly be clarified whether and if so, the extent to which breaches by individual ROs and MICs will potentially be subject to investor compensation. In this regard, we consider that it would be fair and reasonable for investor compensation to only be available if the misconduct or unfitness in question is directly committed by the individual in question, and/or involves wilfulness or dishonesty on the part of the individual, and not if the individual's failure is merely supervisory, technical or inadvertent in nature.

Limits to restitutionary relief and damages

1.19. For restitutionary relief, it should be clarified that there must be no element of windfall and it must be shown that loss was suffered.

1.20. For damages, it should be clarified that the common law tests of foreseeability / remoteness and causation must be applied.

1.21. The issue of a windfall was raised in the *Sun Min* case in the context of determining restoration of counterparties to trades impacted by insider dealing.[9] We consider that the clarification of no windfall should be express, so that the CFI will apply independent consideration to the issue.

1.22. Regarding damages, there does not yet appear to be a section 213 case in which damages were ordered. At least of the cases reviewed[10], none ordered damages.

1.23. As section 213 is civil in nature, damages should only be ordered where the normal tests are met. Foreseeability / remoteness and causation will be live issues, particularly where misconduct or unfitness is not transaction related. For example, in the case of conflicts of interests in the publication of research reports, foreseeability and causation will be issues because there might be a myriad of reasons to make a recommendation or statement in a research report and the recommendation or statement might be made irrespective of the relationship. There might also be a myriad of reasons for trading or transacting other than for the recommendation or statement in the research report. Remedial relief will not be appropriate where the actual and/or main reason upon which the research report author and/or trader acted is not apparent. Similarly, regarding supervisory failures, it is an issue as to whether the damage is caused by the supervisory failure, as even with adequate supervision, the misconduct or unfitness and damage might still have occurred.

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9 *SFC v Sun Min* [2017] 4 HKLRD 211. The Commission and the defendant (D), who had been found to have engaged in insider dealing, had consented between themselves that D would pay a counterparty who sold her shares, the difference between the sale price and the market value of the shares once the inside information became known. The court harboured reservations as to how section 213(2(b) operated and whether this amount was a windfall for the counterparty/seller rather than restitutionary in nature as envisaged by section 213. Ultimately, in that case, given the agreement between the Commission and D, the court made the order requested.

10 *Re Whole Win Securities* (unreported, HCMP 1093/2006, 28 June 2006); *Re Tiffit Securities (Hong Kong) Ltd* (unreported, HCMP 1479/2006, 4 October 2006); *SFC v A* [2008] 1 HKC 89; *Re Wong Kwong Yu* (unreported, HCMP 1496/2009, 8 September 2009); *SFC v Lee Sung Ho* (unreported, HCA 2177/2011, 5 September 2012); *SFC v Tiger Asia Management LLC* (2013) 16 HKCFAR 324; *SFC v Tsoi Bun* [2014] 2 HKLRD 1; *SFC v Sun Min* [2017] 4 HKLRD 211; *SFC v Young Bik Fung* (unreported, CACV 33/2016, 9 November 2017); *SFC v Qunxing Paper Holdings Co Ltd and Others* [2018] 1 HKLRD 1060; *SFC v Unknown Persons trading as Cardell Ltd* [2019] 1 HKLRD 702; *SFC v Yik Fong Fong* [2022] HKCFI 450; *SFC v DFRF Enterprises LLC* [2022] HKCFI 1288; *SFC v Maxim Capital Limited* [2022] HKCFI 1518.

1.24. Currently, it is not clear that foreseeability / remoteness and causation would necessarily be required to be shown for damages to be awarded pursuant to section 213,[11] and thus this should be spelt out expressly.

Substantive and procedural fairness

Consideration of disciplinary sanctions already imposed

1.25. We suggest that it be made express that the CFI should consider the disciplinary sanctions already imposed under section 194 or 196 (or any sanctions imposed by other relevant local or foreign regulatory regimes) and determine whether granting further remedial relief would be disproportionate or otherwise unduly onerous, burdensome or excessive. In particular, this is because section 213 remedial relief is uncapped. The Commission should also consider suspending disciplinary sanctions under section 194 or 196, in particular, any pecuniary penalty to be imposed until after any investor compensation sought is determined.

1.26. Pursuant to sections 194 and 196, pecuniary penalties of the greater of HK$10 million or three times the profit gained or loss avoided as a result of the misconduct may be ordered. Even if the profit gained or loss avoided is less than HK$10 million, HK$10 million does not represent the total cap, since separate pecuniary penalties not exceeding HK$10 million *each* may be imposed in respect of each separate act or omission constituting misconduct.[12] Further, the appropriate level of penalty may be assessed using the number of persons affected by the misconduct as the multiplier.[13] For example, where a regulated person has contravened the Code of Conduct resulting in a financial product being mis-sold to three persons, the Commission may impose a fine not exceeding HK$10 million for each affected person.[14] The burden comes about because pecuniary penalties already take into account the number of persons affected by the misconduct as restoration orders and damages will.

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[11] See *SFC v Qunxing Paper Holdings Co Ltd and Others* [2018] 1 HKLRD 1060 at [49]-[50] and [58]-[60]. In the *Qunxing Paper* case, it was held that section 213 does not merely provide machinery for enforcing rights already vested in investors nor is it merely procedural; instead, it creates a statutory cause of action. It is thus not necessary to bring into section 213 each and every constituent element of a private law cause of action of misrepresentation and deceit including reliance and inducement in assessing loss suffered and compensation for each investor.

[12] See *Moody's Investors Service Hong Kong Limited v SFC* (unreported, SFAT 4/2014, 31 March 2016) at [213]-[215].

[13] See *HSBC Private Bank (Suisse) SA v SFC* (unreported, SFAT 3/2015, 21 November 2017) at [447].

[14] See the SFC Disciplinary Fining Guidelines at page 1.

1.27. Further if restoration orders or damages are ordered after disciplinary fines, it will be very onerous on regulated persons, particularly if fines are ordered to be paid within 30 days or a specified short period. If ordered after revocation or suspension of licence, the regulated person will have lost their means of earning a living to enable them to pay damages or they will still be expected to comply with any restoration order after such loss of means.

1.28. The onerousness or burden created if the relevant relief is granted is a legitimate concern even under the current regulatory regime under sections 194 and 196. According to the SFC Disciplinary Fining Guidelines (page 3), considerations relevant to the level of a disciplinary fine include whether any remedial step was taken since the conduct was identified including compensation, albeit here, the suggestion is vice versa, namely, for compensation or remedial relief to be ordered taking into account the earlier section 194 or 196 disciplinary action. Further, under the SFC Disciplinary Fining Guidelines (page 3), the level of disciplinary fine should not have the likely effect of putting a firm or individual in financial jeopardy. This should be a relevant consideration in the grant of remedial relief under section 213.

1.29. The above also justifies the Commission being required to consider suspending disciplinary sanctions under section 194 or 196, in particular, any pecuniary penalty to be imposed until after any investor compensation sought is determined.

1.30. Oppression is also currently taken into account under section 213 as illustrated by the *Wong Kwong Yu* case.[15]

1.31. In any event, there must be no double recovery. The Australian position expressly precludes double recovery.[16]

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[15] See *Re Wong Kwong Yu* (unreported, HCMP 1496/2009, 8 September 2009) in which the court found the variation of the order sought by the Commission to be oppressive and refused the same. The original order provided for the lodgement into court of share certificates to restrain their disposal or dealing in the value of the alleged loss suffered resulting from a fraudulent scheme. The value of the shares fluctuated and the Commission sought variation of the order to provide that if the market value of the shares decreased below the level of alleged loss at the close of three consecutive trading days, the defendants would be required to deliver further certificates and/or pay into court the equivalent of the shortfall. The variation sought was refused, as it was oppressive and would require crystal ball gazing on the part of the defendants who would be required to retain substantial unencumbered shares or funds in Hong Kong for the purpose of complying with the proposed variation of order.

[16] See, for example, *Grimaldi v Chameleon Mining NL* (No 2) [2012] FCAFC 6 at [648] in the context of director misappropriation and contravention of a civil penalty provision, which may trigger the Australian equivalent

1.32. Ultimately, how remedial relief fits into the disciplinary regime needs to be considered. Currently, in disciplinary actions under section 194 or 196, the Commission regards fines as a more severe sanction than a reprimand,[17] but on the other hand, fines are less serious than the suspension or revocation of a licence.[18] Fines are currently not ordered together with private reprimands as the former are publicised.[19] The Commission should clarify whether remedial orders will only be made after public reprimands or other more severe disciplinary sanction.

1.33. Contraventions of non-relevant provisions in local law or of foreign law (which may create disciplinary issues) such as unauthorised transfer of client data in breach of the Personal Data (Privacy) Ordinance (Cap 486) ("**PDPO**") or foreign investment fund distribution and advice law should also be excluded and remedial relief should not be made available, as such contraventions should be dealt with under their own regime, for example, the PDPO already provides for recourse to civil compensation. This is an issue of comity and avoiding encroachment upon existing jurisdiction.

CFI to make its own determination

1.34. In terms of procedure, we suggest that it is made clear that the CFI must make its own assessment and not rely on the Commission's opinion including by way of its statement of disciplinary action if no SFAT proceedings or Court of Appeal appeals are commenced.

1.35. The Code of Conduct and other standards and guidance are often not prescriptive and are drafted in the form of general expectations or principles, with examples provided not necessarily resulting in misconduct or unfitness, and not necessarily exhaustive. By way of illustration, the Fit and Proper Guidelines use such phraseology as: "*The SFC is not likely to be satisfied that a person is fit and proper if...*" (paragraphs 4.1, 5.1, 6.1 and 7.1) and "*Instances which, if remained unexplained, might result in the person being regarded as having failed this test [referring to poor reputation, character or reliability or lacking in financial integrity or dishonesty]*" (paragraph

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of section 213. The court held that whilst equitable accounting and compensatory remedies, and statutory compensation may operate cumulatively, this is subject to the preclusion of double recovery.

17 See the SFC Disciplinary Fining Guidelines at page 1.

18 See Paper No. 8/01 dated 23 March 2001 by the SFC, HKMA and Financial Services Bureau for the Bills Committee on Securities and Futures Bill and Banking (Amendment) Bill 2000 regarding the Securities and Futures Bill, Part IX – Discipline at [11], https://www.legco.gov.hk/yr00-01/english/bc/bc04/papers/a896e01.pdf

19 See the SFC Disciplinary Fining Guidelines at page 1.

7.1.1(a)). They are open to wide interpretation with broad discretion on the part of the Commission to determine their application. If the Commission's findings in connection with such broadly-drafted expectations or principles are to give rise to a court process for investor compensation, then it is fair and reasonable that the CFI should have the ability to make its own assessment as to the alleged breach.

1.36. As section 213 is only proposed to be available after exercise of powers pursuant to section 194 or 196, it should be clarified that the CFI is to make its own determination. Indeed, this is how the section 213 is intended to operate according to the Court of Final Appeal (the "**CFA**"). In the *Tiger Asia* case, the CFA confirmed that the court may determine whether there has been a contravention of the SFO and make an order accordingly pursuant to section 213.[20]

1.37. The *Sun Min* case involved a consent order agreeing the position as between the Commission and the wrongdoer, but even there, the court emphasised that it must be satisfied that a person has contravened a relevant provision.[21] Accordingly, making it express that the CFI should not simply rely upon the Commission's statement of disciplinary action and must come to its own conclusion ought to be uncontroversial, but at the same time will provide greater procedural certainty and predictability for parties which are facing an application from the Commission under the proposed regime.

1.38. The need for the CFI to come to its own conclusion is not least due to the need for due process in the form of adversarial proceedings. Whilst the standard of proof in relation to a contravention of a SFO provision currently triggering section 213 and disciplinary proceedings under sections 194 and 196 are the same civil standard, namely, on the balance of probabilities,[22] for a section 213 order to be made, this requires the Commission to apply to the CFI. On the other hand, the express wording of sections 194 and 196 simply requires the Commission to be "*of the opinion*" that a regulated person is not a fit and proper person to empower it to exercise disciplinary action. The Commission may form an opinion after investigation and whilst the person concerned is invited to make written submissions, a decision may then be made by the

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20 See *SFC v Tiger Asia Management LLC* (2013) 16 HKCFAR 324 at [22]-[23].

21 *SFC v Sun Min* [2017] 4 HKLRD 211 at [11]. Even where there is no dispute that there had been such contravention, it is not satisfactory to simply send to the court a copy of the MMT report and make reference to an affirmation on the court file containing a paragraph summarising the report's principal findings.

22 See section 387 in relation to a contravention of a SFO provision, save where the provision relates to a criminal offence or proceedings. See *Moody's Investors Service Hong Kong Limited v SFC* (unreported, SFAT 4/2014, 31 March 2016) at [122]-[123], as well as section 218(7), which applies to proceedings before the SFAT.

Commission without an adversarial hearing. This is unless the person concerned makes use of his or her right of review by the SFAT (which is a full merits appeal[23]) and/or of appeal to the Court of Appeal on a point of law. Whilst adversarial hearings in the form of SFAT hearings are available, and the SFAT is a specialist tribunal, in practice, regulated persons may not wish to make an application to the SFAT due to costs, delay, negative publicity / reputational risks and other concerns.

Availability pending appeal

1.39. The Commission should only be entitled to apply for interim relief, and the CFI should not grant any final relief, pending any determination to be made by the SFAT, the Court of Appeal and/or the Commission making a decision afresh due to remission of the matter with respect to a first instance finding by the Commission for section 194 or 196 disciplinary action.

1.40. Waiting for the outcome of SFAT review before final relief is granted is important. The purpose of the SFAT is to review specified decisions made by the Commission (as well as the Hong Kong Monetary Authority).[24] Upon review, whilst a specified decision may be confirmed, it may also be varied or set aside with a new decision substituted or the matter remitted to the relevant authority with directions including to make a decision afresh. The SFAT acts as a safeguard to ensure that the Commission's decisions are reasonable and fair and to enhance the Commission's accountability.[25] The SFAT combines the legal expertise of a judge or former judge who is the Chairman of the Tribunal, who in turn appoints two ordinary members from a panel.[26]

Statutory structure of section 213 proposals

1.41. As a structural matter, to assist in keeping the proposed expanded regime separate from the existing section 213, and furthermore to facilitate statutory references to safeguards

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23 See *Tsien Pak Cheong, David v SFC* [2011] 3 HKLRD 533 (CA) at [32].

24 As listed in Part 2 of Schedule 8 to the SFO including decisions to revoke or suspend licences, responsible officer approvals or registrations; issue of a public or private reprimand; imposition of a prohibition, for example, to apply to be licensed or registered; and orders for payment of a pecuniary penalty pursuant to sections 194 and 196.

25 https://www.sfat.gov.hk/en/index.html

26 The panel currently comprises 22 members, including lawyers, accountants, university professors and senior industry players, for example, senior and executive management of banks, investment banks, securities firms, asset management firms and corporates, who must not be public officers.

and clarifications such as those suggested above, we consider it helpful for relevant provisions to kept distinct and that a new section 213A be introduced instead.

1.42. Section 213 is currently triggered, *inter alia*, by a contravention of the SFO or other relevant provisions, and once triggered, section 213 avails the applicant of the wide range of remedies set out in section 213(2). Keeping the existing regime separate, for example, by way of a distinct section 213A, which will allow the Commission to seek investor compensation off the back of its own disciplinary action in the manner proposed, is conceptually a better "*fit*" for the Commission's proposed objective. This is not least because the purposes of disciplinary action and remedial orders are different: the former for the Commission to act as prosecutor to punish in the general public interest and the latter for the Commission to act as a protector of the collective interests of the investing public who have been injured, by seeking civil remedies on their behalf.[27] Keeping the proposed regime within the "*four walls*" of a new section 213A accords more closely with the Commission's objectives, and is less likely to disturb the current and relatively well-established section 213 regime.

Answer to Question 1(ii)

1.43. Our suggestions for implementation of the proposals to expand the bases on which the Commission may apply for remedial and other orders to include the ability to do so after the exercise of powers under section 194 or 196 are set out above. This includes a new section 213A. We have no particular comments on not making available the equivalent of section 213(2)(a) relief after exercise of powers under section 194 or 196. Regarding the current wording for restoration orders in section 213(2)(b), the words "*where a person has been, or it appears that a person has been, is or may become, involved in any of the matters referred to in subsection (1)(a)(i) to (v), whether knowingly or otherwise*" are not unnecessary, if not problematic, if they are to apply after the exercise of disciplinary powers under section 194 or 196, as the persons involved will be known. In terms of the potential to apply to innocent parties involved in a transaction for the purpose of unwinding the transaction, whilst it is not problematic in theory that the CFI be given jurisdiction over third parties, any extension of section 213 jurisdiction to the disciplinary sphere should be limited, as the SFC's disciplinary jurisdiction is based on the fact that persons are regulated by them, which is to be contrasted with the current trigger for section 213 relief being contravention of SFO or other relevant provisions which are statutory in nature. The UK Financial Services and Markets Act 2000 provides for restitution orders, but only

[27] See *SFC v Tiger Asia Management LLC* (2013) 16 HKCFAR 324 at [16].

against those who have contravened or been knowingly concerned in the contravention of a relevant requirement.

1.44. In any new section 213A, we suggest that the equivalent of subsections 213(7)(a) and (b) should not be included for the making of orders after the Commission's exercise of powers under section 194 or 196 for the sake of consistency of tests to be applied.

1.45. Currently, pursuant to subsections 213(7)(a) and (b), a section 213 order may be made whether or not the person against whom it is to be made intends to engage again or continue to engage in the relevant SFO provision contravention or has previously engaged in such contravention.

1.46. On the other hand, pursuant to sections 194 and 196, in determining whether a regulated person is a fit and proper person and disciplinary action should be taken, the Commission may take into account present or past conduct.

1.47. Hence, the equivalent of subsections 213(7)(a) and (b) should not apply if the new proposals are to be implemented for the sake of consistency.

1.48. In terms of the equivalent of section 213(7)(c), which provides that the CFI may make an order irrespective of whether there is an imminent danger of damage, this is more relevant to the protective orders in the equivalent of section 213(2), in essence, a prohibitory injunction in section 213(2)(a) and a Mareva injunction in section 213(2)(c). The equivalent of section 213(2)(a) is not proposed to be available after the exercise of powers under section 194 or 196, though the equivalent of section 213(2)(c) is proposed to be available. It appears to us that the equivalent of section 213(7)(c) is necessary for the proposal to work if it is to be adopted because if application for section 213 type orders are only made *after* the exercise of powers under section 194 or 196, there is unlikely to be imminent danger of damage, as the damage would likely have already been incurred.

1.49. We have no particular comments on the proposed consequential amendments to the equivalent of section 213(11).

2. *Do you have any comments on the proposed consequential amendments to section 213(3A) in respect of open-ended fund companies (OFCs)? Please explain your view.*

2.1. Other than our comments above, we have no additional comments.

Part 2 – Amendments to exemptions in section 103 of the SFO

3. *Do you agree with the proposal to amend the exemption set out in section 103(3)(k) and the consequential amendments to section 103(3)(j)? Please explain your view.*

Practical difficulties

3.1. We understand the Commission's concern in relation to the CFA's interpretation of SFO, section 103(1) and (3) in *Pacific Sun*[28] and the resulting potential enforcement gap between the issuance of an unauthorised advertisement of investment products intended only for PIs and the actual PI assessment within the investment product sales process, which could expose retail investors to marketing materials intended for PIs only.

3.2. However, by amending SFO section 103(3)(k) in a way such that "*unauthorised advertisements of investment products which are or are intended to be sold only to PIs may only be issued to PIs who have been identified as such in advance by an intermediary through its know-your-client [("**KYC**")] and related procedures, regardless of whether or not such an intention has been stated on the advertisements*", this effectively imposes a heavy obligation on all intermediaries to ensure that every individual or high net worth investor to whom they pre-market must have already qualified as a PI before receiving any such relevant advertisements / marketing materials.

3.3. Albeit a slightly grey area, this proposed obligation is inconsistent with the usual sequence of events during an investment product's sales lifecycle, as any KYC, PI status assessment, or related on-boarding procedures would, following the *Pacific Sun* case, typically be conducted at the same time and as part of the same process, only *after* the issuance of any relevant pre-advertisements or pre-marketing materials (such as teasers and road show materials) but *before* any actual offer document or subscription document is provided.

3.4. In part, this sequence of events is driven by the customer / investor experience and also in part by the fact that these procedures / checks require dedicated resources. Typically, intermediaries would only carry out such procedures / checks at a point in time closer to the actual offer or sale of the relevant investment product, and at the same time as KYC / Anti-Money Laundering ("**AML**") checks and, if required, suitability is performed. In this way, the customer / investor only has to satisfy one all-encompassing set of on-boarding procedures: -

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[28] *SFC v Pacific Sun Advisors Limited and Mantel, Andrew Pieter* (FACC 11/2014, 20 March 2015).

- to qualify as a PI for private placement safe harbour purposes;
- to qualify as the relevant type of PI for SFC Code of Conduct purposes and/or to satisfy suitability requirements (where applicable);
- to complete their KYC / AML and sanctions checks,

all before the time of investing.

3.5. By imposing such an express new obligation to single out the PI status assessment process from the other KYC or on-boarding procedures would risk creating a disjointed marketing process negatively impacting the customer / investor experience.

3.6. In practice, we believe pre-marketing materials that do not amount to the actual offer / sale or subscription documentation (i.e., "teaser" or pre-marketing materials) designed to gauge the interest of potential PIs should be permitted in general without the need for intermediaries to assess that every single recipient or potential recipient of the materials is a PI. In practice, the intermediary would have a good sense that the investor is a PI. When pre-marketing an investment product to a potential new investor, the distributor or product manufacturer does not want the first conversation to be to ask the target investor to provide all his / her / its PI credentials and supporting documents. Equally, we would expect the distributor or manufacturer of investment products intended only for PIs to have internal controls in place to prevent the subscription / purchase of such products by an investor who is not actually qualified as a PI.

3.7. We would agree that any potential investor should be assessed for PI status *before* any actual offer / sales document and subscription document is issued to that investor. We do not believe this prejudices investor protection in any substantive way, but it considerably enhances the customer / investor experience.

Alignment with other existing statutory exemptions

3.8. Separately, we would also take this opportunity to address another related question under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (the "**C(WUMP)O**"), in particular section 38D, where an application to the Commission for authorisation for registration of a "*prospectus*" (defined as any document that is "*offering* ***shares in or debentures of a company*** [our emphasis] *to the public for subscription or purchase*") must be made and approved before the issuance of such prospectus. Statutory exemptions are made available under the Seventeenth Schedule, Part 1 section 2 to the following offers which do not fall within the definition of "*prospectus*":

3.8.1. An offer to professional investors within the meaning of section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) (including professional investors falling within paragraph (j) of the definition of ***professional investor*** *in that section).*

3.8.2. An offer—

(a) to not more than 50 persons; and

(b) containing a [warning] statement specified in Part 3 of the Eighteenth Schedule to [C(WUMP)O].

3.9. By virtue of paragraph 2 of Part 4 of the Seventeenth Schedule of C(WUMP)O, the safe harbours under 3.8.1 and 3.8.2 above can be combined. In addition, by virtue of paragraph 3 of Part 4 of the Seventeenth Schedule of C(WUMP)O, the offer to not more than 50 persons by the same person is measured over a 12-month period.

3.10. We note that the PI safe harbour and 50-person safe harbour are both extended to overlap with the SFO in relation to shares in and debentures of companies (which are classified as "*securities*" under section 1 of Part 1 of Schedule 1 to the SFO), but not to other types of securities, for example interests in limited partnerships or units in unit trusts. Currently, for any other types of "*securities*", while a similar statutory PI safe harbour is made available in section 103(3)(k) of the SFO, there is no express statutory exemption made available under the SFO that mirrors the 50-person safe harbour (after a 12-month period) under C(WUMP)O; instead an intermediary must rely on the old common law *limited offerees test*, where no specific number / bright line is set for the definition of "*public*".

3.11. As noted above, under C(WUMP)O, the PI safe harbour and the 50-person safe harbour can be combined in their usage. However, the legal position is unclear as to whether the SFO PI safe harbour and the common law *limited offerees test* may be combined in their usage. There are differing views in the market regarding whether these safe harbours can be combined for other types of securities (i.e., other than shares and debentures in a company) and so clarity that they can be combined would be welcome.

3.12. Given the overlap between provisions in C(WUMP)O and in the SFO, and the uncertainty in the existing market practice mentioned above, we would therefore welcome an extension of the C(WUMP)O 50-person statutory safe harbour to the SFO, sections 103(1) and (3) with regard to other types of 'securities' (in addition to shares and debentures in a company).

3.13. Aligning the statutory approach for all types of securities under the SFO with that for shares / debentures under C(WUMP)O as suggested above would mean closing an existing – arguably technical - gap between the two pieces of legislation. The closing of this gap would be a significant improvement of the regulatory regimes and would better facilitate relevant intermediaries' risk management process in general, by having a clear set of perimeters to refer to when developing their internal systems and controls around marketing and relying on the SFO private placement safe harbours.

Part 3 – Amendments to the insider dealing provisions of the SFO

4. *Do you agree with the proposal to expand the scope of insider dealing provisions of the SFO to cover insider dealing perpetrated in Hong Kong with respect to overseas-listed securities or their derivatives? Please explain your view.*

4.1. Generally, this is an acceptable proposal. It appears to be a natural evolution and serves to clarify the position. It would avoid the unintended use of section 300, which was used in such cases as *SFC v Young Bik Fung* [2018] HKCFA 45 for insider dealing involving overseas-listed securities. In the CFA judgment itself, it was stated that section 300 should not be a catch all provision.

4.2. However, we do have some comments and observations, in particular, this will subject those engaging in insider dealing to regulatory actions in multiple jurisdictions and differing tests for insider dealing under both Hong Kong law and those of the overseas jurisdiction.

4.3. A sufficient transition period should be provided for to enable time to update internal compliance policies and manuals.

5. *Do you agree with the proposal to expand the scope of insider dealing provisions of the SFO to cover insider dealing perpetrated outside of Hong Kong, if it involves any Hong Kong-listed securities or their derivatives? Please explain your view.*

5.1. Generally, this is an acceptable proposal. It will lead to more certainty rather than relying upon common law principles to find jurisdiction by seeking to identify infringing activities in Hong Kong. We envisage that it will lead to more collaboration with foreign securities regulators.

5.2. However, bringing insider dealing in line with SFO provisions governing other market misconduct such as false trading, price rigging and stock market manipulation is not necessarily a good justification, as the latter entail less discretion. Determining whether there has been insider dealing requires an assessment of whether information is price

sensitive materially affecting the price of listed securities. How materiality is perceived in other countries might not be the same as in Hong Kong.

Should the Commission wish to discuss any of our comments, please do not hesitate to contact .

Yours faithfully

Clifford Chance