procedures. The sections do not limit the type of rules which a recognised exchange company could make and set out a variety of examples which rules could be made for, but no rule may have effect *unless* it has been approved by the SFC under s.24 of the Ordinance. This serves as a check and balance against the powers of the recognised exchange company.

The SFC may also, by written notice under s.23(3) request the recognised exchange company to make or amend rules. However, before such a request is made, the SFC is to consult the Financial Secretary and the recognised exchange company. If the recognised exchange company fails to comply with the request, the SFC itself may make or amend the rules as specified in its written notice.

The Stock Exchange has since established a set of trading rules which governs exchange participantship, trading rights, financial resources rules and accounting requirements, trading, professional conduct, discipline, payment of fees and charges, levies and compensation, and stamp duty. Other rules established by the Stock Exchange are that relating to its clearing houses and the listing rules in respect of the Main Board and GEM Board.

**[23.03] Debate on whether an exchange company as so listed in Hong Kong is indeed a "self-regulating body"**

By its ability to make its own rules (subject to the checks and balances performed by the SFC, as prescribed in s.24), it has been argued by counsel in *Sanyuan Group Ltd v Stock Exchange of Hong Kong* ( HCAL 25/2007) that a recognised exchange company is effectively a self-regulating body. Sanyuan Group Ltd (Sanyuan) was a listed company on the Stock Exchange and had applied to the Stock Exchange for suspension of trading its shares. The resumption of trading of Sanyuan's shares on the Stock Exchange was subsequently not allowed by the Stock Exchange, unless Sanyuan could show compliance with Listing Rule 13.24 which required an issuer to have a sufficient level of operations or assets of sufficient value which could be demonstrated to the Stock Exchange to warrant the continued listing of the issuer's securities. Sanyuan submitted a resumption proposal in this regard but was later informed by the Listing Committee of the Stock Exchange's Listing Division that its proposal did not satisfy the requirements of Listing Rule 13.24 and warned that Sanyuan's listing would be cancelled within the same month. Sanyuan requested a review of the Listing Committee's decision, but the decision was upheld by the Listing Review Committee and which was in turn upheld by the Listing Appeal Committee. Sanyuan therefore applied to the Court for judicial review of the Listing Division's decisions. Sanyuan's main ground of complaint was that it was not told at any juncture throughout the Listing Division's decisions as to what level of operations or assets it had to demonstrate in order to obtain a re-listing.

At the judicial review proceedings, counsel for the Stock Exchange argued that the Stock Exchange was essentially a self-regulating body, on the basis of the following passages from the judgment of the Justice Mr. Reyes:

23. Mr. John Scott SC (appearing for the Exchange) responds that the Exchange is tasked with maintaining, as far as reasonably practicable, an orderly informed and fair market. In discharging such duty, the Exchange must act in the interest of the public with particular regard to the interest of the investing public. See Securities and Futures Ordinance (Cap.571) (SFO) s.21(1) and (2) ….

24. SFO s.23 (Mr. Scott notes) authorises the Exchange to promulgate the [Listing Rules] for the proper regulation and efficient operation of the market, again





bearing in mind the public interest, especially the investing public. See, for example [Listing Rule] 2.03 and (insofar as the [Listing Committee, Listing Review Committee and Listing Appeal Committee] are concerned), Listing Rule 2A.03 ….

25. The Exchange (Mr. Scott says) is thus essentially a self regulating body…

26. The SFO obviously only contains broad provisions reflective of legislative policy that the stock market be regulated in an orderly, informed and fair manner. When it comes to the day-to-day implementation of the Exchange's duties, the legislature (Mr. Scott says) defers to the Exchange's expertise, as reflected in the Exchange's power to fashion rules and procedures (such as the [Listing Rules]) for the detailed regulation of the stock market. The legislature plainly intended (Mr. Scott stresses) the Exchange to have considerable latitude or discretion in formulating and enforcing its rules …

27. Further, the [Listing Rules], [Listing Review Committee] and [Listing Appeal Committee] (Mr. Scott points out) are made up of businessmen and other practitioners (including lawyers, accountants and corporate finance advisers) with considerable experience in the operation of the Exchange. As far as the daily operation of the market is concerned, the Courts can claim no similar expertise …

28. Accordingly, in a judicial review, (Mr. Scott contends) the Court should be extremely slow to substitute its views for those of the experienced members of the relevant committees. If the Court is to overturn the decision of any particular committee, it must be evident to the Court that such committee failed to comply with such legal norm or came to a decision which is wholly unreasonable. The Court cannot review the substantive merits of an administrative decision by a committee. It must instead confine itself to examining the legality of the decision or of the process which the decision was reached …

The Court therein accepted Mr. Scott SC's arguments, but did not agree that the Stock Exchange was able to apply its rules without fairness and transparency:

> 29. I fully accept Mr. Scott's analysis which I have just summarised. But that analysis does not answer Mr. Chang's point. That the Exchange is a self-regulating body and the Exchange's Listing Committees are made up of experts in the market cannot by themselves override the need for fairness and transparency in the application of LR 13.24 …
>
> 30. An applicant must at least be entitled to know what standard of operation or what sort of asset base he is expected to have in order to qualify for re-listing. If his resumption proposal is rejected, an applicant cannot simply be told that his turnover, profit or assets are considered insufficient. That is tantamount to giving no reasons. The applicant further needs to be informed in what sense his financial numbers have been deemed to be insufficient. The applicant is entitled to know just what level of operation or asset base he has fallen below. …
>
> 33. It may often be that a committee will have to go by its "feel" in relation to a given application. But the committee must still ground such "feel" in stated reasons. It may be that the "feel" cannot be fully articulated in words or reduced to a neat numerical calculus. But the membership should at least give a "ball-park" figure or guideline of what it expects from an applicant. The strict application of that "ballpark" figure or guideline could then be left to the discretion of a committee in light of the special circumstances of a given case.

The Court therefore acknowledged and held that a recognised exchange company is indeed a self-regulating body, but certain rules, procedures, and limits must be imposed and as such, does not give it *carte blanche* to apply its rules without regard to principles of fairness.

**[23.04] Statutory declaration**

Section 23(6) to 23(9) deal with statutory declarations which were required to be made pursuant to the rules of a recognised exchange company. They were introduced in 2004 to deal with the difficulty which arose in *R v Low Robert Eli* [1996] 4 HKC 125. Sears J queried if a form required by the Listing Committee of the Stock Exchange to be executed by a director had to comply with the requirements of a statutory declaration required by the Oaths and Declarations Ordinance (Cap.11), when there is nothing in the said Ordinance relating to the Stock Exchange which required this type of formality to be given:

> … [Mr. Robert Eli Low] practised as a partner in a firm of solicitors until his retirement in 1995. In that year, he became a director of Sincere Co Ltd which is a publicly listed company on the Hong Kong Stock Exchange. He made a return and declaration with regard to directors which was required, called Form B, to the Managing Committee of the Stock Exchange known as the Listing Committee. It is an unusual form in that it appears on its face to be a declaration made under the Oaths and Declarations Ordinance (Cap.11). It says "Every director must execute this declaration as a statutory declaration." There is no requirement, as I understand it, in the Ordinance relating to the Stock Exchange for this type of formality to be given as to a declaration by a director. If the Ordinance does not require it, I query whether the Stock Exchange is entitled to insist that it must be executed, but whatever the position, the piece of paper which Mr. Low had signed had been filled up …

The introduction and enactment of the s.23(6) to 23(9) therefore made it clear that the Stock Exchange is entitled to request that statutory declarations and is able to take into account the standards imposed on professionals by law and under professional conduct.

**[23.05] Corporation**

"Corporation" means a company or other body corporate incorporated either in Hong Kong or elsewhere, but does not include a company or other body corporate which is prescribed by rules made under s.397 for the purposes of this definition as being exempted from the provisions of this Ordinance, or to the extent that it is prescribed by rules so made as being exempted from any provision of this Ordinance; see Sch.1, Part 1, s.1 of the Ordinance.

**[23.06] Listing**

"Listing" in relation to securities, means the process by which the securities are listed; see Sch.1, Part 1, s.1 of the Ordinance.

**[23.07] Listed**

"Listed" means listed on a recognised stock exchange. A corporation shall be regarded as listed if any of its securities are listed; securities shall be regarded as listed when a recognised exchange company has, on the application of the corporation which issued them, or on the application of a holder of them, agreed to allow, subject to the requirements of this Ordinance, dealings in those securities to take place on a recognised stock market, and shall continue to be so regarded during a period of suspension of dealings in those securities on the recognised stock market; see Sch.1, Part 1, s.1 of the Ordinance.





**24. Approval of rules or amendments to rules of recognized exchange company**

(1) Subject to subsection (7), no rule (whether or not made under section 23) of a recognized exchange company or any amendment thereto shall have effect unless it has the approval in writing of the Commission.

(2) A recognized exchange company shall submit or cause to be submitted to the Commission—

(a) for its approval the rules and every amendment thereto that require approval under subsection (1), together with explanations of their purpose and likely effect, including their effect on the investing public, in sufficient detail to enable the Commission to decide whether to approve them or refuse to approve them; and

(b) for its information the rules which belong to a class the subject of a declaration under subsection (7) and every amendment to the rules, as soon as reasonably practicable after they have been made.

(3) The Commission shall, not later than 6 weeks after the receipt of a submission under subsection (2)(a) from a recognized exchange company, by notice in writing served on the company, give its approval or refuse to give its approval (together with its reasons for the refusal) to the rules or amendment of the rules (as the case may be) or any part thereof, the subject of the submission.

(4) The Commission may give its approval under subsection (3) subject to requirements which shall be satisfied before the rules or amendment of the rules or any part thereof take effect.

(5) The Commission may in a particular case, with the agreement of the recognized exchange company concerned, extend the time prescribed in subsection (3).

(6) The Financial Secretary may, after consultation with the Commission and the recognized exchange company concerned, extend the time prescribed in subsection (3).

(7) The Commission may, by notice published in the Gazette, declare any class of rules of a recognized exchange company to be a class of rules which are not required to be approved under subsection (1) and, accordingly, any rules of the company which belong to that class (including any amendment thereto) shall have effect notwithstanding that they have not been so approved.

(8) Neither the rules under section 23 nor a notice under subsection (7) is subsidiary legislation.

## COMMENTARY

**[24.01] Enactment history**

Section 24 is based on s.35 of the repealed Stock Exchanges Unification Ordinance (Cap.361); and s.14 of the repealed Commodities Trading Ordinance (Cap.250). This section came into effect on 1 April 2003.

who operate a stock market or futures market and for recognised clearing houses. In some circumstances, questions may arise as to whether the provision of ATS may also constitute operation of a "stock market", "futures market", or a "clearing house".

Therefore, ATS do not include that which are relating to transactions which do not result in a binding transaction. The division was introduced with the intent of facilitating services which result in transactions being made. It is useful to refer to the examples which the SFC had in mind when considering the reforms, namely: (i) bulletin boards and trade-matching services; (ii) broker-run proprietary ATS; (iii) exchange-run ATS; (iv) broker-to-client automated linkages, and (v) internet-based operations.

Note that the definition of "automated trading services" was expanded by the Securities and Futures (Amendment) Ordinance 2014 as follows to cover services for the trading or clearing of OTC derivative transactions. The expanded trading limb is reflected in *new paras.*(ab) and (ba) of the definition, while the expanded clearing limb is reflected in para. (d) of the definition. The expanded clearing limb in so far as it does not relate to Type 7 regulated activity, as this was implemented on 1 September 2016.

The *Securities and Futures (Amendment) Ordinance 2014 (Commencement) Notice 2016* states that:

> services provided by means of electronic facilities, not being facilities provided by a recognized exchange company or a recognized clearing house, whereby—
>
> (a) offers to sell or purchase securities or futures contracts are regularly made or accepted in a way that forms or results in a binding transaction in accordance with established methods, including any method commonly used by a stock market or futures market;
>
> (ab) offers to enter into OTC derivative transactions are regularly made or accepted in a way that forms or results in a binding transaction in accordance with established methods;
>
> (b) persons are regularly introduced, or identified to other persons in order that they may negotiate or conclude, or with the reasonable expectation that they will negotiate or conclude sales or purchases of securities or futures contracts in a way that forms or results in a binding transaction in accordance with established methods, including any method commonly used by a stock market or futures market;
>
> (ba) persons are regularly introduced, or identified to other persons—
>
> (i) in order that they may negotiate or conclude OTC derivative transactions in a way that forms or results in a binding transaction in accordance with established methods; or
>
> (ii) with the reasonable expectation that they will negotiate or conclude OTC derivative transactions in such a way;
>
> (c) transactions—
>
> (i) referred to in paragraph (a);
>
> (ii) resulting from the activities referred to in paragraph (b); or
>
> (iii) effected on, or subject to the rules of, a stock market or futures market, may be novated, cleared, settled or guaranteed; or
>
> (d) transactions—
>
> (i) referred to in paragraph (ab); or
>
> (ii) resulting from the activities referred to in paragraph (ba), may be novated, cleared, settled or guaranteed,





> but does not include such services provided by a corporation operated by or on behalf of the Government or any excluded services

Currently, an overseas person who is only providing or marketing services for the trading of OTC derivatives is not required to apply an ATS authorisation under Part III. However, once paras.(ab) and (ba) of the definition of ATS come into full effect, such persons will need to do so.

### [95.04] Authorisation required only if there is active marketing of the ATS

Section 95 prohibits persons from providing ATS and offering to provide ATS *unless* licensed, registered, or authorised to do so under Part III and later Part V of the Ordinance.

Both s.95(8) and 95(9) effectively prescribe that the authorisation required to provide ATS is only required when the services are actively marketed to persons, whether in Hong Kong or elsewhere, to persons in Hong Kong, by the first-mentioned person himself or by another person on his behalf. However, authorisation is not required if the ATS are marketed to existing clients falling within the three-year time window under s.95(9).

Specifically, s.95(8) provides that a person offers to provide ATS if the services are actively marketed to persons in Hong Kong. In addition, s.95(9) states that a person is not regarded as offering ATS if the offer is made to existing clients to whom the person already provides any financial services, including ATS. In the SFC's view, an overseas person will require authorisation or a licence to provide ATS if, for example, the person actively markets ATS services by sending e-mails or correspondence, or making telephone calls, to Hong Kong residents who are not existing clients or users of the person's services. Such active marketing does not require authorisation or a licence for ATS activity if it is only directed to Hong Kong persons who are existing clients of the ATS provider or users of the ATS services. The SFC also takes the view that operation of a website overseas does not itself amount to active marketing to persons in Hong Kong. Further, acceptance of Hong Kong clients who seek out the ATS does not in our view amount to active marketing.

### [95.05] Principles and guidelines to be complied with for the proper regulation of ATS

Generally, the provisions and guidelines of ATS should be consistent with or promote: (i) the regulatory objectives of the SFC under s.4 of the Ordinance; (ii) the functions of the SFC under the SFO, s.5; and (iii) the matters the SFC shall have regard to under the SFO, s.6(2) in pursuing its regulatory objectives and performing its functions.

Accordingly, the SFC shall consider the following principles, when regulating ATS providers:

(a) the fairness, efficiency, competitiveness, transparency, and orderliness of the securities and futures industry;

(b) understsanding by the public of the operation and functioning of the securities and futures industry and of the relative benefits, risks, and liabilities of investing in financial products;

(c) securing an appropriate degree of protection for members of the public investing in or holding financial products;

(d) the reduction of systemic risks in the securities and futures industry;

(e) the supervision, monitoring, and regulation of activities carried on by persons regulated by the SFC and of such activities of registered institutions as are required to be regulated by the SFC;

(f) promotion, encouragement, and enforcement of proper conduct, competence, and integrity of persons carrying on activities regulated by the SFC;
(g) adoption of appropriate internal controls and risk management systems by persons carrying on activities regulated by the SFC;
(h) the international character of the securities and futures industry and the desirability of maintaining the status of Hong Kong as a competitive international financial centre;
(i) the desirability of facilitating innovation in financial products and activities regulated by the SFC;
(j) the principle that competition among persons carrying on activities regulated by the SFC should not be impeded unnecessarily; and
(k) the principle that, as far as practicable and appropriate, bodies performing similar functions in the market place should be regulated in a similar way, so as to provide a fair and level-playing field between market operators.

The revised guidelines for the regulation of ATS published by the SFC became effective on 1 September 2016 and set out that these principles are to be followed so far as is reasonably practicable to do so. Furthermore, principles (e) and (k) have not been included in the new guidelines; and principle (c) is extended to take into account the public's degree of understanding and expertise in respect of investing in or holding financial products; see *Guidelines for the Regulation of Automated Trading Services* (September 2016) para.13.

### [95.06] Standards of practice for ATS

In addition to the principles and guidelines as set forth by the SFC with regard to ATS, the SFC also promulgated core standards of practice that must be followed in regulating ATS. Accordingly, a person providing such ATS must meet these standards to the satisfaction of the Commission, which includes:

1. **Financial Resources and Risk Management:** The financial resources and risk management policies of an ATS provider should comply with appropriate prudential and operational standards. For a local authorised ATS under Part III of the Ordinance, the SFC will apply this standard on a case-by-case basis. But such ATS will normally meet this standard by simply complying with existing prudential and conduct regulations that apply to licensed dealers and authorised financial institutions. In regard to an overseas exchange authorised under Part III of the Ordinance, these entities will normally meet these standards if they comply with the regulatory regime of its home country.
2. **Operation Integrity:** An ATS provider should maintain electronic facilities with adequate security, capacity, and contingency arrangements. The SFC will also consider the need for independent assessments of the ATS operational integrity as is required in certain circumstances for intermediaries' systems and of recognised exchange companies and clearing houses. In this regard, the SFC will take into account potential systemic risks and the market significance of the ATS.
3. **Fitness:** An ATS provider should be a fit and proper person, as established by an authority in Hong Kong or in its home country. For authorisation under Part III of the Ordinance, the SFC will require the ATS provider in its application for authorisation to demonstrate to the SFC that it and its key personnel are fit and proper persons to provide ATS. Information will also normally be sought on the substantial shareholders of the ATS provider. Although the process will not be the same as that for obtaining a licence under subsequent Part V of the Ordinance,





the SFC will have regard to the standards it already uses in the licensing process and as described in the SFC's *Fit and Proper Criteria*, but these will not be rigidly applied. These include consideration of, among other things, financial integrity, qualifications and experience, reputation, character, and reliability. In addition, the SFC may undertake background checks and liaise with overseas regulators, including those that have entered into information-sharing arrangements with the Commission.

4. **Record Keeping:** An ATS provider should keep full records of its ATS operations, including audit trails of ATS activity. Accordingly, an ATS licensed or registered under later Part V of the Ordinance *or* an overseas exchange authorised under Part III of the Ordinance will likely comply with much of this standard by virtue of existing codes and regulations. There may be instances where the record-keeping requirements for intermediaries do not focus specifically on important aspects of the ATS operation. This might include, where relevant, details (eg time, identities, price, quantity) of order entry or transaction conclusion. In such cases, the SFC will likely require records of these matters to be captured and retained;
5. **Transparency:** An ATS should provide appropriate levels of transparency in relation to ATS operations and traded products, including where relevant order processing arrangements, transaction execution, settlement arrangements, and operational requirements or rules. For ATS licensed or registered under Part V of the Ordinance or authorised under Part III of the Ordinance, the ATS provider will be expected to make available to its users information concerning how the ATS operates as a part of the application and on-going requirements. Where relevant and among other things, this will likely include information concerning: (i) order processing and execution systems; (ii) the rules or other operating requirements; (iii) settlement arrangements; (iv) fees and charges; and (v) margin requirements and product specifications for derivatives products. This is what is already expected of intermediaries concerning providing information about their operations. In addition to the transparency of these ATS operations, the SFC will also consider the transparency of trading information. These requirements really depend on the type of ATS involved. In most equity and derivatives trading systems, best practice standards provide for some level of transparency of bid/ask prices, related quantities, and details of completed transactions. Less transparency typically exists internationally for OTC markets and fixed income markets. This aspect of transparency will be considered on a case-by-case basis with reference to the type of ATS and relevant international best practices standards.
6. **Surveillance:** Surveillance of ATS activity should be performed by the ATS provider, a regulatory authority (including potentially the SFC), or another competent person, and such surveillance should be consistent with relevant market regulation practices in Hong Kong and internationally. In this standard, surveillance carries its meaning of careful watch, supervision for the purposes of direction or control, and superintendence. The level of surveillance the SFC will expect of an ATS will vary depending on the nature of the ATS involved. The SFC may also expect the ATS provider to give access to the SFC to enable it to perform the necessary surveillance. The SFC will take into consideration the ATS' range of activity, the market participants that might be affected by the ATS, whether retail investors may be involved, and whether any systemic risks might arise to determine the nature and extent of the surveillance functions that will apply to each ATS. Most ATS providers will have access requirements to determine who may use the ATS.

These may take the form of, among other possibilities, financial and credit standards, operational requirements, contractual requirements, or institutional requirements. Depending on the type of ATS involved, the SFC will likely expect the ATS to have access requirements to help to ensure the orderly and legitimate use of the ATS. The SFC will expect these to be transparent and to be monitored and enforced. This is particularly important for an ATS where continued access to the ATS by non-qualified users may adversely affect other market participants, for example a user who acts as a trading counterparty and becomes the subject of a winding up or bankruptcy proceeding. The SFC will expect that the main operations of an ATS be monitored continuously to ensure their smooth and reliable operation. Furthermore, the SFC will expect that arrangements are in place to promptly detect and remedy any malfunction in the ATS operations.

7. **Reporting:** An ATS provider should keep relevant regulatory authorities informed of its ATS operations and traded products and of material changes to those operations. An ATS licensed or registered under Part V of the Ordinance will be subject to existing arrangements to inform regulatory authorities of ATS operations and material changes to them. Where this is not the case, the SFC is likely to require that the ATS make reports periodically or on request concerning its ATS operations and material changes to those operations. The requirement in each case will be tailored to the nature of the ATS. In some circumstances, the SFC may require the ATS provider to consult with or obtain the prior approval of the SFC before making material system changes. Material changes might include, for example, implementation of an ATS system architecture upgrade. These same considerations will apply to ATS authorised under Part III of the Ordinance. The SFC also expects that it will require at least annual financial statement reports from ATS providers authorised under Part III. The SFC would not normally require any approval of the fees and charges of the ATS provider. For an overseas exchange authorised under Part III, the SFC will normally seek an arrangement for the overseas exchange to make periodic reports to the SFC of the locations where their ATS are provided in Hong Kong. The SFC will also normally seek periodic statistics on the trading activity originating from Hong Kong.

Under the revised guidelines, the existing 7 standards of practice have been expanded and reorganised into nine core standards of practice in the view to better align the core standards of ATS regulation with relevant PFMI requirements for central counterparties (CCPs), and amended such that to clarify the regulatory requirements.

"Financial Resources" and "Risk Management" have been separated in order to reflect the importance of each. The former focuses on requiring an ATS provider to have sufficient financial resources for proper performance of its operations, functions, and obligations, while the latter focuses on requiring an ATS provider to ensure that risks associated with its business and operations are managed prudently. "Operational Integrity" has been amended to read "System Integrity" to better reflect the features of the ATS. Additionally, two new core standards have been introduced: "Governance" and "Access and Participation." "Governance" incorporates the standard of "Fitness" while emphasizing on the management and decision-making process instead of merely emphasizing on the suitability or qualifications of any particular personnel or shareholder. Finally, "Access and Participation" reflects the importance of having open and fair access to ATS, and having clear and objective criteria for such access.





The revised 9 core standards of practice are as follows:

1. **Financial Resources:** An ATS provider should have sufficient financial resources for the proper performance of its operations, functions, and obligations. "Sufficient" refers to enough financial resources to provide services on an ongoing and continuous basis. In addition, the SFC expects ATS providers who operate as a CCP to have sufficient financial resources to ensure a recovery or orderly wind-down of its critical operations and services. The SFC's assessment will take into account functions performed by the ATS provider, level of activities in Hong Kong, and the risks that such activities pose. The SFC will generally refer to international standards and practices in assessing ATS providers that offer CCP-type services, while assessing ATS providers whose facilities are similar to those of an exchange or electronic platform adopts a pragmatic approach, ie on a case-by-case basis.
2. **Risk Management:** An ATS provider should ensure that risks associated with its businesses and operations are managed prudently. An ATS provider is expected to have a sound risk management framework, as well as policies and procedures in regard to risks borne by it and associated with its business and operations. Further, an ATS provider with facilities similar to a CCP is expected to comply with and produce an assessment of compliance with the PFMI.
3. **System Integrity:** An ATS provider should set up and maintain electronic facilities to achieve a high degree of reliability, availability, and security in respect of its systems, data, and networks, and incorporate adequate capacity and contingency arrangements. Further, an ATS provider is expected to have proper documentation and change management for the system hardware, software, and network configuration; and sufficient backup, recovery facilities, and documented business continuity plans in case of a major system disruption. Such facilities should be tested, reviewed, and modified on a regular basis. In addition, the SFC may require an independent assessment of the electronic facilities used for the provision of ATS taking into account of any past system performance, potential systemic risks, and market significance of the ATS to the Hong Kong market.
4. **Governance:** An ATS should have robust, well-defined, and transparent governance arrangements to properly oversee its management and manage the decision-making process, and ensure that stakeholders' interests are sufficiently accounted for. This includes clear lines of reporting, effective processes to review operational and business performance, proper arrangements to handle conflicts of interest, and adequate internal procedures. Moreover, the governance structure should be comprised of qualified personnel, ie persons who possess the necessary professional qualifications and technical experience for ensuring the proper and continued functioning of the ATS. Further, the SFC expects ATS systematically important to Hong Kong to also take into consideration the impact of their operations on the Hong Kong market, public interest, and financial stability.
5. **Access and Participation:** An ATS provider is expected to have objective, risk-based, and transparent criteria and requirements for participation, which permit fair and open access where circumstances permit as between members of an ATS provider. And, such criteria and requirements should be continually monitored and enforced.
6. **Transparency:** An ATS provider should provide appropriate transparency in relation to its ATS operations, products, and transactional information, including

where relevant: its arrangements for order processing, and for transaction execution or clearing and settlement; the list of products that may be traded or cleared through its facilities; and its rules and operational requirements. The ATS provider is also expected to provide sufficient information to members/users to enable them to understand the risks and responsibilities with regard to participation, particularly, the rights and obligations owed from one to another following an operation disruption or failure. Furthermore, depending on the nature of the ATS, the ATS should make available trading and clearing information where appropriate;

7. **Surveillance:** Surveillance refers to careful watch and supervision for the purposes of influencing, managing, or directing the proper use of its ATS. The level of surveillance expected is dependent on the nature of the ATS involved. Surveillance should be performed by the ATS provider, a regulatory authority (including potentially the SFC), or another competent person, and such surveillance should be consistent with relevant market regulation practices in Hong Kong and internationally. The SFC may require the ATS provider to give access to the SFC to enable it to perform its surveillance functions. In situations where unusual activity may create a disorderly or unfair operating environment, the SFC may require mechanisms to detect such anomalies and investigate the reasons behind them. The SFC may also in certain circumstances consider it appropriate to suspend the trading in the primary market of ATS providers of trade executive services for products in multiple markets pending the release of price-sensitive information. Where an ATS provider offers overseas exchange, CCP or electronic platform providing similar services, the SFC will require the ATS provider to co-operate in investigations. An ATS provider will be expected to perform the surveillance functions as required in its home jurisdiction.
8. **Record Keeping:** An ATS provider should keep full records of its ATS operations, including proper audit trails of activity conducted via the ATS. The SFC will generally take a level-playing field approach, ie to apply similar regulation to ATS providers with similar functions. With regard to ATS providers authorised under Part III of the Ordinance, the SFC will take into account the record-keeping requirements of exchanges and CCPs; therefore, it is likely to require the records relating to the ATS provider and its activities to be available upon request, as well as have on-site and timely access to such records. Further, the SFC may also specify, on a case-by-case basis, the records that must be kept and the retention period to apply.
9. **Reporting:** The SFC will require the ATS provider to submit certain information on a regular basis, on request, or upon the occurrence of an event or the ATS provider being aware of something. Normally, the SFC will require for the ATS provider to submit the following information on a periodical basis: annual financial statements; the location of its members/users in Hong Kong, statistics on the trading; clearing and settlement activities (if applicable) carried out in Hong Kong; and information pertaining to the ATS provider's operations and material changes to those operations. The latter includes: (i) the ATS provider's company structure, business plan, and marketing plan; (ii) the electronic facilties to be used for providing ATS; (iii) the contractual documentation relevant to its members/users in Hong Kong; (iv) the criteria for admitting persons as Hong Kong members/users or for revoking such membership, prior to the changes taking effect; and (v) intended offer of new products to persons in Hong Kong. The information to be provided and frequency of reporting is contingent on the impact of the ATS





provider's activities in Hong Kong. Further, fees and charges the ATS provider imposes in certain circumstances may be subject to approval if the SFC considers that such fees and charges raise regulatory concerns about the ATS provided, and its impact on the market and market participants in Hong Kong.

### [95.07] Overseas exchanges

As previously mentioned, one type of ATS provider eligible for authorisation under Part III of the Ordinance will be a stock exchange or futures exchange outside Hong Kong wishing to provide ATS in Hong Kong. This provision of ATS by an overseas exchange involves the placement of their dedicated trading terminals in Hong Kong or the provision of technical specifications and support services to enable Hong Kong institutions to make computer-to-computer connections to the overseas exchange's systems.

In this regard, overseas exchanges have always been accessible to Hong Kong investors, either through Hong Kong financial intermediaries or overseas intermediaries. While historically trading by Hong Kong persons may have been effected through the telephones, fax, or telex, today it is often done through computer linkages, the Internet, and Extranets.

The SFC believes that authorisation of an overseas exchange under Part III of the Ordinance should be based on an assessment that the overseas exchange is subject to regulation in its home country comparable to the regulation of exchanges in Hong Kong and consistent with international standards. Through its own regulatory benchmarking and participation in international regulatory forums such as the International Organization of Securities Commissions, the SFC will often be in a position to make this assessment without requesting detailed information from the overseas exchange. If not, the SFC will need to request information from the overseas exchange to assist it in making this assessment.

For an overseas exchange to be authorised under Part III of the Ordinance, the SFC expects the following to be provided:

(a) information regarding the products to be traded through the ATS in Hong Kong;
(b) periodic statistics of the nature and volume of such trading in Hong Kong (if applicable);
(c) copies of any documentation which users of the ATS in Hong Kong will enter into concerning the ATS;
(d) information concerning the identity and location of persons using the ATS in Hong Kong;
(e) satisfy the SFC that appropriate levels of information disclosure and co-operation will be made available to the SFC concerning any specific requests or investigations in relation to the ATS in Hong Kong, including information about particular transactions, ATS users, and ATS users' clients;
(f) the application fee;

And the ATS should undertake to:

(g) provide periodic statistics (quarterly) of the nature and volume of such trading in Hong Kong;
(h) provide information on any later changes to the matters set out above regarding certain information that needs to be provided;
(i) limit use of the ATS in Hong Kong to persons licensed or registered with the SFC under Part V of the Ordinance, unless the SFC agrees otherwise; and
(j) limit use of the ATS in Hong Kong to persons licensed or registered with the SFC under Part V of the Ordinance, unless the SFC agrees otherwise.

which are so received or held on behalf of a client of the registered institution or in which a client of the registered institution has a legal or equitable interest: see Sch.1 of the SFO.

The SFC has stated that the CSRs only apply to securities traded or listed on the Hong Kong Stock Exchange or interests in collective investment schemes by the SFC.

### [148.06] Securities collateral

"Securities collateral" means:

(a) in relation to a licensed corporation, means any securities –
  (i) deposited with, or otherwise provided by or on behalf of a client of the licensed corporation to, the licensed corporation; or
  (ii) deposited with, or otherwise provided by or on behalf of a client of the licensed corporation to, any other intermediary or person,
  which are so deposited or provided –
    (A) as security for the provision by the licensed corporation of financial accommodation; or
    (B) to facilitate the provision by the licensed corporation of financial accommodation under an arrangement that confers on the licensed corporation a collateral interest in the securities; or

(b) in relation to a registered institution, means any securities –
  (i) deposited with, or otherwise provided by or on behalf of a client of the registered institution to, the registered institution, in the course of the conduct of any regulated activity for which the registered institution is registered; or
  (ii) deposited with, or otherwise provided by or on behalf of a client of the registered institution to, any other intermediary or person, in relation to the conduct of the regulated activity,
  which are so deposited or provided –
    (A) as security for the provision by the registered institution of financial accommodation; or
    (B) to facilitate the provision by the registered institution of financial accommodation under an arrangement that confers on the registered institution a collateral interest in the securities: see Sch.1 of the SFO.

The SFC has stated that securities subject to an outright transfer do not constitute "securities collateral", although the SFC will always look at the substance of an arrangement.

### [148.07] Dealing with client securities or securities collateral

Section 6 of the CSRs specifies how an intermediary or its associated entity may deal with client securities or securities collateral. In summary, it should only deal with them in accordance with oral or written directions or a standing authority (subject to certain conditions to prevent abuse).

### [148.08] Standing authority

An intermediary may obtain a standing authority from a client so that they can deal with client securities or securities collateral without the need for specific directions.

A standing authority must comply and can be renewed in accordance with s.4 of the CSRs. The SFC has stated that automatic renewal is not allowed under s.4 of the CSRs. However, implicit renewal under s.4(3)(b) of the CSRs is permitted.





A standing authority, if it is drafted in such terms, also allows an intermediary to:
(i) apply client securities or securities collateral for securities pursuant to a securities borrowing and lending agreement;
(ii) subject to s.8A of the CSRs, deposit with an authorized financial institution collateral for financial accommodation provided to the intermediary; and
(iii) deposit securities collateral with a recognized clearing house or another intermediary licensed or registered for dealing in securities as collateral for the discharge and satisfaction of the intermediary's settlement obligations and liabilities.

### [148.09] Repledging

This provision also applies to an intermediary licensed for dealing in securities or licensed for securities margin financing. An intermediary may repledge clients' collateral up to a certain percentage of its aggregate margin loans. Section 8A of the CSRs requires an intermediary to determine at the end of each business day whether the amount of its repledged collateral is below 140% of its aggregate margin loans. If this is exceeded, on the next business day, it must withdraw from deposit repledged securities collateral to ensure the aggregate margin loans do not exceed 140%. See the SFC circular dated 10 October 2017 under 146.05 regarding risk management for licensed corporations providing securities margin financing.

On 17 August 2018, the SFC published a report on securities margin financing activities and a related consultation paper on its Proposed Guidelines for Securities Margin Financing Activities to clarify, codify and standardise risk management practices for securities margin financing.

On 4 April 2019, the SFC released conclusions on the consultation. Under the guidelines, the maximum total margin loans-to-capital multiple brokers can adopt is five times to avoid excessive leverage. They should also control the concentration risks posed by holding individual or connected securities as collateral and by significant exposure to margin clients. In addition, brokers are required to set prudent triggers for margin calls and strictly enforce margin call policies. Guidance was provided to help brokers set prudent haircut percentages for securities acceptable as collateral and conduct stress testing to assess the financial impact of their securities margin financing activities. The guidelines would take effect on 4 October 2019.

### [148.10] SFC Guidance

The CSRs, together with rules made under s.149 of the SFO in relation to client monies, are integral to the regulation of intermediaries and the protection of client assets held or deposited with them or their associated entities. The SFC has stressed the importance of adequate internal controls and has issued a guidance note in April 2003 titled: *Suggested Control Techniques and Procedures for Enhancing a Firm's Ability to Comply with the Securities and Futures (Client Securities) Rules and the Securities and Futures (Client Money) Rules.*

Further, on 5 February 2016, the SFC issued a circular reminding intermediaries licensed for dealing in securities to establish internal control procedures and financial and operational capabilities: *Circular to Licensed Corporations Licensed for Dealing in Securities Protecting Client Assets Against Internal Misconduct.*

On 19 December 2018, having identified a number of cases of misconduct by account executives which had jeopardised clients' interests and involved unauthorised

trading and misappropriation of client assets, the SFC conducted a review and published a self-assessment checklist to assist securities and futures brokers in reviewing their internal controls for protection of client assets and supervision of account executives.

On 8 July 2019, the SFC issued a circular introducing a new measure to protect client assets, that is, requiring intermediaries and authorised institutions to sign a standardised acknowledgment letter containing clauses in line with the requisite standard of protection to be afforded to client assets. Key elements of the acknowledgement letter include the notification of purpose clauses, the no-recourse clause and the conflict clauses. The transition period for implementing this requirement ends on 31 July 2020, where the SFC expects the standardised client asset acknowledgement letters to be signed by intermediaries and countersigned by the corresponding authorised institutions for all applicable client asset accounts.

General guidance can be found in the SFC's *Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission.*

**[148.11] Circularization exercise on clients' accounts**

In view of its recent inspection findings on control deficiencies, on 28 July 2017, the SFC commenced a circularization exercise with a selected accounting firm for reviewing protection of clients' accounts by selected securities brokers. The exercise involved a high-level review of brokers' internal control systems set up to protect clients' assets including controls over client money and client securities. Brokers were reminded to ensure that the personal information of their clients was accurate and up-to-date.

**[148.12] Offence**

Under s.13 of the CSRs, if an intermediary or an associated entity breaches s.4(4) or 12 of the CSRs without reasonable excuse, it commits an offence and is liable on conviction to a fine at level 3. Where the breach of s.4(4) or 12 of the CSRs was with an intent to defraud, the intermediary or associated entity will be liable on conviction to a fine at level 6.

An intermediary or an associated entity that breaches s.5 or 10(1) of the CSRs without reasonable excuse is convicted on indictment, and it is liable to a fine of $200,000 and 2 years imprisonment. Where it is summarily convicted, it is liable to a fine at level 6 and imprisonment of 6 months. Where the breach was with an intent to defraud, and the intermediary or associated entity is convicted on indictment, it is liable to a fine of $1,000,000 and 7 years imprisonment. Where it is summarily convicted, it is liable to a fine of $500,000 and 1 year imprisonment.

**[148.13] Level 3 and level 6 fine**

Under Sch.8 of the Criminal Procedure Ordinance (Cap.221), a level 3 fine is $10,000, and a level 6 fine is $100,000.

**[148.14] Regulatory enforcement**

There have been a number of cases involving improper dealings with client securities or securities collateral. The usual issues that arise in such instances include (i) a lack of standing authority; (ii) failure to provide safe custody of client assets; or (iii) inadequate internal controls. In a number of cases, the fines have been substantial and senior management of the intermediaries concerned have also been disciplined.





**149. Client money held by licensed corporations and their associated entities**

(1) The Commission may make rules requiring licensed corporations and their associated entities to treat and deal with client money of the licensed corporations in such manner as is specified in the rules.

(2) Without limiting the generality of subsection (1) and without prejudice to section 398(7) and (8), the Commission may in the rules referred to in subsection (1)—

(a) require client money of licensed corporations or any part thereof to be paid into segregated accounts established for client money and designated as trust accounts or client accounts;

(b) specify when and how the client money or any part thereof is to be paid into such accounts and require it to be dealt with, and accounted for, in the specified manner;

(c) specify the amount or proportion of the client money that is not to be paid into such accounts, and the deductions that may be made before the client money is paid into such accounts;

(d) specify the circumstances in which the client money may be paid out of such accounts, including the circumstances in which the client money that is the subject of a lawful claim or lien may be paid out of such accounts;

(e) require interest accruing from the holding of the client money in such accounts to be dealt with and paid in the specified manner;

(f) specify the persons in Hong Kong with whom such accounts are to be established and maintained;

(g) provide for authorization by the Commission as a condition for payment out of such accounts in specified circumstances;

(h) require the maintenance of records in relation to such accounts (including records of performance of reconciliations of payments of the client money into and out of such accounts) in the specified manner;

(i) require the submission to the Commission, upon request or at specified intervals, of specified information, records and documents for the purpose of enabling the Commission to ascertain readily whether the rules are being complied with;

(j) require specified matters, and the circumstances relevant thereto, to be notified to the clients of licensed corporations or the Commission, or both;

(k) require a person who becomes aware that he does not comply with any specified provision of the rules that applies to him to notify the Commission of that fact and of any further specified information, within the specified time;

(l) provide for any other matter relating to the client money.

(3) Except as provided in the rules made under this section, client money of a licensed corporation is not liable to be taken in execution against the licensed corporation or an associated entity of the licensed corporation under the order or process of a court.

(4) Rules made under this section may provide that a licensed corporation, or an associated entity of a licensed corporation, which, without reasonable

excuse, contravenes any specified provision of the rules that applies to it commits an offence and is liable to a specified penalty not exceeding—

(a) on conviction on indictment a fine of $200,000 and a term of imprisonment of 2 years;

(b) on summary conviction a fine at level 6 and a term of imprisonment of 6 months.

(5) Rules made under this section may provide that a licensed corporation, or an associated entity of a licensed corporation, which, with intent to defraud, contravenes any specified provision of the rules that applies to it commits an offence and is liable to a specified penalty not exceeding—

(a) on conviction on indictment a fine of $1,000,000 and a term of imprisonment of 7 years;

(b) on summary conviction a fine of $500,000 and a term of imprisonment of 1 year.

(6) A person is not excused from complying with a requirement in any rules made pursuant to subsection (2)(k) to give notification to the Commission only on the ground that to do so might tend to incriminate the person.

(7) Notwithstanding anything in this section, no rules made under this section shall apply to associated entities that are authorized financial institutions.

(8) Notwithstanding anything in subsection (3), that subsection does not prevent client money of a licensed corporation that is received or held by an associated entity that is an authorized financial institution from being taken in execution against the associated entity.

## COMMENTARY

### [149.01] Enactment history

Section 149 is a section partly derived from ss.46 and 47 of the repealed Commodities Trading Ordinance (Cap.250) and ss.83, 85, 121AJ, 121AK, 121AL, 121AM, 121AN and 121AP of the repealed Securities Ordinance (Cap.333).

### [149.02] Overview

This section enables the SFC to make rules in relation to how licensed corporations and associated entities treat and deal with client money. Particularly relevant is the Securities and Futures (Client Money) Rules (Cap.571I, Sub.Leg.) (CMRs), which came into force on 1 April 2003 in order to regulate how intermediaries deal with client money.

### [149.03] Segregated account

Section 4 of the CMRs requires a licensed corporation or its associated entity to establish a segregated account for client money (designated as a trust account or client account) at an authorised financial institution.

An "authorized financial institution" means an authorised institution as defined in s.2(1) of the Banking Ordinance (Cap.155), which includes (i) a bank; (ii) a restricted licence bank; or (iii) a deposit-taking company. See Sch.1 of the SFO.

Under s.4(4) of the CMRs, the licensed corporation or associated entity must make payment of client money, within one business day, to:

- the trust account;
- to the client; or
- in accordance with a written direction or standing authority.





Section 3(2) of the CMRs provides that the CMRs do not apply to money received or held outside Hong Kong while that client money remains outside Hong Kong, or client money that is transferred outside Hong Kong in accordance with the CMRs.

The SFC has stated that the segregated account can be called anything that identifies, signifies or characterises it as a client account. The intermediary should not mix its own money with client money in the segregated account and if it becomes aware that non-client money is comingled in the segregated account it must be paid out within one day.

If there is a shortage of funds to complete a settlement on behalf of a client, the SFC has suggested that the intermediary should consider drawing from its house (ie its own) account.

### [149.04] Associated entity

The obligations in the CMRs on the treatment of client monies apply to an intermediary or an associated entity of the intermediary.

An "associated entity" is, in relation to an intermediary, a company or a registered non-Hong Kong company as defined by s.2(1) of the Companies Ordinance (Cap.622), one which: (a) is in a controlling entity relationship with the intermediary and (b) receives or holds in Hong Kong client assets of the intermediary (Sch.1 of the SFO).

The application, definition, and duties of an associated entity are further explained and expounded upon later under s.165 of the SFO.

### [149.05] Client money

The SFC has stated that dividends on stocks held for clients are client money and should be treated as such.

### [149.06] Dealing with Client Money

Section 5 of the CMRs sets out the parameters for payment of client money out of a segregated account. Essentially, the money should be held in a segregated account until it is paid according to the client's written instructions or pursuant to the client's standing authority, or paid to meet the client's obligations, subject to the exceptions in s.149(2) and 149(3).

### [149.07] Standing Authority

The CSRs permit payments from the segregated account in accordance with a standing authority (subject to certain conditions in s.5(2) and 5(3) of the CSRs).

A standing authority must comply with and be renewed in accordance with s.8 of the CSRs.

The SFC has stated that the client's written direction or standing authority must be obtained if client money received or held in Hong Kong is to be transferred and segregated outside Hong Kong. They have also stated that there is no need for a written direction or standing authority to pay client money into the client's designated bank account, but that such direction or authority is required if payment is to be made to a bank account not in the name of the client.

### [149.08] SFC Guidance

The CSRs, together with rules made under s.149 of the SFO in relation to client monies, are integral to the regulation of intermediaries and the protection of client assets

held or deposited with them or their associated entities. The SFC has stressed the importance of adequate internal controls and has issued a guidance note in April 2003 entitled: *Suggested Control Techniques and Procedures for Enhancing a Firm's Ability to Comply with the Securities and Futures (Client Securities) Rules and the Securities and Futures (Client Money) Rules.*

Further, on 5 February 2016, the SFC issued a circular reminding intermediaries licensed for dealing in securities to establish internal control procedures and financial and operational capabilities: *Circular to Licensed Corporations Licensed for Dealing in Securities Protecting Client Assets Against Internal Misconduct.*

In addition, see *SFC Circular to Licensed Corporations and Associated Entities (25/11/2003): Proper segregation and safeguarding of client money; SFC Circular to Licensed corporations (14/02/2018): Guidance on client facilitation; SFC Circular to Licensed Corporations (14/05/2019): Recent inspection findings related to client facilitation.*

### [149.09] Client money placed with overseas brokers

The SFC released a circular on 22 June 2017 regarding compliance and control issues relating to futures brokers. One of the issues which the SFC highlighted was future brokers placing client money with overseas brokers in amounts which were substantially in excess of the margin required to be posted. The SFC called for the establishment and maintenance of policies and procedures to ensure proper management of risks for clients when conducting overseas transactions. This includes explaining the risks of such trading activities to clients, including the risk that client assets may not be subject to the protections given to client assets held in Hong Kong.

### [149.10] Additional guidance on risk management practices for client money

The SFC provided additional guidance on 18 December 2017 to licensed corporations on establishing and maintaining prudential risk management practices for client money liquidity and the concentration risks of funding sources within group-affiliated entities.

With a view to ensuring financial stability, the SFC expects licensed corporations to proactively manage liquidity risks, including concentration limits for counterparties. General Principle 8 and paragraph 11 of the Code of Conduct require licensed corporations to ensure that client assets are adequately safeguarded. Additional risk management should be considered especially with respect to the deposit locations of client money and sources of funding.

Further, the SFC provided guidance regarding protection of client money kept with affiliated banks. The SFC has stressed the importance establishing, maintaining, and adhering to prudential risk management practices to safeguard client money, and in particular setting and enforcing concentration limits for affiliated financial institutions. This can be done by setting out effective policies and procedures to manage concentration exposure, regularly reviewing concentration exposure, and determining appropriate arrangements and procedures like having segregated accounts at non-affiliated financial institutions to reduce exposure.

On 23 August 2019, the SFC released a circular highlighting the deficiencies or inadequacies in fund managers' liquidity risk management practices. Fund managers were reminded to review their current policies, procedures, systems and processes in light of the observations noted in the Appendix to the said circular and regulatory requirements and take immediate action to rectify any inadequacies or deficiencies. Additionally, in view of global market volatility, fund managers were reminded to perform more frequent and enhanced liquidity stress testing and to have in place





appropriate action plans on how to meet the fund's liquidity needs should any of the stress scenarios materialise. Liquidity risk management, together with securities lending and repurchase arrangements, safe custody of fund assets and disclosure of leverage by fund managers, would remain a key focus of the SFC's supervision of fund managers in the coming year.

### [149.11] Offence

Under s.12 of the CSRs, if an intermediary or an associated entity breaches s.4 or 5 of the CSRs without reasonable excuse, it commits an offence and, if convicted on indictment, is liable to a fine of $200,000 and 2 years imprisonment. Where it is summarily convicted, it is liable to a fine at level 6 and imprisonment of 6 months.

Where the breach was with an intent to defraud, and the intermediary or associated entity is convicted on indictment, it is liable to a fine of $1,000,000 and 7 years imprisonment. Where it is summarily convicted, it is liable to a fine of $500,000 and 1 year imprisonment.

Where s.6, 8(4), 10, or 11 of the CSRs is contravened without reasonable excuse, the intermediary or associated entity is liable to a fine at level 3. Where the contravention was with an intent to defraud, the fine is at level 6.

### [149.12] Level 3 and level 6 fine

Under Sch.8 of the Criminal Procedure Ordinance (Cap.221), a level 3 fine is $10,000, and a level 6 fine is $100,000.

### [149.13] Regulatory enforcement

There have been a number of cases involving improper dealing with client monies. The issues have been (i) the use of client money without proper authority; (ii) the deposit of client money to a non-segregated account; and (iii) the improper transfer of client money. In certain of these cases, senior management was also disciplined for failure to supervise or establish adequate internal controls; see also 148.14.

## 150. Claims and liens not affected

Nothing in sections 148 and 149 and any rules made under any of those sections shall be construed as taking away or affecting a lawful claim or lien which any person has in respect of client assets of an intermediary (whether received or held by the intermediary or an associated entity of the intermediary), but the existence of any such claim or lien does not relieve the intermediary or an associated entity of the intermediary of the duty to comply with the requirements of those rules that apply to the intermediary or the associated entity (as the case may be).

### COMMENTARY

### [150.01] Enactment history

Section 150 is derived from s.48 of the repealed Commodities Trading Ordinance (Cap.250); ss.81B, 86, and 121AO of the repealed Securities Ordinance (Cap.333); and s.25 of the repealed Leveraged Foreign Exchange Trading Ordinance.

### [150.02] Overview

This section seeks to protect lawful claims and liens from being affected by the regulations in handling client securities, securities collateral and client money.

This approach is consistently applied by the Tribunal; see for example *QPL International Holdings* (25 February 2009) and *Mobicon Group Ltd* (23 March 2009).

### [274.05] Location of false trading

Section 274(1) and 274(3) apply to conduct carried out in Hong Kong which is targeted at the Hong Kong markets, while s.274(2) and 274(4) apply to conduct carried out in Hong Kong which is targeted at the securities or futures contracts traded on an overseas market.

#### False or misleading appearance

It is often difficult to distinguish between genuine trading activities and "fictitious or colourable" transactions. An example of such difficulty is in *HKSAR v Fu Kor Kuen Patrick* (2012) 15 HKCFAR 524. It was established at the trial that two defendants traded derivative warrants, all issued by the same issuer, with each other frequently on the stock market to generate a large trading volume and their purpose was to earn rebates under a rebate scheme organised by the issuer (to stimulate the market's interest in the derivative warrant). To do so, they placed buy and sell orders against each other at around the same price and time on numerous occasions during the trading hours. As long as their trading volume reached a certain level, they would each receive a rebate from their own broker which would exceed their combined transaction costs, resulting in an almost risk-free profit.

The prosecution case was that the defendants intended to create a false and misleading appearance of active trading in the derivative warrants or were reckless as to whether it had or was likely to have that effect.

The District Court convicted both defendants for false trading offences under s.291. The Court of Appeal dismissed their appeal against their convictions. On Fu's appeal to the Court of Final Appeal, the CFA found that his purpose was to earn rebates, the defence under s.295(7) was applicable and his appeal was allowed. Although the trades by Fu and Lee were executed and hence they appeared to be genuine trades in that sense, their trading activities did not reflect any "genuine supply and demand" described in *North v Marra Developments Ltd*. Therefore, they can still be regarded as having created a false or misleading appearance of active trading (see *Fu Kor Kuen*, [43]).

#### Active trading

The High Court of Australia in *Braysich v R* [2011] HCA 14 addressed briefly the meaning of the expression "active trading". In that case, the Court accepted that the expression "active trading" would require something more than an ordinary change in the volume or price of the securities.

The determination whether a particular pattern of new trading has created actual or apparent active trading is a function of the prior state of the market in the security, the number of shares actively traded, and the general level of market activity as well as of the particular trading attributable to the alleged manipulator. Therefore, generalisation as to how much trading is active trading is impossible.[1]

The Court of Appeal in the appeal by Fu and Lee in *HKSAR v Fu Kor Kuen Patrick* [2011] 1 HKLRD 655[2] considered that the expression active trading was not a term of art:

1 §115.

2 The appeal of the defendant before the Court of Final Appeal was allowed but on different grounds.





> Whilst the judge did condescend to articulate the dictionary definition of "trade", namely the activity of buying and selling, and he did note that the phrase "active trading" was not defined in the Ordinance he did not seek to define the word "active". He did not need to do so. It is a simple English word, the meaning of which is readily understood. Similarly, he did not determine specifically that the applicants' trading fell within the phrase "active trading". Again, he did not need to do so. No sensible suggestion to the contrary was sustainable. There was no doubt whatsoever that the applicants' trading had, or was likely to have, the effect of creating an appearance of active trading in those warrants.[3]

A similar approach was adopted in the inquiry in the dealings in the shares of *Mobicon Group Ltd* (23 March 2009)[4] where the Tribunal took account of various factors including the background that Mobicon shares were not actively traded, and the number and trading volumes of matched trades.

#### Possible motives

It is plausible that a false or misleading appearance of active trading is created to achieve a number of ulterior motives, including:

(i) the inducement of investors to deal in the securities;
(ii) the use of the securities as collateral for borrowings; and
(iii) the facilitation of a placing of securities or another fund-raising exercise.

#### Deemed intention or recklessness

Under s.274(5), where a person enters into a wash sales or matched orders transaction, within the description provided in s.274(5)(a), 274(5)(b) or 274(5)(c), *unless it is an off-market transaction*, the person shall be deemed to be doing something, or causing it to be done, with the intention that, or being reckless as to whether, it has or is likely to have the proscribed effect under s.274(1) or, where it is targeted at an overseas market under s.274(2). These deeming provisions apply, by operation of law, on satisfaction of the conditions in s.274(5)(a), 274(5)(b) or 274(5)(c).

The deeming provision under s.274(5) expressly provides that it does not apply to an off-market transaction. Under s.274(7), an off-market transaction is one which is not required to be recorded on the relevant market or which, where automated trading services (ATS) is used, is not required to be recorded by means of the ATS, under the rules of the relevant exchange or the rules which apply to the ATS provider.

### [274.06] Statutory Defence

Section 274(6) provides a defence for the defendant whose conduct falls within s.274(5)(a), 274(5)(b) or 274(5)(c). The defendant must establish on a balance of probabilities that the purpose or purposes for which he entered into the impugned transaction(s) *was not and*

3 As the Court put it "On the 19 days on which the applicants traded in the 20 warrants, the subject of the charges, their trading accounted for 75% or more of the total market turnover in those warrants on all but two occasions. Even on those two occasions, their trading was more than 50% of the total market turnover in the warrants. The lowest number of warrants they traded on a particular day was 14 million, whereas on most occasions they traded in many tens of millions of warrants and on a number of occasions in hundreds of millions of warrants on a single day".

4 The report of the Market Misconduct Tribunal into dealings in the shares of Mobicon Group Limited on and between 1 April 2003 and 25 May 2005 (dated 23 March 2009).

*did not include* the proscribed purpose of creating a false or misleading appearance under s.274(1) or 274(2). It may require the defendant to prove a negative as to his or her state of mind at the time of the transaction; see *Braysich v R* [2011] HCA 14, 32, 101.

Similar to a criminal trial, evidence of previous good behaviour may lend support for an inference that there was no unlawful purpose; see *Braysich v R* [2011] HCA 14, 44. Mr. Justice Lunn as Chairman of the Tribunal considered that:

> … a person of good character is less likely than otherwise might be the case to have committed the alleged misconduct.[5]

**[274.07] Transactions resulting in an artificial price**

The word "transaction" is not considered a term of art; see *Bendir v Anson* [1936] 3 All ER 326, 330; see also *R v O'Driscoll* [2003] NSWCCA 166.

The meaning of "artificial or fictitious" has been considered in *Seramco Trustees v Income Tax Commissioners* [1977] AC 287, where Lord Diplock giving the opinion of the Privy Council held (at 298) that:

> "Artificial" is an adjective which is in general use in the English language. It is not a term of legal art; it is capable of bearing a variety of meanings according to the context in which it is used. In common with all three members of the Court of Appeal their Lordships reject the trustees' first contention that its use by the draftsman of the subsection is pleonastic; that is, a mere synonym for "fictitious". A fictitious transaction is one which those who are ostensibly the parties to it never intended should be carried out. "Artificial" as descriptive of a transaction is, in their Lordships' view a word of wider import. Where in a provision of a statute an ordinary English word is used, it is neither necessary nor wise for a court of construction to attempt to lay down in substitution for it, some paraphrase which would be of general application to all cases arising under the provision to be construed. Judicial exegesis should be confined to what is necessary for the decision of the particular case. Their Lordships will accordingly limit themselves to an examination of the shares agreement and the circumstances in which it was made and carried out, in order to see whether that particular transaction is properly described as "artificial" within the ordinary meaning of that word.

In *DPP v JM,* the defendant JM was charged with 39 counts of market manipulation contrary to s.1041A and 2 counts of conspiring with others to commit market manipulation. He pleaded not guilty to each charge. After a jury was empaneled, the trial judge stated a case and reserved 3 questions for determination by the Court of Appeal of the Supreme Court of Victoria. On appeal by the Director of Public Prosecutions against the determination of the Court of Appeal, the High Court of Australia reviewed the authorities including *North v Marra Developments Ltd* (1981) 148 CLR 42 and analysed the inter-related issues of "genuine supply and demand" and "artificial price":

> 71. The forces of "genuine supply and demand" are those forces which are created in a market by buyers whose purpose is to acquire at the lowest available price

5 The report of the Market Misconduct Tribunal into dealings in the shares of Mobicon Group Limited on and between 1 April 2003 and 25 May 2005 (dated 23 March 2009), para.21.





> and sellers whose purpose is to sell at the highest realisable price. The references in s 1041A to a transaction which has, or is likely to have, the effect of creating an "artificial price", or maintaining the price at a level which is "artificial", should be construed as including a transaction where the on-market buyer or seller of listed shares undertook it for the sole or dominant purpose of setting or maintaining the price at a particular level. It is, however, important to emphasise that whether there are *other* kinds of transaction which have the effect of creating or maintaining an artificial price in a market for listed shares[6] is not, and, given the terms of the case stated, should not be, decided.
>
> 72. the price that results from a transaction in which one party has the sole or dominant purpose of setting or maintaining the price at a particular level is not a price which reflects the forces of genuine supply and demand in an open, informed and efficient market. It is, within the meaning of s 1041A, an "artificial price". The offer to supply or acquire of the kind described is made at a price which is determined by the offeror's purpose of setting or maintaining the price. It is not determined by the offeror's purpose, if buying, to minimise, or, if selling, to maximise, the price paid, and it is not determined by the competition between other buyers whose purpose is to minimise the price and other sellers whose purpose is to maximise the price[7]. If the offer results in a transaction, that is a transaction which can be characterised as at least *likely* to have the effect of creating or maintaining an artificial price for trading in the shares
>
> 73. Because s 1041A prohibits transactions which are likely to have that effect, it is not necessary to demonstrate, whether by some counterfactual analysis or otherwise, that the impugned transactions *did* create or maintain an artificial price. It is sufficient to show that the buyer or seller set the price with the sole or dominant purpose described.
>
> 74. Further, if a transaction is made for the sole or dominant purpose of setting or maintaining a price for listed shares, it is not necessary to proffer some additional proof that the impugned transactions "went on to affect the behaviour of genuine buyers and sellers in the market"[8] in order to demonstrate that the transactions had, or were likely to have, the effect of creating or maintaining an artificial price. On-market transactions on the ASX (like the impugned transactions in this case) are made openly. Participants in the market can be (and are) informed of the transactions which occur. Participants in the market are entitled to assume that the transactions which are made are made between genuine buyers and sellers and are *not* made for the purpose of setting or maintaining a particular price. Hence, as Mason J explained in *North v Marra*[9], "in the absence of revelation of their true character [as transactions to set or maintain a particular price] they are seen as transactions reflecting genuine supply and demand and having as such an impact on the market". They have, or at least are likely to have, the effect of setting or maintaining an artificial price for the shares in question.

6 See Avgouleas, *The Mechanics and Regulation of Market Abuse* (2005), 131–154.

7 See also *Australian Securities and Investments Commission v Soust* (2010) 183 FCR 21, 43, [90]; *Australian Securities and Investments Commission v Administrative Appeals Tribunal* (2010) 187 FCR 334, 349, [47].

8 (2012) 267 FLR 238, 295, [260] (Warren CJ).

9 (1981) 148 CLR 42, 59.

> 75. … In applying s 1041A, no distinction can or should be drawn according to whether the purpose of setting or maintaining a price was the sole or dominant purpose of the person concerned. Proof of a dominant, as distinct from sole, purpose of setting or maintaining a price would establish that the relevant transaction established or maintained an artificial price.

To determine if the trading activities under consideration manifest genuine supply and demand, the Court will have regard to a host of factors including, but not limited to: (i) the timing of any offers to sell or purchase; (ii) the volume of financial products the person offers to sell or purchase; (iii) the depth of trading in financial products of that type on that financial market; (iv) the pattern of trading in those financial products preceding the actions under consideration; and (v) any changes in the pattern that are consequential upon those actions or that would not have occurred but for those actions and which do not reflect the forces of supply and demand. See also *JTMJ v Australian Securities and Investments Commission* [2010] AATA 350 (11 May 2010).

**[274.08] Authorized ATS**

The expression "authorized automated trading service" is defined in Part 1 of Sch.1 of the SFO as "automated trading services which a person is authorised to provide under s.95(2) of this Ordinance".

Part 2 of Sch.5 of the SFO defines "automated trading services" to be:

> services provided by means of electronic facilities, not being facilities provided by a recognized exchange company or a recognized clearing house, whereby –
>
> (a) offers to sell or purchase securities or futures contracts are regularly made or accepted in a way that forms or results in a binding transaction in accordance with established methods, including any method commonly used by a stock market or futures market;
> (b) persons are regularly introduced, or identified to other persons in order that they may negotiate or conclude, or with the reasonable expectation that they will negotiate or conclude sales or purchases of securities or futures contracts in a way that forms or results in a binding transaction in accordance with established methods, including any method commonly used by a stock market or futures market; or
> (c) transactions –
>  (i) referred to in paragraph (a);
>  (ii) resulting from the activities referred to in paragraph (b); or
>  (iii) effected on, or subject to the rules of, a stock market or futures market, may be novated, cleared, settled or guaranteed,
>
> but does not include such services provided by a corporation operated by or on behalf of the Government.

An authorized ATS provider is someone who provides an electronic platform on which financial products may be traded or cleared. In general, an authorized ATS provider will be required to have sufficient financial resources for the proper performance of its functions and obligations. As to what constitutes sufficient financial resources, the Commission may take into consideration a number of factors such as the projected expenditure of the ATS operation from time to time, which in turn will be affected by the size and characteristics of the trading platform and the markets traded on the platform. It follows that the financial resources required may change over time as the size and characteristics of the authorized ATS operation evolves and changes.





Furthermore, the SFC has published *Guidelines for the Regulation of an Authorized Automated Trading Service* (ATS Guidelines) and developed procedures for the authorization of an ATS and handling of such applications. The ATS Guidelines set out core standards that a person providing ATS would generally be expected to meet in relation to financial resources and risk management, operational integrity, fitness, record keeping, transparency, surveillance, and reporting.

**[274.09] The "relevant recognised market" and "relevant overseas market"**

Section 245 defines both terms:

> "relevant overseas market"
>
> (a) in relation to securities, means a stock market outside Hong Kong; or
> (b) in relation to futures contracts, means a futures market outside Hong Kong;
>
> "relevant recognized market"
>
> (a) in relation to securities, means a recognized stock market; or
> (b) in relation to futures contracts, means a recognized futures market;

Sch.1 in Part 1 of the SFO provides that:

> "recognized stock market" means a stock market operated by a recognized exchange company;
>
> "recognized futures market" means a futures market operated by a recognized exchange company;
>
> "recognized exchange company" means a company recognized as an exchange company under s.19(2) of the Ordinance.



## 275. Price rigging

(1) Price rigging takes place when, in Hong Kong or elsewhere, a person—
  (a) enters into or carries out, directly or indirectly, any transaction of sale or purchase of securities that does not involve a change in the beneficial ownership of those securities, which has the effect of maintaining, increasing, reducing, stabilizing, or causing fluctuations in, the price of securities traded on a relevant recognized market or by means of authorized automated trading services; or
  (b) enters into or carries out, directly or indirectly, any fictitious or artificial transaction or device, with the intention that, or being reckless as to whether, it has the effect of maintaining, increasing, reducing, stabilizing, or causing fluctuations in, the price of securities, or the price for dealings in futures contracts, that are traded on a relevant recognized market or by means of authorized automated trading services.

(2) Price rigging takes place when, in Hong Kong, a person—
  (a) enters into or carries out, directly or indirectly, any transaction of sale or purchase of securities that does not involve a change in the beneficial ownership of those securities, which has the effect of maintaining, increasing, reducing, stabilizing, or causing

fluctuations in, the price of securities traded on a relevant overseas market; or

(b) enters into or carries out, directly or indirectly, any fictitious or artificial transaction or device, with the intention that, or being reckless as to whether, it has the effect of maintaining, increasing, reducing, stabilizing, or causing fluctuations in, the price of securities, or the price for dealings in futures contracts, that are traded on a relevant overseas market.

(3) For the purposes of subsections (1)(b) and (2)(b), the fact that a transaction is, or at any time was, intended to have effect according to its terms is not conclusive in determining whether the transaction is, or was, not fictitious or artificial.

(4) A person shall not be regarded as having engaged in market misconduct by reason of price rigging taking place through any transaction of sale or purchase of securities referred to in subsection (1)(a) or (2)(a) if he establishes that the purpose for which the securities were sold or purchased was not, or, where there was more than one purpose, the purposes for which the securities were sold or purchased did not include, the purpose of creating a false or misleading appearance with respect to the price of securities.

(5) In this section—

(a) a reference to a transaction of sale or purchase, in relation to securities, includes an offer to sell or purchase securities and an invitation (however expressed) that expressly or impliedly invites a person to offer to sell or purchase securities; and

(b) a reference to entering into or carrying out a transaction of sale or purchase shall, in the case of an offer or an invitation referred to in paragraph (a), be construed as a reference to making the offer or the invitation (as the case may be).

## COMMENTARY

### [275.01] Enactment history

This section came into effect on 1 April 2003. It was derived from s.135(3) and 135(4) of the repealed Securities Ordinance (Cap.333). It was also derived from the repealed ss.998 and 1260 and which are now encapsulated in s.1041C of the Australian Corporations Act 2001. These are in turn based on s.9(a)(2) of the US Securities Exchange Act 1934.

### [275.02] Overview

Section 275 makes it market misconduct for a person to engage in price rigging. Section 275(1) defines price rigging in two ways:

(1) The first involves activities known as "wash trades" of securities entered into which has the effect of maintaining, increasing, reducing, stabilizing or causing fluctuations in their price traded on the stock market or by means of authorized ATS. These are persons engaging in the buying or selling of securities without a change of their beneficial ownership that has the effect of maintaining, increasing, reducing or causing fluctuations in the price of the securities traded on the stock market or by means of authorized ATS; and





(2) The second involves the conduct of *any* fictitious or artificial transaction or device with the intention that or being reckless as to whether it has the effect of maintaining, increasing, reducing, stabilizing or causing fluctuations in the price of securities, or the price for dealings in futures contracts traded on the stock market or by means of authorized ATS.

Section 275(2) covers the situations where the same conduct is targeted at securities or futures contracts traded on a relevant overseas market.

Section 275(3) expressly provides that the fact a transaction is, or at any time was, intended to have effect according to its terms not determinative of the question whether or not the transaction is or was fictitious or artificial. The reason is, as articulated by Sir Anthony Mason in *North v Marra Developments Ltd* (1981) 148 CLR 42, 59:

> Transactions which are real and genuine but only in the sense that they are intended to operate according to their terms, like fictitious or colourable transactions, are capable of creating quite a false or misleading impression as to the market or the price.

### [275.03] Fictitious or artificial

The meaning of "artificial or fictitious" has been dealt with in 274.07:

> "Artificial" is an adjective which is in general use in the English language. It is not a term of legal art; it is capable of bearing a variety of meanings according to the context in which it is used. In common with all three members of the Court of Appeal their Lordships reject the trustees' first contention that its use by the draftsman of the subsection is pleonastic; that is, a mere synonym for "fictitious". A fictitious transaction is one which those who are ostensibly the parties to it never intended should be carried out. (*Seramco Trustees* at 298)

In the context of price rigging, the term "artificial or fictitious transaction" refers to a transaction which would not have been entered into but for the purpose of price rigging and therefore it does not reflect genuine supply and demand; see *North v Marra Developments Ltd* (1981) 148 CLR 42; see also *HKSAR v Fu Kor Kuen Patrick* [2011] 1 HKLRD 655.

### [275.04] Price

Depending on the facts of the case, the word "price" may mean an indicative price disseminated by the Stock Exchange of Hong Kong Limited called a "nominal price"; see 296.05.

In *Securities and Futures Commission v Tsoi Bun* [2014] 2 HKLRD 1, the CFI was asked to consider whether, on the basis of the admission of the defendant to the contravention of s.296(1)(b) of the SFO, the Court should grant the range of final orders sought by the SFC. In its deliberation, the Court was satisfied that on the basis of the admission, the defendant committed price rigging on the futures market in contravention of s.296(1)(b) of the SFO, and it was appropriate to grant the final orders sought. This case furnishes an example of how the market misconduct of price rigging can be committed.

### [275.05] Statutory defence

Similar to s.274(6), s.275(4) provides an innocent purpose defence for a person whose conduct is within the scope of s.275(1)(a) or 275(2)(a). To invoke the defence, the defendant has to establish that, at the material time, the purpose for which the defendant bought or sold the relevant securities *did not* include any purpose of creating a false or misleading appearance with respect to the price of securities.

(d) an interest of a person subsisting by virtue of—
  (i) a charitable scheme made by order of any court of competent jurisdiction; or
  (ii) the vesting of a deceased's estate in any judicial officer between the time of death of the deceased and the grant of letters of administration; and
(e) such interests or interests of such a class, or such short positions or short positions of such a class, as are prescribed by regulations for the purposes of this section.

(2) A person is not taken to be interested in shares or debentures under section 345(5)(b) by reason only that he—
(a) has been appointed as a proxy to vote at a specified meeting of the listed corporation or associated corporation or of any class of its members and at any adjournment of that meeting; or
(b) has been appointed by a corporation to act as its representative at a meeting of the listed corporation or associated corporation or of any class of its members.

(3) An interest in shares or debentures of a holder, trustee or custodian of a scheme referred to in subsection (1)(c)(i), (ii) or (iii), comprised in the property under the scheme, shall not be disregarded under subsection (1)(c) if the holder, trustee or custodian (as the case may be) is also a manager of the scheme.

(4) For the purposes of subsection (1)(c), ***qualified overseas scheme*** (合資格海外計劃) means a collective investment scheme, pension scheme or provident fund scheme which—
(a) is established in a place outside Hong Kong recognized for the purposes of this section by the Commission by notice published in the Gazette; and
(b) is authorized by or registered with the authority (if any) responsible for the authorization or registration of such scheme in the place where it is established, and complies with the requirements of such authority,

but does not include—
(i) an arrangement operated by a person otherwise than by way of business;
(ii) an arrangement under which less than 100 persons hold, or have the right to become holders of, interests (whether described as units or otherwise) that entitle the holders, directly or indirectly, to the income or property of the arrangement;
(iii) an arrangement under which less than 50 persons hold, or have the right to become holders of, interests (whether described as units or otherwise) that entitle the holders, directly or indirectly, to 75% or more of the income or property of the arrangement; and
(iv) such other arrangement as may be specified by the Commission by notice published in the Gazette.

(5) For the purposes of subsection (1), a person shall not be considered as not being a bare trustee in respect of any property by reason only that—
(a) the person for whose benefit the property is held is not absolutely entitled thereto as against the trustee only because he is a minor or is a person under a disability; or





(b) the trustee has the right to resort to the property to satisfy any outstanding charge or lien or for the payment of any duty, tax, cost or other outgoings.

(6) A notice published pursuant to subsection (4)(a) or (iv) is not subsidiary legislation.

## COMMENTARY

**[346.01] Enactment history**
This section parallels s.323 of the SFO in respect of substantial shareholders. However, the exclusions are narrower in scope compared with the exclusion for substantial shareholders under s.323; for instance, discretionary interests under trusts are not disregarded.

**[346.02] Determination of duty to disclose**
Further to s.345 of the SFO, this section sets out various scenarios in which a director or chief executive would have interests in shares or debentures which do not give rise to a duty to disclose.

**[346.03] Securities and Futures (Disclosure of Interests – Exclusions) Regulations (Cap.571AG, Sub.Leg.)**
Reference should also be made to the Securities and Futures (Disclosure of Interests – Exclusions) Regulations (Cap.571AG, Sub.Leg.) in respect of other exclusions from disclosure.

### Division 9—Requirements for giving notification by director and chief executive

**347. Notification to be given by director and chief executive**

(1) Where a person comes under a duty of disclosure under section 341, he shall give notification to the listed corporation concerned and to the relevant exchange company of—
(a) the interests which he has, or ceases to have, in shares in or debentures of the listed corporation or any associated corporation of the listed corporation; and
(b) the short position (if any) which he has, or ceases to have, in shares in the listed corporation or any associated corporation of the listed corporation.

(2) A notification required by this section shall be given to the listed corporation concerned and the relevant exchange company at the same time or (if it is not practicable to do so) one immediately after the other.

(3) The Commission may, by notice published in the Gazette, specify the form in respect of a notification required by this section, either generally or in any particular case, and, without limiting the generality of the foregoing, may in the form—
(a) notwithstanding section 397(1), include directions and instructions relating to the manner in which the form is to be completed, signed, executed and authenticated; and
(b) specify documents by which it is to be accompanied.

(4) For the purposes of subsection (3), the Commission may specify any form by referring in a notice published in the Gazette to the form as separately published by such electronic means as the Commission considers appropriate, instead of setting out the form in a notice published in the Gazette, whereupon the Commission shall for all purposes be regarded as having duly specified the form under subsection (3).

(5) For the purposes of subsection (3), the Commission may specify that different forms are to be used in different circumstances.

(6) Subject to subsection (7), where the Commission has specified any form under subsection (3) in respect of a notification required by this section to be given when a duty of disclosure arises under section 341, the duty shall not be regarded as having been performed unless the notification—
(a) is in the form specified;
(b) is completed, signed, executed and authenticated in accordance with such directions and instructions as are included in the form; and
(c) is accompanied by such documents as are specified in the form.

(7) A notification required by this section shall not by reason of any deviation from a form specified in respect of it by notice published pursuant to subsection (3) cease to be regarded as being in that form, if the deviation does not affect the substance of the form.

(8) A notice published pursuant to subsection (3) is not subsidiary legislation.

## COMMENTARY

**[347.01] Enactment history**

This section replaced ss.28 and 54 of the repealed S(DI)O. It parallels s.324 of the SFO in respect of the duty of substantial shareholders. A comparison may be made to an equivalent provision found in s.324 of the Companies Act 1985 (UK).

**[347.02] Forms**

This section deals with notification under the duty imposed by s.341. The forms mentioned in s.347(3) may be found on the SFC website. The relevant forms in this regard are Forms 3A, 3B, 3C, and 3D – directions and instructions for the completion of each of these forms may also be found on the website. Further details in respect of the forms may also be found in paras.4.2 and 4.6 of the SFC, "*Outline of Part XV*", July 2017.

See also the forms listed on the SFC website at http://www.sfc.hk/web/EN/rule-book/sfo-part-xv-disclosure-of-interests/di-notices.html.

### 348. Time of notification by director and chief executive

(1) A notification required by section 347 shall be given, where the duty of disclosure arises under section 341(1)(a), (b), (c), (d), (e) or (f)—
(a) in the case that at the time at which the relevant event occurs the person concerned knows of its occurrence, within 3 business days after the day on which the relevant event occurs; or
(b) otherwise, within 3 business days after the day on which the occurrence of the relevant event comes to his knowledge.





(2) A notification required by section 347 shall be given, where the duty of disclosure arises under section 341(2)—
(a) within 10 business days after the day on which the relevant event occurs; or
(b) in the case that at the time at which the relevant event occurs the person concerned is not aware—
(i) that he has an interest in shares in or debentures of the listed corporation concerned or any associated corporation of the listed corporation; or
(ii) that he has a short position in shares in the listed corporation or any associated corporation of the listed corporation,
within 10 business days after the day on which he becomes aware that he has such an interest or short position (as the case may be).

## COMMENTARY

**[348.01] Predecessor provisions**

This section replaced s.28(3)(b) of the repealed S(DI)O. A comparison may be made to an equivalent provision found in s.324(1)(b) of the Companies Act 1985 (UK).

**[348.02] Knowledge**

For the purposes of notification, this section sets out the periods in which notifications must be made. Key to the calculation of the period of notification is the concept of "knowledge", ie when the person is considered to have knowledge of the event that requires notification. In particular, para.4.1.2. of the SFC, "*Outline of Part XV*", July 2017 explains that it is knowledge of the event, and not of the duty to notify, that will start the clock running.

**[348.03] Timing of notification**

In the case of most relevant events, the person must give the notification within 3 business days of the day he knows of the relevant event. In the case of relevant events that are referred to an Initial Notification, he must give the notification within 10 business days after he becomes aware of the relevant event.

The period allowed for filing a notice runs from the time he knows of the facts that constitute the event (eg the purchase of the shares, the delivery of the shares, the buyback of shares by the listed corporation), not the day that he realizes that the event gave rise to a duty of disclosure under Part XV.

When a person buys shares, he will normally have to file a notice within 3 business days after he has contracted to buy the shares. When he sells the shares, he will normally have to file a notice within 3 business days after settlement day, ie the day when he delivers the shares to the buyer. If in fact the person ceases to be interested in shares on the date of the contract for their sale, eg due to the operation of the clearing system, he should file a notice within 3 business days of that earlier date. If that person contracts to sell shares with a settlement date that is 5 or more trading days after the date of the contract, then he should file one notice within 3 business days after the date of the contract and file a second notice within 3 business days after settlement day. In the case of a transaction that gives rise to him having a short position, disclosure should normally be made within 3 business days of the date that he enters into the transaction.

The notification should be filed with the Stock Exchange and the listed corporation concerned at the same time or one immediately after the other.

**[348.04] Calculating time**

Reference should be made to Sch.1, Part 1, s.1 of the SFO to the meaning of "business day" when calculating the time period – which excludes Saturdays and Sundays as well as public holidays and gale warning or black rainstorm warning days. The period (of 3 or 10 business days) allowed for filing a disclosure notice is calculated excluding the day that the relevant event occurred.

## 349. Particulars to be contained in notification by director and chief executive

(1) Where a duty of disclosure arises under section 341, a person shall, in performing the duty of disclosure, specify in the notification his name, identifying him also as a director or chief executive (as the case may be), and his address, and (so far as he is aware)—

(a) the date on which the relevant event occurred and—

(i) the date (if later) on which he became aware of the occurrence of the relevant event; or

(ii) in the case referred to in section 348(2)(b), the date on which he became aware that he has the interest in the shares in or debentures of, or the short position in the shares in, the listed corporation or the associated corporation of the listed corporation (as the case may be);

(b) subject to subsection (3), the total number and class of—

(i) shares in the listed corporation and any associated corporation of the listed corporation in which he was interested immediately before the relevant time specifying the percentage figure of his interest in the shares in each class; and

(ii) shares in the listed corporation and any associated corporation of the listed corporation in which he is interested immediately after the relevant time specifying the percentage figure of his interest in the shares in each class;

(c) subject to subsection (3), the amount of—

(i) debentures of the listed corporation and any associated corporation of the listed corporation in which he was interested immediately before the relevant time; and

(ii) debentures of the listed corporation and any associated corporation of the listed corporation in which he is interested immediately after the relevant time;

(d) subject to subsection (3), the total number and class of—

(i) shares in the listed corporation and any associated corporation of the listed corporation in which he had a short position immediately before the relevant time specifying the percentage figure of his short position in the shares in each class; and

(ii) shares in the listed corporation and any associated corporation of the listed corporation in which he has a short position





immediately after the relevant time specifying the percentage figure of his short position in the shares in each class;

(e) the circumstances in which he comes under the duty of disclosure;

(f) where the duty of disclosure arises under section 341(1)—

(i) the number and class of shares in the listed corporation or any associated corporation of the listed corporation in which—

(A) he has acquired an interest, or ceased to have an interest, at the relevant time;

(B) he has come to have, or ceased to have, a short position at the relevant time; or

(C) the nature of his interest changes at the relevant time; and

(ii) the amount of debentures of the listed corporation or any associated corporation of the listed corporation in which—

(A) he has acquired an interest, or ceased to have an interest, at the relevant time; or

(B) the nature of his interest changes at the relevant time;

(g) where he acquires or disposes of the interest referred to in paragraph (f)(i)(A)—

(i) through an on-exchange transaction, the highest price and the average price paid or received per share for the interest he acquires or disposes of (or, in the case that no price is paid or received, that fact); or

(ii) through an off-exchange transaction, the nature of the consideration given or received, and the highest amount and the average amount of the consideration given or received per share, for the interest he acquires or disposes of (or, in the case that no consideration is given or received, that fact);

(h) where he acquires or disposes of the interest referred to in paragraph (f)(ii)(A)—

(i) through an on-exchange transaction, the highest price and the average price paid or received per unit for the interest he acquires or disposes of (or, in the case that no price is paid or received, that fact); or

(ii) through an off-exchange transaction, the nature of the consideration given or received, and the highest amount and the average amount of the consideration given or received per unit, for the interest he acquires or disposes of (or, in the case that no consideration is given or received, that fact);

(i) subject to subsection (3), the capacity in which the interest in shares in or debentures of, or the short position in shares in, the listed corporation or any associated corporation of the listed corporation is held immediately after the relevant time and, if the interest in the shares or debentures, or the short position in the shares, is held in more than one capacity, the number of shares or amount of debentures held in each capacity;

(j) subject to subsection (3), where the duty of disclosure arises on the occurrence of an event in consequence of which the nature of

his interest in shares in or debentures of the listed corporation or any associated corporation of the listed corporation changes, the nature of his interest immediately before and immediately after the relevant time;

(k) subject to subsection (3), where he is taken to be interested in shares in or debentures of, or have a short position in shares in, the listed corporation or any associated corporation of the listed corporation under section 344(1), 344(2), 344(3) or 345(14)—

(i) the number and class of the shares or amount of the debentures; and

(ii) the name and address of, and his relationship with, each of the other persons having an interest in the shares or debentures or having a short position in the shares,

in which he is so taken to be interested or have a short position under each of those sections taken separately;

(l) where he no longer has an interest in shares in or debentures of, or a short position in shares in, the listed corporation or any associated corporation of the listed corporation, the fact that he no longer has such an interest or short position; and

(m) such other information as may be required in the form specified for the purpose.

(2) Where any shares the particulars of which have to be specified in a notification by a person under subsection (1)(b), (d), (f), (j) or (k) are the underlying shares of equity derivatives, the person shall also specify, subject to subsection (3), separately in the notification—

(a) the total number of shares which are the underlying shares of any of the following categories of equity derivatives that are listed or traded on a recognized stock market or traded on a recognized futures market, in which he was interested, or had a short position, immediately before the relevant time—

(i) cash settled equity derivatives (specifying separately if they are futures or options); or

(ii) physically settled equity derivatives (specifying separately if they are futures or options);

(b) the total number of shares which are the underlying shares of any of the following categories of equity derivatives that are neither listed or traded on a recognized stock market nor traded on a recognized futures market, in which he was interested, or had a short position, immediately before the relevant time—

(i) cash settled equity derivatives (specifying separately if they are futures or options); or

(ii) physically settled equity derivatives (specifying separately if they are futures or options);

(c) the total number of shares which are the underlying shares of any of the equity derivatives referred to in paragraph (a) in which he is interested, or has a short position, immediately after the relevant time;

(d) the total number of shares which are the underlying shares of any of the equity derivatives referred to in paragraph (b) in which





he is interested, or has a short position, immediately after the relevant time;

(e) the period within which rights under each of the equity derivatives may be exercised (***exercise period***); and

(f) the expiry date of the exercise period.

(3) Where a duty of disclosure arises under section 341(1)—

(a) subsection (1)(b), (c) and (d) shall apply in relation to a person as if a reference to the listed corporation and any associated corporation of the listed corporation in that subsection was a reference to the corporation—

(i) in the shares in or debentures of which he has acquired an interest, or ceased to have an interest, at the relevant time;

(ii) in the shares in or debentures of which he has come to have, or ceased to have, a short position at the relevant time; or

(iii) the nature of his interest in the shares in or debentures of which changes at the relevant time;

(b) the particulars required to be specified under subsection (1)(i), (j) or (k) or (2) shall relate only to—

(i) the shares in which—

(A) he has (or is taken to have) acquired an interest, or ceased to have an interest, at the relevant time;

(B) he has (or is taken to have) come to have, or ceased to have, a short position at the relevant time; or

(C) the nature of his interest changes (or is taken to change) at the relevant time; and

(ii) the debentures in which—

(A) he has (or is taken to have) acquired an interest, or ceased to have an interest, at the relevant time; or

(B) the nature of his interest changes (or is taken to change) at the relevant time.

(4) Where a duty of disclosure arises under section 341(2)(a)(i), (b)(i), (c)(i) or (d)(i), a person shall, in performing the duty of disclosure, also specify in the notification—

(a) in respect of his interest in the shares which are the subject of the disclosure acquired—

(i) through an on-exchange transaction, the highest price and the average price paid per share for the interest acquired within 4 months immediately before the day on which the relevant event occurred; or

(ii) through an off-exchange transaction, the nature of the consideration given, and the highest amount and the average amount of the consideration given per share, for the interest acquired within 4 months immediately before the day on which the relevant event occurred; and

(b) in respect of his interest in the debentures which are the subject of the disclosure acquired—

(i) through an on-exchange transaction, the highest price and the average price paid per unit for the interest acquired

within 4 months immediately before the day on which the relevant event occurred; or

(ii) through an off-exchange transaction, the nature of the consideration given, and the highest amount and the average amount of the consideration given per unit, for the interest acquired within 4 months immediately before the day on which the relevant event occurred.

(5) For the purposes of subsection (1)(b), ***percentage figure*** (百分率數字), subject to subsections (6) and (7), means the percentage figure found by expressing the number of all the shares in the listed corporation concerned or the associated corporation of the listed corporation in which the person is interested immediately before or immediately after (as the case may be) the relevant time as a percentage of the number of the issued shares in the listed corporation or associated corporation (as the case may be).

(6) For the purposes of subsection (5), where the listed corporation concerned or the associated corporation of the listed corporation grants to the person rights to subscribe for, or offers to the person, its shares, as part of a rights issue, the number of the issued shares in the listed corporation or associated corporation (as the case may be) at all times from the grant or offer (as the case may be) up to the completion or termination of the rights issue (whichever is the earlier) is taken to be the aggregate of—

(a) the number of the issued shares in the listed corporation or associated corporation (as the case may be) immediately before the grant or offer (as the case may be); and

(b) the number of the new shares to be issued upon the completion of the rights issue.

(7) For the purposes of subsection (5)—

(a) in determining the number of shares in which a person is interested, there shall be disregarded any short position which that person has in the shares which, if included in the calculation of the number of shares in which the person is interested, would reduce the number of shares in which the person is interested; and

(b) the particulars of the shares in which that person has a short position, or has ceased to have a short position, shall be specified separately in the notification.

(8) For the purposes of subsection (1)(d), ***percentage figure*** (百分率數字) means the percentage figure found by expressing the number of all the shares in the listed corporation concerned or the associated corporation of the listed corporation in which the person has a short position immediately before or immediately after (as the case may be) the relevant time as a percentage of the number of the issued shares in the listed corporation or associated corporation (as the case may be).

(9) Where the share capital of the listed corporation or the associated corporation of the listed corporation is divided into different classes of shares—

(a) a reference in this section to the number of shares in the listed corporation or associated corporation (as the case may be) in which the person is interested or has a short position shall be construed as a reference to the number of the shares in each of the classes taken separately; and

(b) a reference in this section to a percentage of the number of the issued shares in the listed corporation or associated corporation (as the case may be) shall be construed as a reference to a percentage of the number of the issued shares in each of the classes taken separately.

(10) In subsection (6), ***completion*** (完成), in relation to a rights issue, means the issue of shares in the listed corporation or the associated corporation of the listed corporation pursuant to the rights issue.

(11) Where an event on the occurrence of which a director or chief executive comes under a duty of disclosure under section 341 arises from the grant by the listed corporation, or any associated corporation of the listed corporation, of debentures or rights to subscribe for debentures, or the exercise or assignment of those rights so granted, the notification shall also specify—

(a) the—

(i) price paid or received—

(A) for the grant of those debentures or those rights; or

(B) on the exercise or assignment of those rights,

(or, in the case that no price is paid or received, that fact); or

(ii) consideration given or received—

(A) for the grant of those debentures or those rights; or

(B) on the exercise or assignment of those rights,

(or, in the case that no consideration is given or received, that fact),

(as the case may be);

(b) the period within which those rights may be exercised (***exercise period***); and

(c) the expiry date of the exercise period.

(12) Where an event on the occurrence of which a director or chief executive comes under a duty of disclosure under section 341 arises from the grant by the listed corporation, or any associated corporation of the listed corporation, of equity derivatives or rights under any equity derivatives, or the exercise or assignment of those rights so granted, the notification shall also specify the—

(a) price paid or received—

(i) for the grant of those equity derivatives or those rights; or

(ii) on the exercise or assignment of those rights,

(or, in the case that no price is paid or received, that fact); or

(b) consideration given or received—

(i) for the grant of those equity derivatives or those rights; or

(ii) on the exercise or assignment of those rights,

(or, in the case that no consideration is given or received, that fact),

(as the case may be).

(13) Subject to subsection (12), nothing in this section shall require details of the price that has been paid or may be payable, or the consideration that has been given or may be given, for or under equity derivatives (where the underlying shares of the equity derivatives are shares which are the subject of the disclosure) to be specified in the notification.