The Securities and Futures Commission
54/F, One Island East
18 Westlands Road, Quarry Bay
Hong Kong

12 August 2022

Re: Consultation Paper on Proposed Amendments to Enforcement-Related Provisions of the Securities and Futures Ordinance

Dear Sir/Madam,

The Asia Securities and Financial Markets Association (**ASIFMA**)[1] appreciates the opportunity to respond to the Securities and Futures Commission (**SFC**)'s Consultation Paper on Proposed Amendments to Enforcement-related Provisions of the Securities and Futures Ordinance (**SFO**) (**Consultation Paper**). Feedback set out in this response has been collected from ASIFMA's members, including those who participated in a working group set up for the purposes of responding to the Consultation Paper.

ASIFMA wishes to thank the SFC for the opportunity to share this feedback on the Consultation Paper. We would greatly appreciate the opportunity to meet with the SFC to discuss this feedback with the SFC in further detail. Please let us know when it would be an appropriate time for us to do so.

Unless otherwise defined herein, the terms used in this response have the meanings assigned to them in the Consultation Paper. As a general observation, while our members are generally supportive of a number of the SFC's proposals in the Consultation Paper, we note that our responses as set out below are in relation to the proposals <u>as outlined</u> in the Consultation Paper. However, the level of detail provided by the SFC in relation to each of these proposals varies significantly and the Consultation Paper does not include draft text for these amendments. This has made it difficult for us and our members to provide exhaustive feedback on these proposals. Given the significance and ramifications for the industry of a number of the SFC's proposed amendments, we believe it is critical for the SFC to provide an opportunity for further consultation following

[1] ASIFMA is an independent, regional trade association with over 160 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, and competitive Asian capital markets that are necessary to support the region's economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the United States and AFME in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region.

the publication of the text of the proposed amendments, so to ensure that the industry is fully consulted regarding the nature of these amendments.

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.**

ASIFMA and its members have a number of significant concerns regarding the proposed amendments to section 213 of the SFO, which are outlined below. While we are not opposed to measures to improve investor protection and understand the SFC's aims in seeking to introduce these amendments, we generally do not agree with the proposal as currently articulated by the SFC and consider its introduction would be a significant departure from the existing legislative framework, which empowers the SFC to issue codes and guidelines, while also being out of kilter with the approach adopted by comparable jurisdictions.

However, if the SFC does decide to proceed with this proposal, we consider that it is imperative that the SFC provide more robust, detailed and prescriptive guidance regarding its approach to disciplinary proceedings, fining powers and the seeking of section 213 orders. There are also a range of matters on which the industry would appreciate clarification from the SFC prior to the implementation of these proposed amendments. Further, as noted above, we consider it crucial that the SFC consults further on the actual text of the proposed amendments to section 213, so that the industry may raise any further concerns or matters for clarification with the SFC. We consider this to be particularly important with regard to section 213, given the magnitude of the proposed changes and the potential impact which orders under the revised section 213 may have on firms.

A) <u>Concerns regarding use of disciplinary actions based on breaches of SFC codes and guidelines and/or findings regarding fitness and properness as a trigger for significant pecuniary penalties</u>

ASIFMA and its members have concerns about the appropriateness of the proposed use of disciplinary actions, based on breaches of SFC codes and guidelines and/or findings regarding fitness and properness, as a trigger for significant pecuniary penalties (in the form of damages and/or compensation orders) being made against licensed or registered persons.

First, we are concerned that amending section 213 to allow the SFC to apply for orders under this provision where the SFC has exercised its powers under sections 194 and 196 against a regulated person, including as a result of findings that a person has breached the SFC's codes and guidelines, is inconsistent with the current legal status of the SFC's codes and guidelines. In particular, we note that section 169(1) of the SFO, which empowers the SFC to publish codes of conduct, describes such codes as being '*for the purpose of giving* *guidance relating to the practices and standards with which intermediaries and their representatives are ordinarily expected to comply in carrying on the regulated activities for which the intermediaries are licensed or registered.*' Similarly, section 169(4) of the SFO notes that '*a failure on the part of an intermediary, or a representative of an intermediary, to comply with the provisions set out in any code of conduct published under this section… shall not by itself render it or him liable to any judicial or other proceedings*'. Section 399 of the SFO also provides that the Commission '*may publish…such codes and guidelines as it considers appropriate for providing guidance…for the furtherance of any of its regulatory objectives* [or]…*in relation to the operation of any provision of this Ordinance*'.

The SFC's own website notes that:

> [The SFC's] *codes and guidelines are not subsidiary legislation and failure to comply with them does not by itself render a person liable to any judicial or other proceedings. The codes and guidelines, for example, seek to assist intermediaries to comply with applicable regulatory requirements so that they are fit and proper to remain licensed or registered.*[2]

However, the practical effect of the SFC's proposed amendments to section 213 would be to transform the SFC's codes and guidelines from a source of guidance as to the practices and standards expected of licensed firms, to documents which in practice may give rise to the imposition of significant, uncapped pecuniary penalties where the SFC chooses to seek orders under section 213 where firms are found to have contravened them.[3] We are concerned that this:

- Appears likely to be inconsistent with the legislative provisions empowering the SFC to issue such documents (i.e. sections 169 and 399 of the SFO);
- Is likely to have undesirable outcomes, given that the manner in which the SFC's codes and guidelines have been introduced, consulted on and amended from time to time is significantly different to, and less robust than the process by which legislative requirements are introduced, deliberated upon and amended (including, for example, in the SFO itself). Further, given that the codes and guidelines have historically been described by the SFC as '*guidance* [to assist] *intermediaries to comply with regulatory requirements*'[4], rather than as standalone regulatory requirements in their own right, these documents have been drafted in a way that is often very different from the approach taken to legislative drafting. For example, the SFC's Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**) includes general principles that, while suitable for inclusion in

[2] See https://www.sfc.hk/en/Rules-and-standards/Codes-and-guidelines.

[3] We note, for example, that the SFC clearly suggests in the Consultation Paper at paragraph 9 that one of its current concerns with the status quo is that '*a breach of the SFC's codes and guidelines (eg, the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission) by a regulated person, however serious, cannot currently give rise to a cause of action under section 213 if it does not fall within any of the circumstances outlined in paragraph 6.*'

[4] See https://www.sfc.hk/en/Rules-and-standards/Codes-and-guidelines.

guidance provided to the industry, are nevertheless very clearly different in their nature and framing than the "relevant provisions" identified in the current formulation of section 213(1), which are generally drafted with an eye to precision and certainty. Given this, ASIFMA and its members have significant concerns about the appropriateness of these provisions forming the basis for orders exposing intermediaries to potentially very substantial, uncapped pecuniary penalties; and
- Is inconsistent with the approach taken in comparable jurisdictions such as Australia and Singapore, which is likely to affect Hong Kong's international competitiveness (as discussed below).

Second, ASIFMA and its members are concerned that there are significant differences between the process by which the SFC decides to exercise its disciplinary powers under sections 194 or 196, versus the process through which the Court of First Instance (**CFI**) determines under section 213(1) that it may make an order under section 213(2) (e.g. as a result of a finding that there has been a contravention of a relevant provision).

Notably, while any finding by the CFI that there has been a contravention of a relevant provision will be the result of a robust court process handled in accordance with detailed procedural rules, this is very different from the process by which the SFC may make a determination to exercise its powers under sections 194 or 196. In particular, we note that the SFC's existing guidance regarding the way in which it approaches disciplinary proceedings[5] and exercises its fining power[6] is very high level and generic in comparison to international equivalents, which generally provide significantly more detailed, prescriptive and robust guidance regarding the processes and procedures followed by regulators in taking disciplinary actions.[7] While the guidance adopted by international peers of the SFC nevertheless stop short of the level of rigor that may be associated with court procedure, we consider that guidance of this type does however provide a firmer foundation for taking disciplinary actions and/or imposing pecuniary penalties than the SFC's current guidance. For example, we note that not only is the SFC's guidance brief when compared to other international standards, but it also makes it clear that significant discretion still lies with the SFC regarding the process through which it makes a decision to take disciplinary action. For example, in contrast to the process through which the CFI may determine that a relevant provision has been contravened (which we would expect to involve multiple court hearings), there is no default entitlement to make oral submissions to the SFC as part of the disciplinary process.

ASIFMA and its members are concerned that, without more robust, detailed and prescriptive guidance being issued by the SFC regarding its approach to disciplinary proceedings and fining powers, a finding by the SFC

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[5] See https://www.sfc.hk/en/Regulatory-functions/Enforcement/Disciplinary-proceedings.
[6] See https://www.sfc.hk/-/media/EN/assets/components/codes/files-current/web/guidelines/disciplinary-fining-guidelines/disciplinary-fining-guidelines.pdf.
[7] See, eg, the UK Financial Conduct Authority's Enforcement Guide and Decision Procedure and Penalties Manual (**DEPP**), available here: https://www.handbook.fca.org.uk/handbook/EG/ and https://www.handbook.fca.org.uk/handbook/DEPP/.

under sections 194 or 196 based on the process in place today may not be regarded by the CFI as a sufficiently clear foundation on which it may base an order under section 213 imposing significant pecuniary penalties (in the form of potentially uncapped damages and/or compensation orders). Similarly, we consider it key that the SFC provides detailed guidance as to the circumstances in which it will seek orders under the amended section 213, and in particular the factors which the SFC intends to take into consideration in deciding whether to seek damages as opposed to (or in addition to) compensation / restitutionary orders. This sort of guidance would be of significant benefit to both the CFI and the industry, in terms of providing much needed certainty in relation to the intended use of these amended provisions.

Given this above, we firmly believe that if the SFC does proceed with amending section 213 as outlined in the Consultation Paper, these amendments should be accompanied by further amendments to section 213 requiring the SFC to refrain from seeking orders under section 213 based on the exercise of the SFC's powers under sections 194 and 196 unless a) it has consulted on and published detailed guidelines indicating its intended approach to seeking such orders and b) agrees to follow those guidelines.[8] Further, we consider that these guidelines regarding seeking orders under section 213 should be complemented by the amendment of the SFC's existing guidance regarding disciplinary actions[9] to provide significantly more detailed and prescriptive guidance regarding the way in which it conducts enforcement proceedings and takes disciplinary action.[10] At the very least, to provide reassurance to the industry we would strongly encourage the SFC to voluntarily commit to consulting on draft guidance prior to the amendment of section 213.

B) <u>The SFC's proposed approach is out of step with comparable jurisdictions</u>

[8] These amendments would be modelled on the requirement under section 199 which require the SFC to refrain from performing its functions under sections 194(2) or 196(2) unless similar requirements are complied with.
[9] See https://www.sfc.hk/en/Regulatory-functions/Enforcement/Disciplinary-proceedings.
[10] For example, such guidance could be modelled on the FCA's Enforcement Guide and DEPP, which cover topics such as:

- Criteria considered by the FCA in whether to exercise its powers to obtain restitution, including whether profits are quantifiable, losses are identifiable, the number of persons affected and whether redress is available elsewhere, including through another regulator or compensation scheme;
- Decision making in relation to issue of decision notices;
- Factors considered in relation to the length of a suspension or restriction of an individual or firm's licence;
- Processes for negotiation of a settlement;
- Factors relevant to whether the FCA will seek an injunction;
- Factors relevant to whether the FCA will commence criminal proceedings; and
- Factors relevant to the FCA's decision to investigate a particular matter and/or take enforcement action.

ASIFMA and its members appreciate that the pecuniary penalties which may be ordered by the SFC in relation to disciplinary proceedings under sections 194 and 196 may appear comparatively modest when viewed in contrast to those which may be ordered by regulators in other major international financial centres. However, we are concerned that the proposed amendments to section 213 to allow for what appear to be uncapped compensation orders and / or damages orders in relation to breaches of SFC codes and guidelines would be out of step with the approaches adopted in comparable jurisdictions. In particular, we note that:

- Compensation / restitutionary orders may only be sought by regulators in the UK,[11] Singapore[12] and Australia[13] in respect of particular categories of statutory breaches, rather than contraventions of regulatory guidance such as codes and guidelines; and
- Similar to the existing limits on the SFC's power to impose pecuniary penalties, there are caps on the magnitude of penalties available in both Australia[14] and Singapore[15] in relation to breaches of relevant legislative provisions.

Given the above, ASIFMA and its members are concerned that the amendments to section 213 would be a significant departure from the approach taken to penalties and compensation more broadly in other leading

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[11] Section 382 of the Financial Services and Markets Act 2000 (**FSMA**) provides that a restitution order is available where the court is satisfied that a person has contravened a "relevant requirement, or has been knowingly concerned in the contravention of such requirement". A relevant requirement is defined as:

- Requirement imposed by or under the Financial Services and Markets Act 2000, or by a qualifying provision specified, or of a description specified, by the Treasury by order;
- Requirement imposed by or under any other Act and whose contravention constitutes an offense under s 402(1) (i.e. insider dealing, regulations relating to money laundering, terrorist financing / money laundering);
- Requirement imposed by the Alternate Investment Fund Managers Regulation 2013;
- Requirement imposed by Pt 7 of the Financial Services Act and whose contravention constitutes an offence under that Part (offences relating to financial services).

[12] The Monetary Authority of Singapore (**MAS**) is empowered to take civil penalty action (which may include compensation orders) in respect of disclosure offences under Part VII of the Securities and Futures Act (**SFA**) and market misconduct offences under Part XII of the SFA.

[13] The Australian Securities and Investments Commission (**ASIC**)'s power to seek compensation orders as part of civil penalty proceedings is limited to only to breaches of the provisions identified in section 1325(1), Corporations Act; section 12GM, ASIC Act; and section 178, National Credit Act.

[14] The maximum civil penalty for individuals is the greater of the following per contravention of a civil penalty provision: 5,000 penalty units (currently AUD$1.11 million / approximately 6m HKD) or three times the benefit obtained and detriment avoided. The maximum civil penalty for companies is the greater of the following per contravention of a civil penalty provision:

- 50,000 penalty units (currently AUD $11.1 million / approximately 60m HKD)
- three times the benefit obtained and detriment avoided, or
- 10% of annual turnover, capped at 2.5 million penalty units (currently AUD $555 million / approximately 299m HKD).

[15] MAS may make submissions to the court as to the appropriate quantum of penalty to be ordered. However, the SFA will also identify certain maximum penalties for specific types of contraventions. In the case of market misconduct offences, for example, the penalty can be up to the greater of three times the amount of profit made or the amount of loss avoided as a result of the contravention, or SGD$2m (approximately 11.3m HKD).

jurisdictions in two key respects, which we consider likely to have a particularly detrimental impact on Hong Kong:

- First, while we appreciate that a cap on compensation / restitutionary orders is by definition impractical, ASIFMA and its members are deeply concerned that the lack of a cap on damages under section 213 will put Hong Kong at a comparative disadvantage vis a vis other comparable regional centres, such as Singapore and Australia. In particular, we are concerned that the lack of predictability with regard to the total financial impact of an enforcement action may exacerbate the current trend towards relocation of staff and/or business units with regional (rather than Hong Kong specific remits) to other APAC jurisdictions in the context of Hong Kong's ongoing Covid-19 restrictions. If this occurs, this is likely to have a significant impact on Hong Kong's status as an APAC "hub", which is a status intrinsically linked to its status as an international financial centre.
- Second, we are concerned that allowing compensation orders to be sought in relation to breaches of codes and guidelines, rather than statutory requirements, will also put Hong Kong at a significant disadvantage in comparison to Australia and Singapore, by widening the scope of breaches which may give rise to significant financial penalties.

In conclusion, ASIFMA and its members consider that the proposed amendments to section 213 are out of kilter with the approaches to enforcement adopted in comparable jurisdictions, and as such are likely to have an impact on Hong Kong's international competitiveness, given that these amendments appear likely to significantly increase the potential financial impact on intermediaries that are the subject of disciplinary proceedings by the SFC. In particular, members are particularly concerned that these amendments will significantly increase the cost of doing business in Hong Kong (and thus the attractiveness of this market) at a time in which Hong Kong's status as an international financial centre is already under considerable pressure from other financial centres, due to the ongoing Covid-19 restrictions.

C) <u>Matters on which clarification is required</u>

In addition to the above, there are a range of matters on which our members would appreciate clarification if the SFC does decide to proceed with this proposal:

- First, we would welcome a policy statement from the SFC that an amended section 213 would apply only to disciplinary actions taken by the SFC pursuant to sections 194 or 196 after the commencement of the amended section 213, in respect of conduct which also occurred after the commencement date.
- Second, we would welcome clear statements in the amended legislation regarding the role of the CFI in reviewing the exercise of the SFC's powers under sections 194 and 196 as part of the CFI's determination as to whether it is '*desirable*' under section 213(4) to make the orders sought by the SFC. We consider it important that such statements address the SFC's expectations with regards to how any such review

would interact with the role of the Securities and Futures Appeals Tribunal, and the standard that would be applied in any such review – for example, would it be a merits review or a judicial review.

- Third, we would welcome guidance in the amended legislation regarding the definition of damages and the SFC's intended approach to the calculation of damages where it seeks damages orders from the CFI under section 213(8). Our understanding at present is that the SFC does not intend to impose a cap on the damages payable under this provision, which, as outlined above, we are concerned will have a detrimental impact on Hong Kong's competitiveness. However, notwithstanding this issue, it would be much appreciated if the SFC could clarify as to whether it considered that the approach which should be taken to damages would be one based on profit gained or loss avoided. If so, it would be much appreciated if the SFC could clarify whether it would only seek a damages order from the CFI <u>instead</u> of imposing a pecuniary penalty pursuant to sections 194 and 196, given that the SFC already has power to order pecuniary penalties based on profit gained or loss avoided under those provisions. If the SFC intends to take a different approach towards the calculation of damages orders sought from the CFI, it would be very helpful if the SFC could clarify this and provide an explanation of its intended approach to damages orders, including in situations such as IPO sponsor cases and product mis-selling.
- Fourth, while we appreciate that the SFC does already seek compensation / restitutionary orders under section 213(2)(b), it appears likely from the SFC's comments in the Consultation Paper that this provision will become increasingly relied upon by the SFC if it decides to proceed with the amendments outlined in the Consultation Paper. Given this, it would be much appreciated if the SFC could provide further guidance regarding its intended approach to the identification of persons entitled to receive payments as a result of an order under the amended section 213(2) in certain situations – e.g. IPOs and mis-selling of complex products
- Fifth, the proposed section 213(1)(c) would allow the SFC to apply for orders under section 213 where it has <u>exercised</u> any of its powers under sections 194 or 196 against a regulated person. However, we would appreciate confirmation that this means that the SFC must have already made a decision under sections 194 or 196 <u>and</u> that the licensed person against whom such a decision has been made must have already exhausted all avenues of appeal with respect to that decision (e.g. the right to appeal to the SFAT), prior to the SFC making an application to the CFI for an order under section 213(1)(c). Further, we would appreciate clarification as to how long the SFC would have to make an application to the CFI under section 213(1)(c) after it has exercised its powers under sections 194 or 196, and confirmation that however long this period is would <u>not</u> effectively extend the limitation period available in respect of such a claim.
- Sixth, it would be much appreciated if the SFC could provide guidance as to the types of situations in which it intends to seek compensation / restitutionary orders against senior managers (e.g. responsible officers and/or managers in charge), and in particular whether it would limit the seeking of such orders against senior managers to situations in which misconduct has been directly committed by the manager and/or involves willfulness and/or dishonesty.

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

We repeat our comments with regard to the proposed amendment of section 213 of the SFO as set out above.

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.

ASIFMA and its members have significant concerns regarding the proposed amendments to sections 103(3)(k) and 103(3)(j), which we consider likely to impose substantial additional burdens on the industry.

Further, and as noted in the introduction to this response, we consider it imperative that the SFC consults further on the actual text of their proposed amendments to section 103(3)(k) (and section 103(3)(j)) so that the industry has an opportunity to comment on any unintended consequences that may arise as a result of the text proposed by the SFC, particularly as it is currently unclear exactly how the SFC proposes to amend these provisions in order to achieve the end result sought by the SFC as outlined in the Consultation Paper.

A) Proposed amendments to section 103(3)(k)

ASIFMA and its members are concerned that the proposed amendments to section 103(3)(k) will require significant changes to the way in which products are currently offered and advertised to professional investors (**PIs**), in ways that are disproportionate to the SFC's concerns as set out in the Consultation Paper.

Impact on intermediaries

At present, intermediaries will generally undertake steps to verify a client's PI status at onboarding.

However, in certain cases, a range of intermediaries (e.g. private banks, investment banks and asset managers) may distribute unauthorized advertisements, mainly in the form of the provision of marketing materials in one-to-one communications, to a prospective client prior to onboarding, based on the intermediary's KYC processes and the intermediary's reasonable belief that the client would meet the PI requirements.

In other cases, unauthorized advertisements may be sent to a client who may control various accounts (such as an individual name account, a family trust and a private investment vehicle). At the point of the provision of the materials, the intermediary may have already taken steps to verify the PI status of the individual name account. However, the client may ultimately invest through another legal entity for which the firm will have not verified the PI status at the point of distribution of the advertisements (although PI status will of course be verified prior to the point of sale). However, in this case again the intermediary will have provided the materials where on the basis of having reasonable grounds to believe the investing entity would meet the PI requirements, based on that intermediary's KYC processes.

In all cases, the materials (or advertisements) will also state the unauthorized investment product may only be sold to PIs and the intermediary will verify the client's PI status prior to the client investing into the investment product.

The Consultation Paper states that '*following the proposed amendments, 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 and related procedures, regardless of whether or not such an intention has been stated on the advertisements*.' ASIFMA and its members consider there to be ambiguity as to what degree of certainty the SFC expects of intermediaries with regard to the identification of PI status through KYC and '*related processes*', with this ambiguity being amplified by the fact that the SFC has not made the proposed legislative text available for consultation at this stage. As noted above, we consider it important for the SFC to consult on the form of that text and look forward to an opportunity to do so in the future.

However, we consider that it would be sensible for the SFC to provide guidance indicating that intermediaries may rely on having established <u>reasonable grounds</u> (through KYC and related procedures) to believe that the recipient of such materials meets the PI requirements, rather than requiring intermediaries to have taken steps to verify this status. <u>Verification</u> of such status would of course be done prior to investing in the product (as is done today under the status quo). Our members believe that this approach should be sufficient to ensure that retail investors are not provided with '*unauthorised offers or solicitations to invest in risky or complex products which are unsuitable for them*' as per the SFC's objective as set out in the Consultation Paper. Further, we consider that even in the event that a retail investor <u>does</u> inadvertently receive such materials (for example, due to the investor misrepresenting their wealth to an intermediary), the robust PI verification processes put in place by intermediaries to comply with the SFC's existing requirements with regard to PIs will be sufficient to ensure that a retail investor cannot in fact <u>invest</u> in such a product, which we consider would present a significantly greater harm to the investor in comparison to merely being provided with marketing materials regarding such a product.

We consider that without this sort of guidance and clarification from the SFC, the SFC's proposed amendment to section 103(3)(k) will have disproportionate impacts on intermediaries, as it will:

- Require intermediaries to undertake PI verification much earlier in a client relationship than currently occurs, and that this will create a situation in which an intermediary will be required to request that a prospective client provides sensitive information relevant to verification of PI status prior to a client establishing if they actually wish to invest with that particular intermediary (as this decision will normally only be made once the prospective client has had the chance to consider advertising materials for the intermediary's product offerings). In short, this is likely to create a situation in which a prospective client may approach an intermediary seeking details of a particular product, but the intermediary will be required to request information regarding the prospective client's PI status prior to providing those product details – to which the prospective client may respond by informing the intermediary that they are unwilling to provide those details until they receive details of the product. Such a "circular loop" situation would disproportionately hamper intermediaries' efforts to onboard clients.

- Require clients to identify which of their accounts they may wish to invest in a particular product through, before they have had the chance to fully consider the nature of the product after receiving advertising materials regarding that product.

Impact for online marketing

Our members are also concerned that the SFC's proposal would have a significant impact on online marketing. In particular, our members are concerned that this will impact on intermediaries' online marketing in a range of situations, including where intermediaries:

- Make marketing materials freely available on their website to users in a range of jurisdictions, including Hong Kong;
- Allow interested investors to sign up to receive marketing materials via email distribution lists; and/or
- Require only self-certification of PI status in order to access marketing materials through their website.

On the basis of the SFC's proposal as set out in the Consultation Paper, it appears highly likely that these forms of marketing will contravene section 103(3)(k), even where such marketing materials note that the products in question are intended to be sold only to PIs and that verification of PI status will be required prior to any sale taking place. Our members are concerned that this will significantly impact on their marketing efforts, and may impact the competitiveness and profitability of their Hong Kong based businesses in comparison to those located in other jurisdictions with fewer restrictions on online marketing. Ultimately, this may also lead to less choices being made available online to PI clients of Hong Kong based businesses. To the extent that the SFC considers that any of the above forms of distribution (including, for example, self-certification of PI status) would be compliant with the amended form of section 103(3)(k), ASIFMA and its members would welcome clarification of this.

Clarification sought from the SFC regarding liability for secondary distribution

Given the very broad definition of "issue" for the purposes of section 103 of the SFO (which we note includes '*distributing or otherwise disseminating*' materials), we would also welcome clarification from the SFC regarding intermediaries' liability for secondary distribution of their materials to non-PIs, both in relation to onward distribution by the initial recipient of materials, as well as liability for the conduct of distributors and/or promoters. In particular, we would welcome confirmation from the SFC that there will be statutory defences available to intermediaries who have taken reasonable steps to limit circulation of their materials to PIs only.

In the alternative, we would welcome clarification from the SFC as to what it would consider to constitute reasonable steps to limit circulation of materials to PIs only. For example, does the SFC consider that it would be sufficient for an intermediary to require a distributor / promoter to agree in their distributor / promoter agreement that marketing materials must not be distributed to non-PIs? Or would a clear disclaimer in the marketing materials noting that the materials must not be redistributed be sufficient?

Confirmation sought from the SFC regarding impact of proposed amendments

Given the significance of the proposed amendments to section 103(3)(k), ASIFMA and its members would welcome confirmation from the SFC that the proposed amendments to section 103(3)(k) will not have broader ramifications for the industry's reliance on certain other exemptions in relation to PIs, including the exemptions under sections 174 and 175, as well as the carveouts in Schedule 5 from the definitions of 'dealing in securities' and 'dealing in futures contracts', where a person acts as principal and deals only with PIs.

Similarly, we note that under Part 1 of the Seventeenth Schedule of the Companies (Winding Up and Other Miscellaneous Provisions) Ordinance (Cap. 32) (**CWUMPO**), offers of shares or debentures (including advertisements of such offers) to PIs are excluded from compliance with prospectus requirements under CWUMPO. However, there is no corresponding requirement under CWUMPO for the issuer of an offering document (or other advertisement of an offer) to ensure that recipients of such advertisements are in fact PIs prior to distribution of the relevant document.

Creation of uneven playing field vis a vis insurers

Our members are also concerned that the proposed amendment to section 103(3)(k) is likely to exacerbate the already uneven "playing field" that exists between intermediaries and insurers in Hong Kong. In particular, we note that insurers are generally not subject to the requirement to assess the PI status of investors prior to distribution of marketing materials,[16] and that this means that retail customers in Hong Kong may receive marketing materials for complex insurance products even though distribution of equivalent materials in relation to investment products would be prohibited. As such, our members are concerned that the imposition of this requirement will place intermediaries at a disadvantage with regard to the sale of products vis a vis insurers. As such we would urge the SFC to work with the Insurance Authority to ensure that a level playing field is applied across the two industries in order to adequately protect retail investors and ensure that there is no regulatory arbitrage between licensed firms / registered institutions and insurance companies.

Clarification sought regarding non-Hong Kong domiciled umbrella funds

[16] For the avoidance of doubt, we note that insurers are subject to some equivalent requirements under the Insurance (Special Purpose Business) Rules in relation to insurance-linked securities.

We note that non-Hong Kong domiciled umbrella funds may consist of some sub-funds authorized by the SFC as well as other funds that are not authorized by the SFC. At present, the details of all sub-funds will be presented in the same prospectus and/or annual report which is widely distributed in Hong Kong, although this document will always clearly indicate which sub-funds are authorized and which sub-funds are not. Our members would be grateful for clarification from the SFC as to whether the proposed amendment to section 103(3)(k) would mean that no unauthorized funds may be included in this document.

B) Impact of proposed amendments to s 103(3)(j)

ASIFMA and its members similarly have significant concerns regarding the impact of proposed amendments to section 103(3)(j) of the SFO.

First, even where an intermediary may have confirmed that a recipient of its advertisements, invitations or documents in respect of securities and other relevant productions under section 103 is based outside of Hong Kong at the time that the recipient is added to the intermediary's distribution list, we are concerned that intermediaries are likely to struggle to ensure that the recipient is physically outside of Hong Kong at the time a particular advertisement, invitation or document is in fact distributed. We consider this issue to be particularly problematic in relation to materials distributed via email or available for download via an intermediary's website.

We consider there would be significant logistical difficulties associated with, for example, an intermediary requiring its clients to notify them of any travel in or out of Hong Kong on a continuous basis as a condition of continuing to receive marketing materials (as opposed to as a condition of acquiring investment products). We would further expect that the vast majority of clients would not be willing to provide such information to an intermediary for the purposes of allowing the intermediary to comply with this provision. As such, we would welcome clarification from the SFC that:

- It would be sufficient for an intermediary relying on the exemption under s 103(3)(j) to confirm at any time prior to distribution of materials that the recipient is based outside of Hong Kong (i.e. has a non-Hong Kong contact address); and
- The SFC does not intend the amendments to section 103(3)(j) to require an intermediary to verify the current physical location of the recipient outside of Hong Kong at the time of distribution of such materials.

Finally, we would also welcome the SFC's confirmation that, as per our concern raised above in relation to liability for secondary distribution to non-PIs, the SFC will not consider the intermediary to have contravened section 103(3)(j) where an intermediary has sought to verify that the recipients of particular materials are currently located outside of Hong Kong, but materials are then forwarded on and eventually are distributed to Hong Kong based investors.

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.**

ASIFMA and its members are generally supportive of this proposal, which, as noted in the Consultation Paper, would bring Hong Kong into line with other comparable jurisdictions. However, members would greatly appreciate an opportunity to review and comment on the text of the proposed amendments for the reasons given above.

However, members would appreciate further guidance and clarification from the Commission on two matters connected with this proposal:

- Applicability to debt securities, including OTC trades in debt securities: Given that the definition of "security" under the SFO includes categories of debt instruments such as debentures and bonds, our working assumption is that these proposed amendments would apply to overseas-listed debt securities as well as equity securities. However, members would appreciate clarification as to whether these amendments would apply in relation to OTC transactions in overseas listed debt securities.
- Cross-border data transfer regimes: While our members welcome the SFC's proposals to tackle cross-border insider dealing, given the increasing interconnectivity of global financial markets, our members have raised concerns that regulatory investigations into such conduct may require the production of data from offshore, including records regarding overseas trading which may be held by overseas affiliates of Hong Kong licensed intermediaries. However, the increasing robustness of restrictions on cross-border data transfer can impose significant restrictions on the ability of these overseas affiliates to comply with foreign regulatory requests. Further, for example, under the new Data Security Law of the PRC, cross-border transfer of data stored onshore is generally restricted subject to the approval of the PRC regulators. Furthermore, cross-border transfer of certain types of data (e.g. important data, personal information) could be subject to further restrictions. Internationally, banking secrecy issues have for many years posed challenges for intermediaries to comply with requests from regulators. Given this, our members would appreciate the SFC's consideration of these issues and we would appreciate the SFC's understanding with regards to the impact of these restrictions on compliance with investigation notices in the future.

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-listed securities or their derivatives? Please explain your view.**

ASIFMA and its members are generally supportive of this proposal, although we would again welcome an opportunity to review and comment on the text of the proposed amendment. However, we again note that that regulatory investigations into such conduct may require the production of data from offshore, including records regarding overseas conduct which may be held by overseas affiliates of Hong Kong licensed intermediaries, and that compliance with such requests may be impacted by cross-border data transfer restrictions.

We are grateful for the opportunity to share our feedback on the Consultation Paper. We remain at your disposal for any questions you might have in relation to the above response.

Best regards,

Patrick Pang

Managing Director and Head of Compliance and Tax

ASIFMA