

# **SFC Publishes Long-Awaited Conclusions on Enforcement-Related Reform Proposals**

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On 8 August 2023, the Securities and Futures Commission of Hong Kong (SFC) published its consultation conclusions on proposed amendments to enforcement-related provisions of the Securities and Futures Ordinance (Cap 571) of the Laws of Hong Kong (the SFO). The SFC will proceed with the proposal to broaden the territorial scope of the insider dealings provisions. However, taking into account the complex issues raised during the consultation, the SFC will not for now proceed with the proposal to extend the statutory remedy of injunctions and other orders to breaches of SFC codes of conduct and guidelines, or the proposal to limit the scope of the professional investors exemption for investment advertisements. Nonetheless, intermediaries are reminded that investment advertisements should include a warning or legend in a prominent place, making it clear on its face that the securities or investment product is only being offered to professional investors. The SFC indicated it would continue to assess the adequacy of its current avenues for seeking financial redress for investors with a view to enhancing investor protection.

## **INSIDER DEALING**

Currently, the insider dealing provisions in the SFO apply only to conduct in Hong Kong, involving securities listed on The Hong Kong Stock Exchange Limited. Insider dealing conducted in Hong Kong involving overseas listed securities would not constitute an offence under the SFO, but could constitute a breach of the SFC's codes of conduct if perpetrated by a licensed intermediary. Similarly, insider dealing conducted outside Hong Kong involving Hong Kong listed securities would not constitute an offence under the SFO, as the provisions are not currently extraterritorial.

The SFC proposed extending the scope of the insider dealing provisions under the SFO to cover (a) insider dealing perpetrated in Hong Kong involving overseas listed securities or their derivatives and (b) insider dealing perpetrated outside Hong Kong involving Hong Kong listed securities or their derivatives. Given the increasingly international nature of capital markets and trading, cross-border misconduct and enforcement is a priority for regulators globally. Accordingly, these proposals to enhance the insider dealing provisions were welcomed by a majority of the respondents in the consultation, and in its consultation conclusions, the SFC announced that it would proceed with the legislative process to enact the amendments. The SFC clarified in the consultation conclusions that in respect of insider dealing involving overseas listed securities, the proposal is that the conduct would only constitute insider dealing under the SFO if it would also be unlawful in the relevant overseas

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jurisdiction.

The draft amendments will be published in due course and be subject to the usual legislative process. A transition period is not currently envisaged but a timeframe for implementation has not yet been announced.

## **SECTION 213—INJUNCTIONS AND OTHER ORDERS**

Section 213 of the SFO allows the SFC to apply to the court for injunctions or other orders where there has been a breach of, among other things, certain provisions of the SFO or the terms and conditions of any license granted under the SFO. This remedy has been used to obtain injunctions and restraining orders, as well as compensation or restitution orders.

This remedy is available for breaches of certain statutory requirements under the SFO, but not for breaches of the SFC's codes of conduct or guidelines. This applies even if an intermediary has been found guilty of serious misconduct. The SFC considered this to be a gap in its statutory remedies and proposed to extend section 213 to include situations where the SFC has determined that an intermediary is guilty of misconduct, or is otherwise not fit and proper, and has exercised its disciplinary power to revoke or suspend the license of, or impose pecuniary penalties on, the intermediary.

This proposal was problematic on jurisprudential grounds, as it would have blurred the long-established distinction between legally binding statutory obligations, and codes and guidelines, which have no force of law. Codes of conduct are principles-based and broad to guide best practices, whereas the statutory provisions are baseline legal requirements and should clearly define the boundaries for legal liability. Intermediaries are encouraged to raise code issues proactively with the SFC to seek the best practical outcome for clients. However, where there is an alleged breach of statutory obligations, an intermediary is entitled to adopt a more defensive strategy to defend its legal rights, including exercising its right against self-incrimination. Extending section 213 to a breach of regulatory duties could have introduced significant uncertainties for regulated persons.

The proposal also posed procedural issues. An exercise of the SFC's disciplinary powers is subject to an appeals procedure. Under the proposed amendments, there would have been the possibility of a court considering a section 213 application while a disciplinary appeals procedure is ongoing, with the potential for contradictory outcomes. The SFC acknowledged this issue and indicated that it had proposed to not commence section 213 proceedings until any disciplinary appeals procedure had been exhausted. In addition, there was concern that the proposals may extend the limitation period under the SFO, which commences from the date of the loss or breach. Under the proposal, the section 213 order is triggered after the disciplinary decision by the SFC, which would in effect postpone the commencement of the limitation period from the date of loss or breach to the date of the decision. The SFC indicated this was not the intention but accepted it would have been the result of the proposals.

The SFC maintains that the current available remedies for compensating aggrieved investors are not sufficient, particularly where the breach in question is solely in relation to the SFC's codes and guidelines and not the SFO. However, taking into account the complex issues raised in the consultation, the SFC has decided to put these proposals on hold for now.

## **SECTION 103—INVESTMENT ADVERTISEMENTS AND PROFESSIONAL**

## INVESTORS EXEMPTION

Subject to certain exemptions, section 103 of the SFO prohibits the issue of investment advertisements without prior authorization by the SFC. One such exemption is where the advertisement is issued in respect of securities or investment products that are intended to be disposed of only to professional investors.

In practice, an investment advertisement would typically include an appropriate legend that the securities or product is only being offered to professional investors, and the professional investor status would be confirmed by the intermediary (through know-your-client (KYC) procedures and investor representations) prior to the securities or product being sold to the investor. However, the investment advertisement may be distributed to or seen by persons who do not qualify as professional investors.

The SFC's concern is that this may expose retail investors to unauthorized advertisements of complex or risky investment products suitable only for professional investors and that such products may be sold to retail investors in breach of suitability requirements. The proposal was to limit the professional investor exemption to investment advertisements that are only issued to professional investors who have been identified as such by the intermediary through KYC procedures.

The proposal presented practical difficulties and did not reflect the commercial realities of product marketing. For example, private wealth clients may not be willing to open an account and provide KYC information unless they had received product flyers for investment products that interested them. Requiring the intermediary to establish professional investor status before sending out any product flyers could unduly limit the intermediary's ability to market to new clients. Furthermore, it was unclear how the exemption could operate with online marketing at a time when financial markets are becoming more international and embracing multimedia channels of distribution.

Taking into account the concerns raised in the consultation, the SFC has decided not to proceed with this proposal in the current form. However, intermediaries were reminded that to rely on the exemption, they must demonstrate a clear intention to dispose of the investment products only to professional investors. The investment advertisement should include a warning or legend in a prominent place, making it clear on its face that the securities or investment product is only being offered to professional investors.

## CONCLUDING COMMENTS

Having a robust regulatory and enforcement framework is vital to maintaining Hong Kong's status as a leading international financial center. We welcome the SFC's continued efforts to strengthen our regulatory regime and willingness to consider industry feedback in developing an appropriate framework.

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