TIMOTHY LOH LLP

Comments On The Consultation Paper On Proposed Amendments To Enforcement-Related Provisions Of The Securities And Futures Ordinance

August 10, 2022

Thank you for the opportunity to comment on your proposals to amend enforcement-related provisions of the Securities and Futures Ordinance ("**SFO**"). We support expanding the extra-territorial effect of the insider dealing provisions but have strong reservations about:

(a) expanding the basis on which the Securities and Futures Commission ("**SFC**") may apply for remedial and other orders against a regulated person under s. 213; and

(b) limiting the exemptions from SFC authorisation for advertisements in relation to professional investors and persons outside Hong Kong under s. 103(3).

1. Expansion on Basis for Orders against Regulated Persons under s. 213

Question 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.

We are concerned as to whether the proposal to amend s. 213 of the SFO to enable the SFC to apply for court orders under s. 213 where the SFC has exercised its discretionary powers under s. 194 or s. 196 will adequately respect due process.

Though each person being disciplined under ss. 194 or 196 must have a reasonable opportunity of being heard, ultimately, decisions under those sections are administrative in nature and are decided by a regulator acting simultaneously as the investigator, prosecutor and judge, both as to matters of law and facts. In contrast, in a typical judicial proceeding where the government alleges individual wrongdoing, the investigator, the prosecutor and the judge are all independent of each other.

If court orders are to be made under s. 213, they should be made on the basis of a finding by the court of a basis for disciplinary action under ss. 194 or 196 and should not rely upon a finding by the SFC of such a basis. The court should, for example, be given the opportunity to decide whether it agrees with the SFC's interpretation of the SFC's codes and guidelines, particularly given that these codes and guidelines are often drafted in broad terms to encapsulate principles rather than specific directions and the SFC is not bound by precedent in the same way the courts are.

Such an approach would mirror the current approach in s. 213, which requires the court to make its own independent finding of, for example, market misconduct before making orders thereunder.

An alternative would be to require procedurally that all avenues of appeal to the Securities and Futures Appeals Tribunal and, where applicable, to the courts beyond, be satisfied before a court could be bound by the SFC's findings under ss. 194 or 196.

2. Limiting Exemptions for Advertisements under s. 103(3)

Question 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.

The proposed amendment to restrict investment offers and invitations to professional investors seems unworkable and it is questionable whether additional investor protection benefits from the proposal outweigh the additional commercial and compliance burdens which would result from it.

For complete disclosure, this firm successfully acted on behalf of the appellants in the Court of Final Appeal decision in *SFC v. Pacific Sun Advisors Limited and Mantel, Andrew Pieter* (FACC 11 of 2014) which this proposed amendment seeks to overturn.

It appears from the consultation that the SFC's present concern is "retail investors may be exposed to unauthorised offers or solicitations to invest in risky or complex products which are unsuitable for them" and that "a mere intention to sell investment products only to PIs... makes the regime extremely difficult, if not impossible, to enforce".

(a) Exposure to Unsuitable Investment Products – The first concern, namely that retail investors may be exposed to unsuitable investment products, was addressed by the Court of Final Appeal in the *Pacific Sun* case as follows:

> 40. *An obvious flaw in the Commission's argument is that* **if the investment products are not in fact sold or intended to be sold to the general public** *and instead are sold or intended to be sold only to professional investors*, **there is no necessity for protection to be afforded to the general public since they are not exposed to any material risk…** .
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> 42. *The thrust of the Commission's argument in this respect would appear to be that, because the advertisements did not expressly state that the Fund was or was intended to be disposed of only to professional investors*, **retail investors might have their interest piqued and, relying on the minimum investment amount, might wrongly think the Fund was intended for them. But, if that were so, a retail investor would soon be disabused of this misapprehension upon his expressing an interest in the Fund to the appellants. Once telephone or other inquiries informed a retail investor that the Fund was not intended for disposal to him, there would be no interest of the retail investor for the statutory regime to protect, save possibly from a waste of the time necessary to discover that the Fund was only for professional investors…** [emphasis added]

In other words, it is unclear what material risk retail investors face by being exposed to unsuitable investment products if, in fact, they are unable to invest in them. There is no data or other evidence in the consultation which suggests what the risk is.

(b) Perceived Enforcement Difficulty – The second concern expressed by the SFC, namely the difficulty of enforcing authorisation requirements on the basis of an exemption available on a mere intention to sell to professional investors, must be balanced against the burdens of determining whether a prospective client or investor is a professional investor without any product context.

There may well be reason to suspect that an investment product distributor will sell an investment product to an ordinary investor which ought only be sold to a professional investor. In this case, there is no real harm to the investor until the sale completes and it turns out that the investor was a retail investor only. Here, the SFC's concern is that enforcement cannot pre-empt this harm – it can only address the harm once it has materialized.

However, without a product to form the subject matter of a discussion, there may well be difficulties for the investment product distributor to obtain information from the prospective investor to determine whether he is a professional investor or a retail investor. What prospective investor will provide personal information about his financial situation unless he is interested in a specific product or service? How many prospective investors take an interest in a specific service without an underlying product in mind?

The consultation is silent on whether there is any data or other evidence to suggest that investment products which ought to be available only to professional investors are being sold to retail investors and, more importantly, would not have been sold but for earlier enforcement action. In the absence of such evidence, why is enforcement when harm in fact arises insufficient?

SFO, s. 103(3)(j) provides an exemption from SFC authorisation for advertisements in relation to investment products sold or intended to be sold only to persons outside Hong Kong. The SFC considers that, given that the language of s. 103(3)(j) is similar to that of s. 103(3)(k), s. 103(3)(j) should also be amended for consistency and to avoid confusion.

For the reasons set out above, we do not support the proposal to amend s. 103(3)(k) and it follows that there is no reason to amend s. 103(3)(j) as proposed.

3. Extra-territorial Expansion of Insider Dealing Provisions

We support your proposals to broaden the scope of the insider dealing provisions of the SFO to cover:

(a) insider dealing perpetrated in Hong Kong with respect to overseas-listed securities or their derivatives; and

(b) insider dealing perpetrated outside of Hong Kong, if it involves any Hong Kong-listed securities or their derivatives

On the basis that it is preferable to operate from a uniform insider dealing regulatory framework applicable to trades of securities anywhere in the world. At present, for example, it is sub-optimal to regulate trades of Hong Kong securities under market misconduct provisions and to regulate trades of non-Hong Kong securities through the anti-fraud provisions.

4. Conclusion

We would be happy to discuss our submission further should this be useful.

TIMOTHY LOH LLP
Suite 1008, 10th Floor
St. George's Building
2 Ice House Street
Central, Hong Kong