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Hong Kong SFC's disciplinary action scrutinized by SFAT

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In a recent determination, the Securities and Futures Appeals Tribunal reviewed the handling of disciplinary proceedings by the Securities and Futures Commission and revisited procedural and fining principles.

Introduction

On March 13, 2023, the Securities and Futures Appeals Tribunal (SFAT) upheld the decision of the Securities and Futures Commission (SFC) publicly to reprimand and fine I-Access Investors Limited (I-Access) HK$600,000 for breach of the SFC Code of Conduct for Persons Licensed by or Registered with the SFC (the Code of Conduct).

The case related to a system-testing conducted by Hong Kong Exchanges and Clearing Limited on a non-production day during which test data were disseminated through HKEX's Orion Market Data Platform (OMD-C). I-Access' computer system's receipt of the test data falsely triggered stop loss sell standing orders of its clients.

On the evidence, the SFAT upheld the SFC's findings that I-Access was guilty of two areas of misconduct. First, the breach of General Principle 3 of the Code of Conduct,[1] by failing to configure its computer system so as to prevent receipt or dissemination of data transmitted through the OMD-C system on the testing day. Secondly, breaches of General Principles 1, 2 and 5,[2] by failing to promptly notify all affected clients of the incorrect triggering of their standing orders. The SFAT agreed that I-Access' failings were, or at least were likely to be, prejudicial to the interest of the investing public /public interest, and considered the sanction imposed by the SFC was neither excessive, nor disproportionate nor unjust.

The SFAT's determination is particularly helpful in addressing some of the key procedural aspects of the disciplinary process and highlighted that the attitude and lack of remorse of a disciplined person will be taken into account and result in substantial penalties.

Key points to note

SFC is required to enhance clarity in the basis for disciplinary actions.

The SFAT first reiterated the basic point that the SFC's exercise of disciplinary powers has to begin with the issuance of a Notice of Proposed Disciplinary Action under section 194 of the Securities and Futures Ordinance (Cap. 571) (SFO), the purpose of which is to inform the subject of the proposed proceedings and hence prevent disciplinary powers from being exercised without first giving the subject "a reasonable opportunity to be heard" under section 198(1).

Secondly, and following on from the first, basic point, a regulated person who is about to be disciplined (and thus entitled to "a reasonable opportunity to be heard") must be told "with unequivocal clarity and precision, on what basis

that disciplinary process is taking."

Sections 194(1) and 194(2) identify two broad heads for disciplinary action, expressed in the alternative:

1. sub-sections 194(1)(a) and 194(2)(a) - "a regulated person is, or was at any time, guilty of misconduct;" or;
2. sub-sections 194(1)(b) and 194(2)(b) - "the Commission is of the opinion that a regulated person is not a fit and proper person to be or to remain the same type of regulated person."

Misconduct (for the purposes of the first limb in sections 194(1) and (2)) is defined in section 193(1) with five separate limbs – sub-paragraphs (a) to (e).

First, this means that the SFC must specify in its notice under which of the two limbs of sections 194(1) and (2) the disciplinary sanction is considered appropriate. It must be specific as to whether it is one of them ((a) or (b)) or both ((a) and (b)). It can be both limbs. But, the SFC cannot use "and/or" in its notice.

Second, if the SFC is relying on the first limb (misconduct), the regulated person must also know, from the section 194 notice, "on which limb of section 194(1) the SFC is considering relying as a trigger for the exercise by it of its disciplinary powers and, if one of the limbs is misconduct, the paragraph in the definition of misconduct which is the basis for the SFC's finding of misconduct". Of course, the SFC can specify multiple sub-paragraphs of section 193(1)(a) to (e). But, again, the SFC cannot use the "and/or" language.

The SFAT was very clear about this. The SFAT stated that the practice of using "and/or" was "wholly unacceptable and should stop immediately."

Further, the SFAT observed that the SFC should not only make clear in their decision on what basis they have found misconduct but, in addition, where it is section 193(1)(d), must clearly spell out that in its opinion "the act or omission is or is likely to be prejudicial to the interest of the investing public or to the public interest." The SFC should also indicate that it has had regard to the Code of Conduct before forming that opinion.

Code of Conduct has a special role in disciplinary processes.

The SFAT explained the role of the Code of Conduct in disciplinary processes. Section 399(8) SFO states that the Code is not subsidiary legislation, and section 1.4 of the Code further makes it clear that breaching the Code shall not by itself render a person liable to any judicial or other proceedings. Nevertheless, the Code has a special role to play in disciplinary processes – the SFC is obliged to take into consideration any breaches of the Code (i) when it is required to form an section 193(3) opinion, such as in the case of finding of guilt based on section 193(1)(d), as required by section 193(3); and (ii) when the SFC considers the fitness and properness of the regulated person, as provided in section 1.4 of the Code.

Review by SFAT is a *de novo* full merits review.

The SFAT followed the Court of Appeal's judgment in *Tsien Pak Cheong David v Securities and Futures Commission* [2011] 3 HKLRD 533 ("David Tsien" case), and reaffirmed that a review of a regulatory decision by the SFAT is a full merits review with the tribunal conducting the review as if it were the original decision-maker exercising its own independent judgment. The David Tsien case however did not specifically address whether, in conducting its full merits review, the SFAT should also be required to form the same opinion as required of the SFC under the SFO. The SFAT answered this question by citing, among others, the court's statement in *Tam Sze Leung and Ors v Secretary for Justice and the SFC* [2022] HKCFI 2330 that the review by the SFAT is a *de novo* full merits review, i.e. in the present case, the SFAT is not limited to decide only if the SFC could reasonably form the section 193(3) opinion on the evidence as if it

were a judicial review of the SFC's decision. Rather, it must consider all the evidence and form its own opinion.

Documentary assertions of facts should be supported by sworn evidence.

The SFAT reiterated that the SFC bore the burden of proof on the balance of probabilities in the proceedings before it, as provided in section 218(7) SFO. In terms of evidence, the SFAT held that factual representations made in the SFC's correspondences should not be regarded as an acceptable form of proof; rather, witnesses should be called to testify the facts asserted. Whilst any documentary assertion of fact by a person with knowledge of the facts, such as in a record of interview or a letter written by the regulated person, can be relied upon as evidence of facts being asserted, its weight may be adversely affected if those assertions are not supported by sworn evidence, or are contradicted by other sworn evidence.

Lack of remorse will justify a more severe penalty than otherwise might be the case.

The SFAT, the court's findings in the David Tsien case, recognized that the core functions of the SFC are the protection of investors, the maintenance of the integrity of the securities and futures industry, and the preservation and promotion of public confidence in the industry. The SFAT emphasized the deterrence effect that the punishment must carry in order to advance these objectives, which would always depend on the nature and seriousness of the misconduct.

The SFAT took into consideration the following factors when considering the appropriate level of sanction with respect to each of the two areas of I-Access' misconduct:

- **Level of incompetence –** incompetence can be in terms of the carrying out of regulated activities and, more significantly, appreciation of responsibilities. The SFAT repeatedly remarked on the level of I-Access' incompetence when considering the seriousness of both areas of misconduct:
  - "… the applicant has revealed a very poor level of understanding of the OMD-C computer system. Furthermore, the applicant has demonstrated a very poor appreciation of its responsibilities…"
  - "…the privilege of being permitted to work within the securities industry brings with it great responsibilities… [t]hose responsibilities are reflected in the Code of Conduct but, regrettably, they appear to be unfamiliar to the applicant."
- **Whether the misconduct was intentional –** this is a very important factor. SFAT held that "[t]here is a need for the punishment to be severe in order to deter others from thinking that they can treat the interests of their clients with similar indifference and to adequately punish the applicant for his misconduct." In the I-Access case, the SFAT considered that I-Access' actions were clearly intentional, and that I-Access decided not to promptly notify its clients of the incident to minimise reputational damage to itself. The SFAT therefore considered the misconduct in the handling of clients to be "of a far more serious level" than its very poor level of understanding of the OMD-C system (which SFAT accepted to be not intentional), and imposed a much more severe overall penalty.
- **Impact on clients and the market –** the SFAT remarked that the failure to notify clients did not cause any losses to any of I-Access' clients, whereas the incompetent understanding of the OMD-C system "not only impacts upon the affected clients but also on the reputation of the Hong Kong securities industry." Whilst this was one of the factors considered, it was not discussed in detail in the SFAT's decision.
- **Lack of remorse and refusal to acknowledge responsibility –** this is perhaps the most important lesson to learn from this case. A lack of remorse could put an investigated and disciplined person in a much worse position in terms of penalty. I-Access' attitude throughout the SFC's investigation was heavily criticized by the SFAT:
  - "To say that there is a lack of remorse is something of an understatement. Perhaps of greater concern, is the lack of insight that the applicant possesses in respect of its responsibility for the incident. The applicant has

shown an unwillingness to consider even the possibility that it might be at fault. The applicant's conduct is not just a failure of competence; it also reflects a total indifference to what lessons it can learn from the incident in order to better serve its clients."

- "Again the applicant has shown a total lack of remorse and a desire to blame everyone else but himself. His attitude can only be described as a willful refusal to acknowledge any wrongdoing on his part."

The SFC regarded this lack of remorse and a desire to blame everyone else, "putting the interests of clients completely secondary to the self-interest of the applicant" as "caus[ing] reputational harm to the Hong Kong securities and futures industry."

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[1] General Principle 3 of the Code of Conduct – capabilities: have and employ effectively the resources and procedures needed for the proper performance of its business activities.

[2] General Principle 1 – honesty and fairness. General Principle 2 – Diligence – due skill, care and diligence. General Principle 5 – avoidance of conflicts of interest, and fair treatment of clients where they cannot be avoided.