Tackling Market Misconduct
Enforcement Division

An article on the new market misconduct regime under the Securities and Futures Ordinance (SFO) is available on the SFC website[1]. Its main points are highlighted here[2]:

The SFO will become law in early 2003. Its new "market misconduct" regime is aimed at better protecting Hong Kong's markets and investors from the detrimental effects of serious crime and misconduct.

Existing regime inconsistent

Presently, insider dealing is a civil wrong, whilst other forms of market misconduct are crimes. The Insider Dealing Tribunal's (IDT) flexible inquisitorial procedures contrast starkly with the complex criminal procedures, which have inhibited the prosecutions of complex market manipulation. Moreover, those successfully prosecuted often faced fines with little deterrent effect, the maximum under the Securities Ordinance being only $50,000.

By international standards, the IDT has achieved good success, owing to its civil proceedings, flexibility, and its effective penalties.

Original proposal, human rights constraints and modifications

In 1999, a Market Misconduct Tribunal (MMT) modelled on the IDT, that has jurisdiction over all forms of market misconduct, was proposed.

Originally, the MMT was to retain the IDT's fining powers. However, international human rights law developments meant that, if the MMT were to keep high fines, its proceedings would have to become more "criminal" in return. To retain the IDT's most important procedural features, the MMT had to abandon high fines.

It was decided to retain the IDT's procedural flexibility, which is instrumental to its success. High fines were substituted by new civil sanctions, such as "cold shoulder" orders, and compound interest for disgorgement orders.

To enhance the new regime's deterrent effect, a criminal regime will be retained alongside the MMT. Also, it will be procedurally easier for market misconduct victims to sue the perpetrators for damages.

An overview: more effective market misconduct laws

The SFO will

- largely re-enact the existing insider dealing laws, but will improve the current laws on market manipulation and disclosure of false and misleading information;
- allow market misconduct victims to seek compensation from the perpetrators provided it is fair, just and reasonable;

[1] *An article entitled "Fairer markets: the SFO and more effective market misconduct laws" was prepared by Mr. Eugene K.T. Goyne, Director of the Enforcement Division of the Securities and Futures Commission.*

[2] *The excerpt was prepared by Mr. Daniel Lam, Manager of the Enforcement Division.*

- empower the SFC to create defences to the market misconduct provisions, in order to speedily meet the needs of rapidly changing business practices.

Market Misconduct Tribunal and the dual regime

Following the SFC's investigations into suspected market misconduct, decisions on whether to take civil (MMT) or criminal proceedings will be made in accordance with the Department of Justice's existing prosecution policy.

In addition to its extended jurisdiction and expanded range of penalties, the MMT will have a Presenting Officer, replacing the counsel assisting the IDT. He is more like a prosecuting counsel and is more independent.

Insider dealing

While re-enacting the existing insider dealing and the civil IDT provisions with some clarifications and improvements, significantly, the SFO will also criminalize insider dealing and create some new defences.

Forms of market manipulation

The existing market manipulation law has room for improvement. The new provisions, based on Australian laws which have proven to be effective, will create identical civil and criminal provisions outlawing:

- false trading
- price rigging
- stock market manipulation

The **false trading** provisions will outlaw 4 types of conduct:

- creating a false or misleading appearance of active trading with respect to securities or futures
- transactions that create or maintain an artificial price for securities or futures
- "wash sales", ie trades involving no change in beneficial ownership
- "matched orders", ie a person selling at a price at which he or his knowing associate has offered to buy a similar number of securities and vice versa

In relation to last 2 types, no mental element need be proved, but it will be a defence that none of the trader's purposes were to create a false or misleading appearance.

The prohibition against **price rigging** will cover 2 scenarios:

- engaging in wash sales which have certain effects (eg reduction, stabilization) on securities' prices; here, the defendant has to prove their purposes were innocent
- using fictitious or artificial transactions to achieve certain effects on securities' or futures' prices

The **stock market manipulation** provisions will outlaw engaging in transactions in securities that affect any securities' prices, intending to induce certain investment decisions about such securities or related securities.

Disclosure of false or misleading information about securities or futures

The SFO will outlaw the disclosure of false or misleading information about securities or futures likely to induce investment decisions or materially affect price. Negligence is sufficient mental element for civil liability. However, defences are available for businesses involved in passively disseminating information from others, eg printers and publishers.

Disclosure of information about prohibited transactions

The SFO will outlaw a person disclosing information that a transaction contravening the market misconduct provisions will affect specific securities' or futures' prices, if he or his associate has entered into that transaction, or will benefit from the disclosure. The purpose is to prevent market misconduct perpetrators from spreading information relating to their offending transactions.

Duty to act to prevent market misconduct

The SFO will require a corporation's officers to take reasonable measures to prevent the corporation from contravening the market misconduct provisions. If an officer or officers breach their duty, they will be subject to MMT orders, but are not civilly liable.