

Securities and Futures Commission Confirms Amendment to the Insider Dealing Provisions

18 August 2023

Introduction. On 10 June 2022, the Securities and Futures Commission (the “SFC”) commenced a [consultation](#) (the “Consultation”) on proposed amendments to enforcement-related provisions of the Securities and Futures Ordinance (the “SFO”). Please see [here](#) for our previous Client Update on the Consultation.

In the Consultation, three parts of amendments were proposed to be made to the SFO:

- Extending the SFC’s powers to apply for various forms of relief (including injunctions, restoration orders and orders for damages) under section 213 of the SFO against a regulated person where the SFC has exercised its disciplinary powers against such person for misconduct or lack of fit and properness—this power is currently not available to the SFC unless the relevant conduct also constituted a contravention of certain “relevant provisions” or any notice, requirement, condition or terms of licence or registration,¹ which means that as things stand, the SFC has no means, where there is solely a breach of the SFC’s codes or guidelines, to require intermediaries to compensate aggrieved investors;²
- Aligning the ambit of the professional investor (“PI”) exemption to section 103(1) of the SFO³ with the original legislative intent, as the SFC considered that the PI exemption had been given a wider construction than was intended in a Court of Final Appeal (“CFA”) decision;⁴ and

¹ Consultation, paragraph 9.

² Consultation Conclusions, paragraph 39.

³ Section 103(1) makes it a criminal offence for a person to issue, or have in his possession for the purposes of issue, an advertisement, invitation or other document which he knows is or contains an invitation to the public to enter into or offer to enter into an agreement to deal in securities or other structured products, or to participate in a collective investment scheme, unless authorized by the SFC to do so.

⁴ Consultation, paragraph 17. The CFA held in its decision in *SFC v (1) Pacific Sun Advisors Limited and (2) Mantel, Andrew Pieter*, FACC 11 of 2014 dated 20 March 2015 that the PI exemption as currently worded applies to exempt a person from liability under section 103(1) if the advertisement relates to an investment product that was intended to be and was in fact only sold to PIs, even though the advertisement may have been issued to the

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- Broadening the scope of the insider dealing provisions of the SFO.

The consultation period ended on 12 August 2022, with the SFC receiving 27 written submissions from industry associations, law firms, professional bodies and individuals.⁵

Consultation Conclusions. In its consultation conclusions published on 8 August 2023 (the “Consultation Conclusions”), the SFC confirmed that it will only proceed with Part 3 of the proposed amendments to expand the scope of the insider dealing provisions of the SFO (see below).

On the other hand, the SFC decided to put Parts 1 and 2 of the proposed amendments on hold following concerns raised by the majority of the respondents to the Consultation, including:

- In relation to Part 1: the imposition of legal remedies for breach of codes and guidelines which do not have the force of law, the risk of parallel proceedings and contradictory outcomes and potential extension of the limitation period; and
- In relation to Part 2: the practicality of conducting KYC at preliminary market stage and the possibility of unfair advantage being accorded to more sizeable financial institutions who already have a large existing client base should this proposal be implemented.⁶

That said, the market may not have seen the last of the proposals in Parts 1 and 2. The SFC stated in its concluding remarks for Part 1 that it would “*consider a broader range of possible options to meet [its] policy objective of enhancing the prospects of investors getting fair compensation in intermediary misconduct cases*”,⁷ and only confirmed that Part 2 would not proceed “*in its current form*”,⁸ which suggests that these proposals might be revived in a different form in the future.

Consultation Conclusions on Insider Dealing. Having considered the submissions, most of which were supportive of this proposal, the SFC has decided to proceed with the proposed amendments to expand the scope of the insider dealing provisions of the SFO to cover: (i) insider dealing perpetrated in Hong Kong with respect to securities listed on overseas stock markets or their derivatives; and (ii) insider dealing perpetrated

general public. The SFC has, therefore, proposed to amend the exemption such that it would only operate to exclude liability where the advertisement is only issued to PIs.

⁵ Consultation Conclusions, paragraph 2.

⁶ Consultation Conclusions, paragraphs 46-47.

⁷ Consultation Conclusions, paragraph 40.

⁸ Consultation Conclusions, paragraph 52.

outside of Hong Kong which involves any securities listed on the Stock Exchange of Hong Kong or their derivatives.

It is believed that the proposed amendments would “*strengthen investor protection, protect the integrity and reputation of [Hong Kong’s securities] markets, as well as bring the SFO insider dealing regime in line with other major common law jurisdictions*”.⁹ This is because the current insider dealing regime under the SFO only prohibits insider dealing with respect to “listed securities” of a listed corporation or their derivatives, and a listed corporation refers to one that is listed on the Stock Exchange of Hong Kong Limited, including securities dually listed in Hong Kong and another jurisdiction or their derivatives.¹⁰ There is also a lack of express provisions in the SFO prohibiting insider dealing in Hong Kong-listed securities or their derivatives where such acts take place outside Hong Kong.¹¹

As a result of this lacuna, as covered in our previous [Update](#), the SFC had to rely on section 300 of the SFO for the purpose of seeking civil remedies under section 213 of the SFO in the case of [SFC v Young Bik Fung & Ors \[2019\] 1 HKC 254](#), where the defendants engaged in insider dealing activities in Hong Kong in respect of the shares of a bank listed in Taiwan.¹² This required proof of the commission of an offence involving fraud and/or deception, the elements of which are very different from those required to establish the offence of insider dealing under the SFO.¹³ Whilst the SFC was ultimately successful in that case, section 300 is designed to cover acts of fraud or deception involving transactions between specific persons rather than fraud that deceives, and conduct that misleads, the market as a whole.¹⁴

This conceptual difference further affects the nature of relief which can be sought against the defendant and the amounts payable by the wrongdoers. A restoration order granted under section 213 by reason of a contravention of section 300 aims to return the profits made from the illicit trades to the victims of the fraud or deception, whereas a restoration order granted under section 213 by reason of a contravention of the insider dealing provisions aims to restore aggrieved investors affected by the illicit trades to the position they were in before they entered into the relevant transactions.¹⁵

⁹ Consultation Conclusions, paragraph 57.

¹⁰ Consultation, paragraph 34.

¹¹ Consultation, paragraph 42.

¹² Consultation, paragraph 37.

¹³ Consultation, paragraph 41.

¹⁴ Consultation, paragraph 38.

¹⁵ Consultation, paragraph 39.

The proposed amendments, once enacted through the usual legislative process, will address these “loopholes” by ensuring that the SFC has the powers to tackle cross-border securities crimes and market misconduct.¹⁶

Finally, the SFC provided the following clarifications on the scope and applicability of the proposed amendments:¹⁷

- With regards to the proposed expansion of the insider dealing regime to include overseas-listed securities or their derivatives, the amended provisions will stipulate that the misconduct would also need to be unlawful in the relevant overseas jurisdiction.
- The SFC does not seek to change the applicability of the insider dealing regime with regard to over-the-counter transactions in listed debts securities nor the current scope of the definition of “derivatives” contained within sections 245 and 285 of the SFO. It only seeks to change the territorial scope of the insider dealing regime.
- Any notification requirements set out within the Code of Conduct for Persons Licensed by or Registered with the SFC will apply to the new regime. As such, firms should report to the SFC when they become aware of any suspected breaches under the broadened scope.

Market participants and others affected by these changes to the insider dealing provisions should closely monitor developments in this area, including the legislative amendments to be formulated, to ensure that their internal compliance policies and manuals are updated in a timely manner, as the SFC has indicated that there will not be any transition period.

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Please do not hesitate to contact us with any questions.

¹⁶ Consultation, paragraph 32.

¹⁷ Consultation Conclusions, paragraphs 58-61.



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