Hong Kong Venture Capital and Private Equity Association
香港創業及私募投資協會
The Association for Private Capital in Asia

12 August 2022

Attention:
enfconsultation@sfc.hk

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

HKVCA is pleased to see the objectives of protecting investor interests and upholding Hong Kong's reputation as an international financial centre being achieved through continued optimisation of enforcement action. We have no objection to the amendments to the insider dealing provisions of the SFO which is indicated in Part 3 of the consultation paper.

Whilst we agree with the Securities and Futures Commission (the "Commission") setting standards as to the appropriate language, content, risk warnings and disclosures for advertisements for collective investment products in accordance with the IOSCO Principles on this topic, the Association has concerns with respect to the proposed amendment to section 103 of the SFO which in essence imposes a criminal liability on the issue of an advertisement to a non Professional Investor ("PI") regardless of intent or circumstance and without regard to the existence of potential harm. The proposed amendments could cause serious disruption to the ability of licensed corporations to speak with new potential investors.

Further, as the proposed amendments to section 213 of the SFO authorise wide-ranging powers to seek compensation and damages from regulated persons, the exercise of such powers must be subject to appropriate safeguards and sufficient oversight by the courts rather than the Commission.

We provide details to our specific concerns in the following paragraphs for your consideration.

Concerns: Part 1, Amendments to exemptions in section 103 of the SFO

We note from paragraph 17 of the Consultation that the Commission's opinion is that the Court of Final Appeal ("CFA") has given a wider construction to one of the exemptions to section 103(1) of the SFO, namely the PI exemption under section 103(3)(k), than was intended by the underlying policy.

We disagree with that opinion. The CFA has decided, based on all the evidence before it, that the legislative intent was that advertisements could be issued which "are or are intended to be disposed of only to professional investors".

The Commission further opines that as a result of the relevant CFA decision, problems may arise in enforcing this provision to protect retail investors. We would question this analysis and, in particular, ask the Commission to explain what harm may come to retail investors by the issue of advertisements for products which will *in fact* will only be sold to professional investors.

This is particularly relevant to our membership where there are inherent checks and balances in the process of subscribing to or investing in private equity funds involving lawyers, custodians, fund administrators, transfer agents as well as Hong Kong managers of or advisors to such funds such that

a retail investor is highly unlikely to ever be invested in such a product let alone caused harm by the inadvertent receipt of an advertisement for such a product.

The amendment would potentially jeopardize private capital fund managers/advisers who as part of their normal course of business prepare pre-marketing materials (including by way of example. invitations to participate, information decks, pitchbooks, red herring PPMs, draft investment terms) to potential investors, consisting of institutional investors, family offices and ultra-high-net-worth individuals (UHNWs). The requirement that advertisements, invitations and documents relating to investments (which would include pre-marketing) may only be issued to PI's who have been identified as such "in advance" (paragraph 28 of the Consultation) by an intermediary through its know your client and related procedures is divorced from commercial realities of fund-raising in the private capital industry. It should also be noted that in practice potential investors do not expect to provide their information at a premarketing stage.

Whilst private capital fund managers typically maintain information on the prospective investor universe and have information as to the PI status of existing investors, the criminal liability attached simply to the issue of an advertisement to a new potential investor will deter large international fund management companies from participating in the Hong Kong market. This could also impede the growth of small to medium-sized local fund managers by greatly increasing the difficulties for soliciting new potential investors. This information is gathered at a later stage of commitment, post due diligence by such investors and at the time when the method of investment (subscription, creation of an LP, co-investment, etc.) has been largely decided.

Further there is a risk that a fund manager could be prosecuted for an unforeseeable breach of the proposed amended section 103 in the situation where a potential investor who has in fact been properly identified as a PI by the manager could pass information onto a third party without the knowledge of the fund manager but nevertheless creating a potential liability.

The Association strongly objects to the proposal to amend s.103(3)(j) to include PIs outside Hong Kong. This is an unnecessary extension of the Commission's powers and as most jurisdictions have rules regarding cross border marketing and advertising it is duplicative and burdensome. Further it is dealt with already in the Circular to Licensed Corporations Regulatory Compliance regarding Cross-border Business Activities.

We are of the view that this amendment would, if introduced, severely impact the ability of Hong Kong fund managers to raise capital offshore.

Concerns: Part 2, Amendments to section 213 of the SFO

Under the proposed section 213(1)(c), we note that there is no information set out as to how the Commission will proceed with applications. The Commission would be, in effect, acting on its own disciplinary findings, which are based on its views of the evidence, albeit that a regulated person is provided with an opportunity to be heard. The lack of separation of roles, responsibilities and powers creates issues.

The SFO should be amended to provide a clear right for the CFI to review the merits of the Commission's findings when deciding to make an order under section 213(2). The new powers would appear to be open to challenge in the courts on a wide-ranging basis, not only for the reasons specified above, but also in relation to issues regarding the assessment of loss and causation.

The Commission should accordingly engage in a more wide-ranging consultation on these proposed changes and take the time and effort to craft proposals, which not alone are fair and proportionate, but also likely to withstand scrutiny by the courts.

We are concerned that the current proposal gives the Commission unfettered power to seek compensation and damages based on the Commission's own factual findings and is too broad in scope.

Comment on appropriate forum for determination of facts

The proposal to allow the Commission to bring s.213 proceedings based on disciplinary action taken against a regulated person for breach of the Code and Guidelines represents a significant departure from the existing regime.

The current s.213 limits the Commission's recourse to restoration orders etc. to circumstances where a person has, or it appears to the Commission that a person has, contravened a provision of the SFO or a notice, requirement, condition under a provision of the SFO or a license term or condition under the SFO. Expanding the eligibility criteria under s.213 to the Commission's Codes and Guidelines (which do not have the force of law) in its current proposed form would create significant uncertainty over the Court's right to determine, or to reach a contrary view on, the facts and conclusions drawn by the Commission from its internal disciplinary process.

Unless the amended s.213 provides a clear right for the Court to review the merits of the Commission's disciplinary decision:

- a regulated person may be compelled to pursue an appeal to the SFAT (and the Court of Appeal on a point of law) to ensure that issues are fully considered in a third-party forum at the first instance; and

- even if a regulated person exhausts all rights of appeal under the disciplinary process, the Court in the s.213 proceeding may nevertheless reach a different factual finding to that of the Commission in its disciplinary processes.

In these circumstances, the regulated person will have expended considerable time and resources in defense of the parallel proceedings with little or no prospect of recovery. This is undesirable and especially detrimental to regulated persons with less financial resources.

Comment on scope of the amended s.213

The purpose of the Commission's Code and Guidelines is to allow the Commission to establish the practices and standards with which a regulated person is expected to comply.

Under the current proposal, all forms of disciplinary action taken by the Commission may trigger an action under s.213. This is unnecessarily broad and does not reflect the varying degrees of severity in the types of disciplinary sanctions available under section 194 or 196 of the SFO for breach of a provision of the Code or Guideline.

Furthermore, under s.399 of the SFO, the Commission may publish such codes and guidelines as appropriate: (i) for the furtherance of its regulatory objectives; (ii) in relation to any matter relating

to the Commission's functions under the SFO; or (iii) in relation to the operation of a provision of the SFO. In our view, only category (i) is consistent with the purpose of the amended s.213.

Given the different severity in disciplinary sanctions and the breadth of the Code and Guidelines, we believe the Commission should identify the specific provisions of the Code and Guideline and/or the types of disciplinary action that fall within the ambit of the amended s.213 of the SFO, in order to provide clarity on the application of the amended s.213.

In view of the considerations set out above, the SFC should engage in more wide-ranging consultation on these proposed changes and continue to develop these proposals to ensure fairness to all regulated persons.

Conclusions

The Association appreciates that the Commission's objective is to protect the interests of investors as well as upholding the reputation of Hong Kong's financial markets. However, the amendment proposed to s.103 could be highly detrimental to the private capital industry, and in our view is unnecessary. If the Commission resolve to amend s.103 we strongly advocate for a further opportunity to be consulted on the proposed wording, that the amendments do not (inadvertently) capture premarketing activities and impact current market practice. Further the Commission should consider the release as soon as practical of draft FAQs to clarify the industry's concerns (for which we would be happy to provide input).

The Association would be keen to submit further comments on the draft SFO amendments.

Yours sincerely

Bonnie Lo
Chair of HKVCA Technical Committee

About HKVCA

HKVCA is a member-based trade association which was established in Hong Kong in 1987. It currently has 480 members of whom 300 are Hong Kong based private equity managers across the full spectrum of the industry from venture capital, through growth capital and growth buyouts to institutional fund investors, fund of funds and secondary investors. HKVCA represents small teams investing in start-ups as well as the world's 10 largest private equity firms.