

CHARLTONS
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2022
INSIDER DEALING
IN HONG KONG
Overview & Update

Webinar



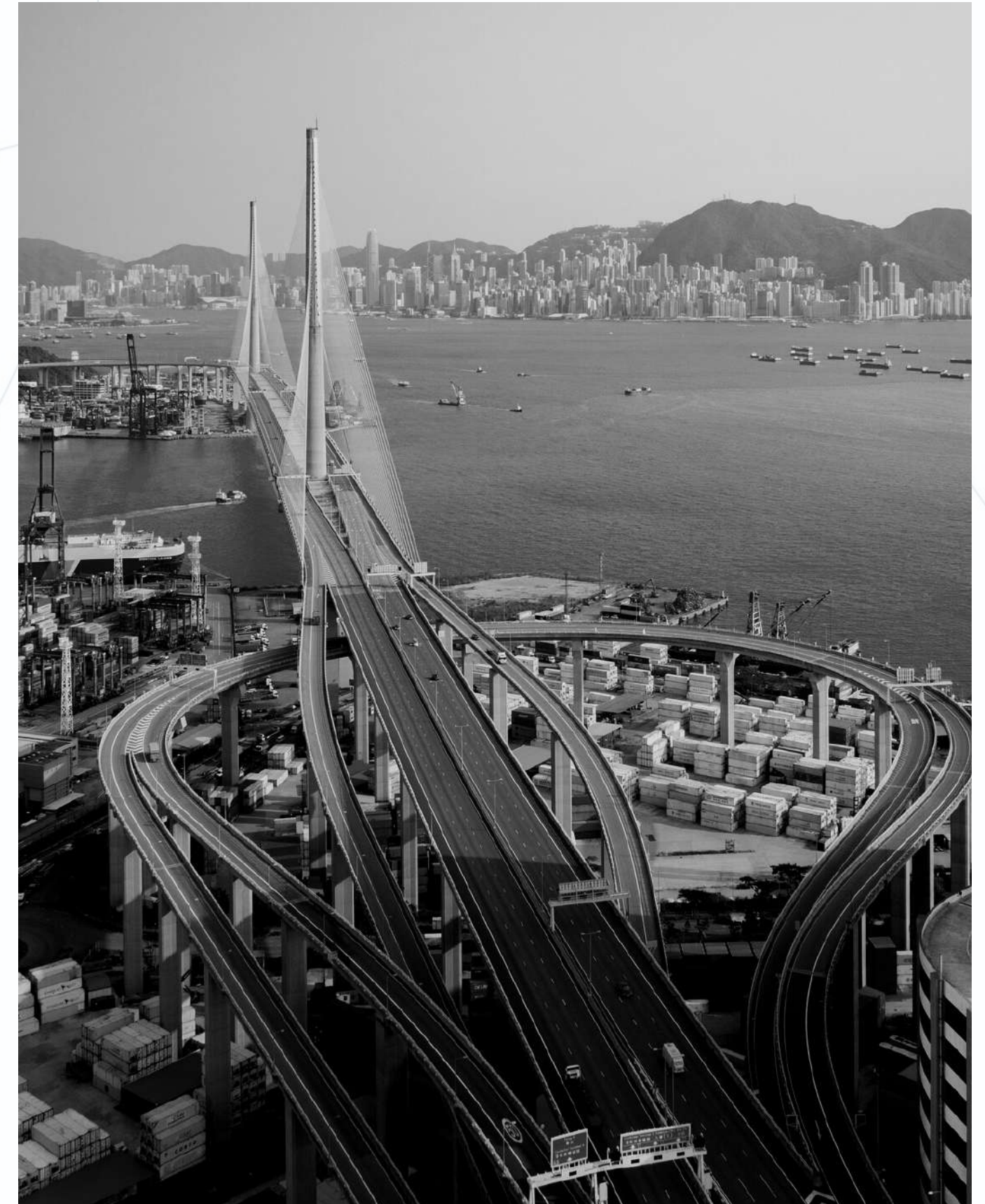
INTRODUCTION

Securities and Futures Ordinance (SFO) contains:

- i. civil market misconduct offences (Part XIII); and
- ii. criminal market misconduct offences (Part XIV).

6 types of market misconduct:

- i. insider dealing;
- ii. false trading;
- iii. price rigging;
- iv. disclosure of information about prohibited transactions;
- v. disclosure of false and misleading information inducing transactions; and
- vi. stock market manipulation.



DEFINITION AND SCOPE

What is insider dealing?

- A person connected with an HKEX-listed company has privileged information, which could impact the company's share price when it becomes publicly known, and trades or procures someone else to trade the company's securities or derivatives to make a profit or avoid a loss before the information becomes publicly known; or
- A person obtains information from another person they know to be connected with a listed company and trades or procures another person to trade in the company's securities or derivatives so as to make a profit or avoid a loss before the information becomes publicly available.



DEFINITION AND SCOPE

7 circumstances of insider dealing under the SFO

a. Person with inside information deals in shares of a corporation with which he is connected – Sections 270(1)(a) and 291(1)(a).

A person connected with a listed corporation has information he knows is inside information and:

- i. deals in the corporation's listed securities or their derivatives or in those of a related corporation; or
- ii. counsels or procures another person to deal in such listed securities or derivatives, knowing or having reasonable cause to believe that the other person will deal in them.

DEFINITION AND SCOPE

7 circumstances of insider dealing under the SFO

b. Take-over offer - bidder deals in shares of target - Sections 270(1)(b) and 291(2).

A person who is contemplating or has contemplated making a take-over offer for a listed corporation and knows that the information that the offer is contemplated, or is no longer contemplated, is inside information:

- i. deals in the corporation's listed securities or their derivatives or in those of a related corporation otherwise than for the purpose of the take-over; or
 - ii. counsels or procures another person to deal in such listed securities or derivatives otherwise than for the purpose of the take-over.
- It does not stop the director of the bidder from buying shares in the target (or indeed counselling or procuring others to do so) in a “dawn raid” where the sole purpose of such purchases is to facilitate the take-over itself.



DEFINITION AND SCOPE

7 circumstances of insider dealing under the SFO

c. Person connected with a corporation leaks inside information about that corporation - Sections 270(1)(c) and 291(3).

When a person connected with a listed corporation:

- i. has information which he knows is inside information; and
- ii. discloses the information, directly or indirectly, to another person

knowing or having reasonable cause to believe that the other person will use the information to deal, or counsel or procure another person to deal, in the corporation's listed securities or their derivatives, or in those of a related corporation.

- To cover those who deliberately leak confidential information with a view to someone using that information to make a favourable deal trading the securities.



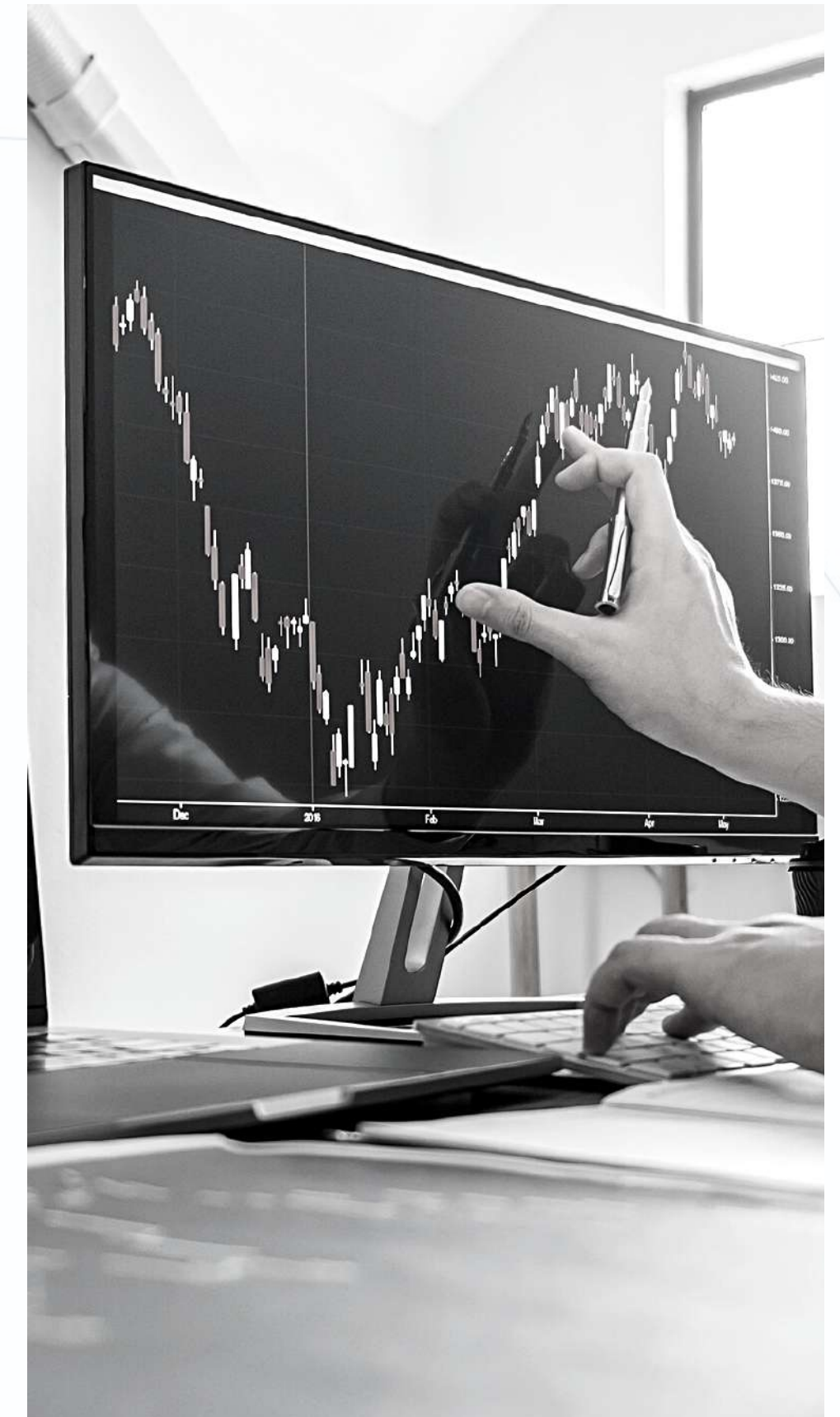
DEFINITION AND SCOPE

7 circumstances of insider dealing under the SFO

d. Bidder leaks take-over information - Sections 270(1)(d) and 291(4).

A person who is contemplating or has contemplated making a take-over offer for a listed corporation and knows that the information that the offer is contemplated or no longer contemplated is inside information discloses the information, directly or indirectly, to another person, knowing or having reasonable cause to believe that the other person will:

- use the information to deal or to counsel or procure another person to deal in the corporation's listed securities or their derivatives or in those of a related corporation.



DEFINITION AND SCOPE

7 circumstances of insider dealing under the SFO

e. Recipient of inside information from a person connected with a corporation deals in shares of that corporation - Sections 271(1)(e) and 291(5).

When a person has information which he knows is inside information in relation to a listed corporation which he received, directly or indirectly, from a person whom he knows is connected with the corporation and whom he knows or has reasonable cause to believe held the information as a result of being so connected:

- i. deals in the corporation's listed securities or their derivatives or in those of a related corporation; or
- ii. counsels or procures another person to deal in such listed securities or derivatives.



DEFINITION AND SCOPE

7 circumstances of insider dealing under the SFO

f. Recipient of inside information about a take-over deals in shares of the target - Sections 270(1)(f) and 291(6).

When a person has received, directly or indirectly, from a person whom he knows or has reasonable cause to believe is contemplating or no longer contemplating making a take-over offer for the listed corporation, information to that effect which he knows is inside information in relation to the corporation and:

- i. deals in the corporation's listed securities or their derivatives or in those of a related corporation; or
 - ii. counsels or procures another person to deal in such listed securities or derivatives.
- This provision catches the recipient of the leaked information who uses it either by dealing himself or by counselling or procuring someone else to deal.

DEFINITION AND SCOPE

7 circumstances of insider dealing under the SFO

g. Person with inside information seeks to facilitate a dealing on an overseas market - Sections 270(2) and 291(7).

When a person who knowingly has inside information in relation to a listed corporation in any of the previous circumstances and:

i. counsels or procures another person to deal in the corporation's listed securities or their derivatives or in those of a related corporation, knowing or having reasonable cause to believe that the other person will deal in such listed securities or derivatives outside Hong Kong on an overseas stock market; or

ii. discloses the inside information to another person knowing or having reasonable cause to believe that he or some other person will use the inside information to deal or counsel or procure another person to deal in the corporation's listed securities or their derivatives or in those of a related corporation outside Hong Kong on an overseas stock market.

- extends the *mens rea* element
- covers dealings in securities dually-listed in Hong Kong and overseas



DEFINITION AND SCOPE

Insider dealing in foreign-listed securities

- The court may rely on section 300 of the SFO:
 - using fraudulent or deceptive devices in
 - transactions in securities, futures contracts or
 - leveraged foreign exchange trading.
- [SFC v. Young Bik Fung & Others](#):
 - Facts:
 - Betty was seconded to a Hong Kong bank to assist with a takeover of a co. listed in Taiwan.
 - Discussions took place between the two banks between August to September 2006 and a tender offer was announced on 29 September 2006.
 - 20 September 2006 - a new securities account was opened with Tai Fook and the third defendant purchased 1,576,000 shares at an average price of NT\$16.99.
 - 29 September - tender offer was announced and the third defendant accepted the offer for all the shares and distributed the profit (around HK\$2.69 million)



DEFINITION AND SCOPE

Insider dealing in foreign-listed securities (cont'd)

- SFC v. Young Bik Fung & Others:
 - Held:
 - Due to the extra-territorial feature of the case, the Court relied on section 300 of the SFO.
 - Section 300 applied because the offer to buy the securities was made in Hong Kong.
 - The third defendant's acceptance of the tender offer in Hong Kong would also have brought the case within section 300.
 - Betty's conduct amounted to a scheme or act of deception.
 - The CFA – s. 300 could be applied in respect of securities listed outside Hong Kong, provided “substantial activities constituting the crime” occurred within Hong Kong.



DEFINITION AND SCOPE

"Securities"

- shares, stocks, debentures, loan stocks, funds, bonds or notes of, or issued by, or which it is reasonably foreseeable will be issued by, a body, whether incorporated or unincorporated, or a government or municipal government authority;
- rights, options or interests (whether described as units or otherwise) in, or in respect of, any of the foregoing;
- certificates of interest or participation in, temporary or interim certificates for, receipts for, or warrants to subscribe for or purchase, any of the foregoing;
- interests in a collective investment scheme;
- any interests, rights or property commonly known as securities, whether in the form of an instrument or not; and
- structured products not falling within the above where a structured product is:
 - an instrument under which some or all of the return or amount due (or both the return and the amount due) or the method of settlement is determined by reference to one or more of:
 - changes in the price, value or level (or a range within the price, value or level) of any basket of more than one type, or any combination of types, of securities, commodity, index, property, interest rate, currency exchange rate or futures contract; or
 - the occurrence or non-occurrence of any specified event or events (excluding an event or events relating only to the issuer or guarantor of the instrument or to both the issuer and the guarantor);
 - changes in the price, value or level (or a range within the price, value or level) of any type or combination of types of securities, commodity, index, property, interest rate, currency exchange rate or futures contract;
 - a regulated investment agreement; or
 - any interests, rights or property prescribed, or of a class or description prescribed, by notice under section 392 of SFO as being regarded as structured products.

DEFINITION AND SCOPE

"Listed securities"

Definition of "listed securities" includes:

- **issued unlisted securities** provided that, at the time of the insider dealing, it is reasonably foreseeable that they will be listed and they are subsequently in fact listed; and
- **unissued securities** provided that, at the time of the insider dealing, it is reasonably foreseeable that they will be issued and listed and they are subsequently in fact issued and listed.



“CORPORATION”

The definition of “corporation” includes the large number of companies which are listed in Hong Kong but incorporated abroad.

DEFINITION AND SCOPE

Person connected with a corporation

Sections 247 and 287 -

- a. he is a **director or employee of that corporation or a related corporation** (including shadow directors, i.e., persons in accordance with whose instructions the corporation's directors are accustomed or obliged to act);
- b. he is a **substantial shareholder** (i.e. has an interest in 5% or more of the issued voting share capital) in the corporation or a related corporation;
- c. **his position** may reasonably be expected to give him access to inside information concerning the corporation by reason of the following:
 - i. a **professional or business relationship** existing between himself (or his employer or a corporation of which he is a director or a firm of which he is a partner) and that corporation, a related corporation or an officer or substantial shareholder in either corporation; or
 - ii. his being a **director, employee or partner of a substantial shareholder of the corporation** or a related corporation; or



DEFINITION AND SCOPE

Person connected with a corporation (cont'd)

Sections 247 and 287 -

d. he has access to inside information by virtue of being connected (within the meaning of a, b or c above) with another corporation where that information relates to a transaction (actual or contemplated) involving both corporations or involving one of them and the listed securities of the other or their derivatives, or to the fact that such transaction is no longer contemplated; or

e. he was connected with the corporation within the meaning of a, b, c or d above at any time within 6 months preceding any relevant dealing.

A corporation is connected with another corporation if any of its directors or employees are so connected.

Under sections 248 and 288, any public officer or member or employee of certain bodies who in his capacity as such obtains inside information about a corporation will be deemed to be connected with that corporation.



DEFINITION AND SCOPE

"Related corporations"

- Two or more corporations will be related corporations of each other if one of them is:
 - a. the holding company of the other;
 - b. a subsidiary of the other; or
 - c. a subsidiary of the holding company of the other.
- Corporations are also related where the same individual:
 - a. controls the composition of the board of directors of one or more corporations;
 - b. controls more than half of the voting power at general meetings of one or more corporations; or
 - c. holds more than half of the issued share capital (excluding any part which carries no right to participate beyond a specified amount on a distribution of either profits or capital) of one or more corporations.



DEFINITION AND SCOPE

"Inside information" must be specific

Section 245(1) SFO defines "inside information" in relation to a corporation as **specific** information about:

- a. the corporation;
- b. a shareholder or officer of the corporation; or
- c. the listed securities of the corporation or their derivatives,
 - not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the corporation,
 - but if it were generally known to them, would be likely to materially affect the price of the listed securities.
 - Information will be specific if it is capable of being identified, defined and unequivocally expressed.

Firststone International Holdings Ltd, Chinese Estates Holdings Ltd, Chinney Alliance Group Limited, Gilbert Holdings Ltd

Information will be sufficiently specific:

"if it carries with it such particulars as to a transaction, event or matter, or proposed transaction, event or matter, so as to allow that transaction, event or matter, to be identified and its nature to be coherently described and understood."



DEFINITION AND SCOPE

Information in the media, analyst research reports or electronic subscription databases

Cannot be assumed to be information that is generally known to the market.

In determining whether this kind of information is generally known, consider:

- how widely the information is disseminated
- accuracy and completeness of the information
- whether the market can rely on that information

Information that is likely to have a **material effect** on the price of the listed securities

- The information must be price sensitive.
- The effect must be material.



DEFINITION AND SCOPE

Dealing in securities

- Under section 249 of the SFO a person deals, whether he acts as principal or agent.
- Agreeing to deal and buying or selling the right to deal will also be dealings under the SFO.



DEFENCES TO INSIDER DEALING

The dealing, counselling or procuring was made:

- for the sole purpose of acquiring qualifying shares as a director or intending director of a corporation;
- in good faith in performance of an underwriting agreement for the listed securities or derivatives in question; or
- in good faith as a liquidator, receiver or trustee in bankruptcy.

DEFENCES TO INSIDER DEALING

Chinese wall defence

A corporation (e.g. an investment bank or sponsor firm) will have a defence if it can demonstrate that:

- a. there were **effective arrangements in place** (i.e. a “Chinese wall”) to ring-fence any inside information in the possession of any of its directors and employees; and
- b. each person who took the decision for the corporation to deal, counsel or procure a dealing in the listed securities or derivatives in question **did not have the inside information at that time** and **had not received advice from those in possession of such information**.



DEFENCES TO INSIDER DEALING

Innocent purpose defence

- It is a defence if the purpose for which a person dealt in or counselled or procured another to deal in the listed securities or their derivatives or disclosed information **did not include the purpose of securing or increasing a profit or avoiding or reducing a loss**, whether for himself or another, by using the inside information.
- It is a defence if a person dealt or counselled or procured another to deal in a corporation's listed securities or their derivatives:
 - a. acted as agent;
 - b. **did not select or advise on the selection** of such listed securities or derivatives; and
 - c. he **did not know** that the person for whom he acted was connected with that corporation or had the inside information.



DEFENCES TO INSIDER DEALING

Off-market dealings

It will be a defence if the dealing occurred off-market in Hong Kong and:

- a. the person dealing in listed securities or their derivatives and the other party :
 - i. entered into the dealing directly with each other; and
 - ii. at the time of the dealing, the other party knew, or ought reasonably to have known, of the inside information; or
- b. where a person counselled or procured another person to deal in listed securities or their derivatives, he counselled or procured the other party to enter into the dealing directly with him and at that time the other party knew, or ought reasonably to have known, of the inside information.

A person will have a defence if they dealt off-market in listed securities or their derivatives but did not counsel or procure the other party to deal and at the time of the dealing the other party knew, or ought reasonably to have known, that such person was a person connected with the corporation.



DEFENCES TO INSIDER DEALING

Off-market dealings (cont'd)

A person who counselled or procured another person to deal in listed securities or their derivatives will have a defence if they can establish that:

- a. the other person did not counsel or procure the other party to the dealing to deal in the listed securities or derivatives; and
- b. at the time he counselled or procured the other person to deal, the other party to the dealing knew, or ought reasonably to have known, that the other person was a person connected with the corporation.

DEFENCES TO INSIDER DEALING

Off-market dealings (cont'd)

A defence is available to a person who dealt or counselled or procured another to deal in a corporation's listed securities or their derivatives where:

- a. the person acted in connection with any dealing which was under consideration or was the subject of negotiation, or in the course of a series of such dealings, and with a view to facilitating the accomplishment of the dealing or the series of dealings; and
- b. the inside information was market information arising directly out of his involvement in the dealing or the series of dealings.

Definition of "market information"

DEFENCES TO INSIDER DEALING

Off-market dealings (cont'd)

- Sections 272 and 293 – a defence where;
a trustee or personal representative dealt in or counselled or procured a dealing in listed securities or their derivatives on advice obtained in good faith from an appropriate person who did not appear to him to be a person who would have been involved in insider dealing if he himself had dealt in the listed securities or their derivatives.
- Sections 273 and 294 -
a defence where a person dealt in listed securities or their derivatives in the exercise of a right to subscribe for or otherwise acquire such securities or their derivatives which was granted to them or was derived from securities held by him at a time when he was not aware of any inside information.



DEFENCES TO INSIDER DEALING

Key case - SFC v. Yiu Hoi Ying Charles and Others

Innocent purpose defence

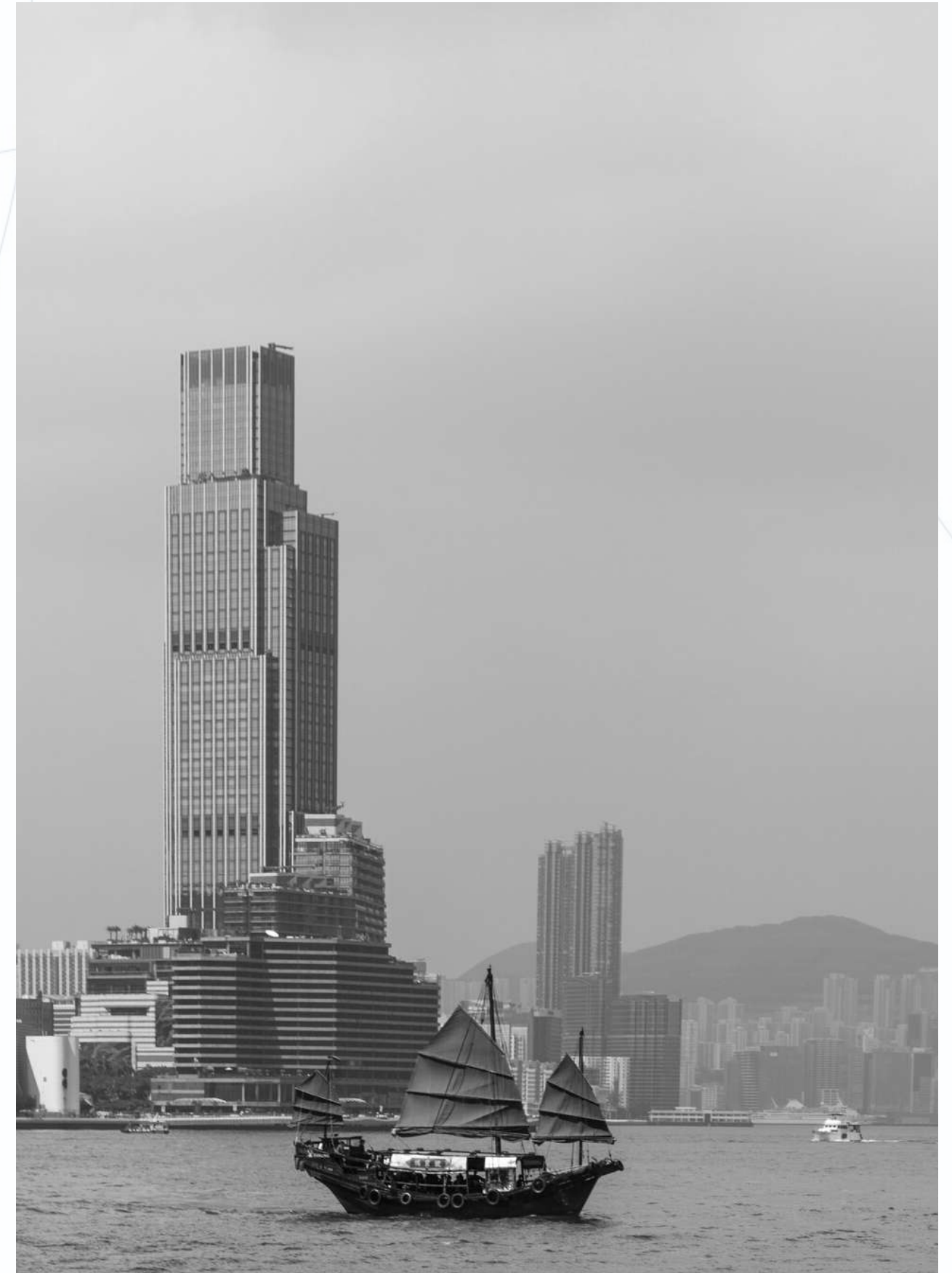
- The respondents, Mr. Yiu Hoi Ying Charles (Mr. Yiu) and Ms. Wong Nam Marian (Ms. Wong) held 6 million shares and 10 million shares in Asia Telemedia Limited (ATML), respectively.
- ATML owed a debt of HK\$58.08 million to Goodpine Limited.
- In April 2007, Goodpine Limited served a statutory demand on ATML and stated that it would issue a winding-up petition against ATML if the debt was not repaid within 21 days.
- Mr. Yiu and Ms. Wong sold their shareholdings and made profits of HK\$5.3m and HK\$5.1m respectively.
- The SFC alleged - the respondents' knowledge of Goodpine Limited's statutory demand to ATML constituted inside information and that they engaged in insider dealing when they relied on that information to dispose of their ATML shares at a profit.
- Mr. Yiu and Ms. Wong relied on the innocent purpose defence.
- The MMT (and later the Court of Appeal) accepted that defence.
- The defence was rejected in the CFA's four- to-one decision for the SFC.

DEFENCES TO INSIDER DEALING

Key case - SFC v. Yiu Hoi Ying Charles and Others

Innocent purpose defence

- The CFA stated that using inside information means turning the possession of inside information into action.
- Mere withholding or non-disclosure of inside information is insufficient to show use of the inside information.
- The inside information had to be exploited for financial advantage.
- The ruling suggests that officers of a listed corporation are considered to be using inside information and cannot rely on the innocent purpose defence if they possess inside information which is not publicly known when they deal in the corporation's securities.
- MMT orders against Mr. Yiu and Ms. Wong:
 - 3-year disqualification order against Mr. Yiu
 - HKICS disciplinary referral order against Ms. Wong
 - 3-year cold shoulder orders, cease and desist orders, disgorgement orders, and Government and SFC cost orders



CONSEQUENCES OF INSIDER DEALING

- The MMT conducts civil proceedings and imposes civil sanctions.
- It is an independent body chaired by a judge / former judge who sits with two members and a presenting officer
- It is inquisitorial and is entitled to direct that the SFC carry out further investigations and report its findings to the MMT.
- The presenting officer is a lawyer whose role is to present evidence to the MMT.

CONSEQUENCES OF INSIDER DEALING

MMT proceedings

SFC can institute proceedings before the MMT under SFO Section 252 to determine the following:

- a. Whether any market misconduct has taken place;
- b. the identity of the persons engaged in market misconduct; and
- c. the amount of any profit gained or loss avoided as a result of the market misconduct.

The MMT may identify a person as having engaged in market misconduct if:

- a. he has perpetrated any market misconduct;
- b. the market misconduct was perpetrated by a corporation of which he is an officer with his consent or connivance; or
- c. another person engaged in market misconduct and he assisted or connived with that person in the perpetration of the market misconduct, knowing that such conduct constituted or might constitute market misconduct.



CONSEQUENCES OF INSIDER DEALING

MMT orders

- 1 a disqualification order
- 2 cold-shoulder order
- 3 cease and desist order
- 4 disgorgement order
- 5 cost orders
- 6 a disciplinary referral



CONSEQUENCES OF INSIDER DEALING

Appeals - MMT orders

- May appeal to the Court of Appeal on a point of law.
- Need to obtain leave of the Court of Appeal for an appeal based on a question of fact (section 266).

MMT CASE - Re CHINA HUIYUAN JUICE GROUP LTD

- Ms. Sun made a profit of HK\$55.1 million + when she sold all her shares in the company within 48 hours after the public announcement of the Coca-Cola takeover.
- Ms. Sun had close connections with the management of the company, but no direct evidence that she received insider information.
- She denied having any inside information or knowledge of the takeover.
- Issue is with the circumstantial evidence and inferences from handwritten notes on the takeover in Ms. Sun's secretary's diary.
- MMT held:
 - If the identity of the connected person who passed on the inside information could not be ascertained, the MMT would decide, based on all available evidence, whether a compelling inference could be drawn
 - The MMT inferred that the information came from an insider even though the insider's identity could not be ascertained.
 - The inside information in the diary must have come from Ms. Sun or she must have known of the information.



CONSEQUENCES OF INSIDER DEALING

Criminal liability

- All forms of market misconduct are liable to prosecution as a criminal offence under Part XIV of the SFO (maximum penalty of 10 years' imprisonment and a fine up to HK\$10 million).
- The court may also make disqualification, cold shoulder and disciplinary referral orders.
- Non-compliance is an offence liable to a maximum fine of HK\$1 million and up to 2 years' imprisonment.
- No "double jeopardy":
 - A person who has been subject to criminal proceedings under Part XIV may not be subject to MMT proceedings if:
 - those proceedings are still pending; or
 - no further criminal prosecution could be brought against that person again under Part XIV in respect of the same conduct and vice versa (sections 283 and 307).
 - The decision as to whether to take civil or criminal proceedings is made by the Secretary for Justice.
 - The SFC may also institute summary criminal proceedings before a magistrate for less serious market misconduct offences.



CONSEQUENCES OF INSIDER DEALING

Civil liability - private right of action

- The SFO provides a private right of civil action against the perpetrator in favour of anyone who has suffered a pecuniary loss as a result
 - unless it is fair, just and reasonable that the perpetrator should not be liable (sections 281 and 305).
- A person will be taken to have committed market misconduct if:
 - a. they have carried out any market misconduct;
 - b. a corporation of which he is an officer carried out the market misconduct with his consent or connivance; or
 - c. any other person committed market misconduct and he assisted or connived with that person in the perpetration of the market misconduct, knowing that such conduct constitutes or might constitute market misconduct.
- Not necessary to have a finding of market misconduct before civil proceedings but findings are admissible as prima facie evidence.



CONSEQUENCES OF INSIDER DEALING

Liability of officers of a corporation

Duty of Officers

- Section 279 of the SFO - duty on all officers of a corporation to take reasonable measures to ensure that proper safeguards exist to prevent the corporation from acting in a way which would result in the corporation perpetrating any market misconduct.
 - “officer of a corporation” includes a director, manager or secretary of, or any other person involved in the management of, the corporation.
- Section 258 - where a corporation has been identified as having been engaged in market misconduct and the market misconduct is directly or indirectly attributable to a breach by any person as an officer of the corporation of the duty imposed on him under section 279, the MMT may make one or more of the orders even if that person has not been identified as having engaged in market misconduct himself.

Civil Liability

- Anyone who suffers pecuniary loss as a result of market misconduct has a right of civil action to seek compensation.

Criminal Liability

- **Section 390 SFO** - where it is proved that an offence committed under Part XIV was aided, abetted, counselled, procured or induced by, or committed with the consent or connivance of, or attributable to the recklessness of, any officer of the corporation, or any person purporting to act in any such capacity, that person, as well as the corporation, is guilty of the offence and liable to be punished accordingly.



CONSEQUENCES OF INSIDER DEALING

Liability of officers of a corporation

Disciplinary Proceedings

- Under Part IX SFO - any regulated person who is guilty of misconduct or who, in the opinion of the SFC, is not a fit and proper person to be or to remain the same type of regulated person, is subject to a widened range of disciplinary procedures.
 - “Misconduct” - any contravention of the SFO or of the terms of any licence issued or registration made under it.
- Examples of disciplinary procedures:
 - revoke or suspend a person's licence in respect of all or any part of the regulated activities;
 - impose a fine not exceeding the greater of HK\$10 million or 3 times the amount of the profit gained or loss avoided by the regulated person as a result of his misconduct, or such other conduct which led to the SFC's opinion that he is not fit and proper;
 - impose prohibition orders;
 - approvals granted to responsible officers may also be suspended or revoked.



CONSEQUENCES OF INSIDER DEALING

Proceedings under section 213 SFO

- Section 213 – CFI may, on the application of the SFC, grant orders to prevent or remedy breaches of the SFO and other relevant ordinances.
- Section 213 of the SFO also covers:
 - a. aiding, abetting or assisting, counselling or procuring another person to commit a breach of the SFO;
 - b. inducing, by threats, promises or otherwise, another person to commit a breach of the SFO;
 - c. directly or indirectly being knowingly involved in, or a party to, a breach of the SFO; or
 - d. attempting or conspiring with others to commit a breach of the SFO.
- Available remedies:
 - a. Injunctions and orders requiring the person to take steps to restore the parties to a transaction to the position they were in before the transaction; or
 - b. restraining or prohibiting a person from acquiring, disposing of or dealing in any property



CONSEQUENCES OF INSIDER DEALING

Landmark cases

[SFC v. Tiger Asia](#)

- Confirmed the power of the Court of First Instance to make orders without a prior finding of market misconduct by the MMT or a criminal courts
- Facts:
 - Tiger Asia received confidential and price sensitive information regarding placements of the shares of two banks. It then took short positions in the shares of the two companies (before the placings were announced to the public) and made a substantial profit.
 - Tiger Asia also manipulated the CCB share price during the closing auction session.
- Held:
 - The court ordered Tiger Asia and the two senior officers to pay around HK\$45.3 million to investors affected by their insider dealing.

[HKSAR v. Du Jun](#)

- Facts:
 - Du Jun was convicted of insider dealing in the shares of China Resources Holdings and sentenced to six years' imprisonment and fined HK\$1.7m.
- Held:
 - In s.213 proceedings, the court granted a restoration order against Du Jun, ordering him to pay HK\$23.9m to 237 affected investors.



SFC JUNE 2022 CONSULTATION PAPER

- SFC Consultation paper on Proposed Amendments to Enforcement-related Provisions of the Securities and Futures Ordinance
- Part 3 of the Consultation Paper sets out proposed amendments to Parts XIII and XIV of the SFO to widen the territorial scope of Hong Kong's insider dealing regime.

SFC JUNE 2022 CONSULTATION PAPER

Insider dealing in Hong Kong involving overseas-listed securities (or their derivatives)

- Suspected insider dealing in Hong Kong of overseas-listed securities (or their derivatives) are dealt with by providing [intelligence to the relevant overseas securities regulators](#), or [relying on fraud or deception market misconduct provisions](#) of the SFO.
 - The *Young Bik Fung* case , the SFO insider dealing provisions did not apply as the relevant corporation was not listed in Hong Kong
 - The CFA determined that there had been a contravention of section 300 of the SFO and on this basis, the CFA granted orders under section 213 of the SFO
- However, there is a [significant conceptual difference](#) between the type of conduct that section 300 prohibits as compared to that prohibited by the insider dealing provisions.
 - Section 300 deals with acts of fraud or deception involving transactions between specific people
 - Insider dealing prohibitions aim to prevent the conduct of taking advantage of inside information to make gains by stealing a march on the rest of the market.



SFC JUNE 2022 CONSULTATION PAPER

Insider dealing in Hong Kong involving overseas-listed securities (or their derivatives) (cont'd)

- The nature and amount of relief available is different.
 - In the Young Bik Fung case, as Betty, a fiduciary, had defrauded or deceived her principals.
 - The section 213 restoration order based on the section 300 contravention was to return the profits from the illicit trades to the bank.
 - The bank was a victim of the fraud or deception.
 - However, if the restoration order was based on a contravention of the insider dealing provisions (section 270 or 291), the order would be calculated on the basis of restoring aggrieved investors impacted by the illicit trades to the position in which they were before the relevant transactions were entered into.
- In another case, a Hong Kong licensed intermediary dealt in the securities of an overseas-listed entity prior to the announcement of a placing exercise.
 - The dealing occurred when in possession of inside information which was provided by another Hong Kong-based licensed intermediary. Apart from the mechanics of trading, the acts relating to the offence occurred in Hong Kong.
 - The SFC did not have adequate evidence to establish that the suspect had engaged in any fraudulent or deceptive acts, so could not take action under section 300 of the SFO.

SFC JUNE 2022 CONSULTATION PAPER

Insider dealing in Hong Kong-listed securities (or their derivatives) which takes place outside of Hong Kong

- The SFO insider dealing provisions currently do not explicitly apply to insider dealing involving Hong Kong-listed securities (or their derivatives) where the acts specified in section 270 or 291 occur outside Hong Kong.
 - To determine the territorial jurisdiction, the SFC applies the common law test of whether a substantial measure of the activities of the crime have taken place within Hong Kong
- **Over 60% of the insider dealing cases** handled by the SFC between 2017 and 2021 related to insider dealing perpetrated outside of Hong Kong involving Hong Kong-listed securities (or their derivatives).
- SFC is proposing to **extend the SFO insider dealing regime** to cover any act which takes place **outside of Hong Kong** involving Hong Kong-listed securities (or their derivatives).



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Alignment with other SFO market misconduct provisions and other major common law jurisdictions

- Other market misconduct provisions in SFO Parts XIII and XIV expressly prohibit acts carried out “[in Hong Kong or elsewhere](#)” which affect Hong Kong’s financial markets.
- SFO provisions governing other types of market misconduct also prohibit acts carried out in Hong Kong which [affect overseas financial markets](#), subject to the acts also being unlawful in the relevant overseas jurisdiction.
- The insider dealing laws of other major common law jurisdictions, including Australia and Singapore, cover:
 - i. overseas conduct in respect of local issuers’ securities; and
 - ii. local conduct in respect of overseas issuers’ securities.
- Implementation of the proposals would allow the SFC to tackle insider dealing perpetrated in Hong Kong involving A-shares that are traded through Stock Connect.

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Proposed amendments to the SFO

1. Amend the definition of “listed” in sections 245(2) and 285(2) of the SFO to include overseas-listed securities or their derivatives.
 - The definition currently only covers securities listed on a recognised stock market, i.e. the stock market operated by HKEx, or their derivatives.
2. Add a new section to Parts XIII and XIV of the SFO to expand the territorial scope of insider dealing to also govern any acts of insider dealing involving:
 - i. Hong Kong-listed securities or their derivatives regardless of where they occur; and
 - ii. overseas-listed securities or their derivatives if any one or more of such acts occur in Hong Kong.
3. Repeal sections 270(2) and 291(7) of the SFO
 - which presently extend the scope of the insider dealing provisions to dealings in securities dually-listed in Hong Kong and overseas (or their derivatives), as these sections would become redundant.

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Proposed amendments to the SFO

4. Amend section 271(5) of the SFO - the off-market dealings defence

- To make the defence available re. insider dealing involving overseas-listed securities (or their derivatives).

5. Align the two formulations of the mens rea element in relation to insider dealing taking place through disclosure of inside information by adopting the formulation in sections 270(2)(b) and 291(7)(b).

- The mens rea element of sections 270(2)(b) and 291(7)(b) which **apply to dually-listed securities** (or their derivatives), is satisfied where :
 - the person disclosing the inside information knows or has reasonable cause to believe that the **other person to whom the information is disclosed** “or some other person” will deal in the listed securities or their derivatives.
- The mens rea element of the other sub-sections of sections 270 and 291 which **apply to securities listed only in Hong Kong** (or their derivatives), is satisfied where:
 - the person disclosing the inside information knows or has reasonable cause to believe that only “the other person” to whom the information is disclosed will deal in the listed securities or their derivatives.
- The formulation of the mens rea element that applies to Hong Kong-listed securities (or their derivatives) is therefore narrower as it does not cover “some other person” dealing.