

Bills Committee on Securities and Futures Bill and Banking (Amendment) Bill 2000

**Summary of Public Comments and Administration's Response on
Part VIII of the Securities and Futures Bill**

Clause no.	Respondent	Respondent's comments	Administration's response
<i>Part VIII – Supervision and Investigations</i>			
General	Hong Kong Bar Association	The new information gathering powers will significantly enhance the SFC's investigatory powers in cases of suspected crime or misconduct and are to be welcomed. The new provisions set out a clear code and provide the Commission with "teeth" to enforce it.	We welcome the Bar Association's support for the enhanced investigatory and supervisory powers. The provisions are also balanced by adequate safeguards.
172	HKSA	Audit working papers are prepared by auditors when they perform work that is necessary to provide a reasonable basis for their opinion. These papers are the property of the auditor and not the company. They may or may not be useful for the purpose of an investigation. The HKSA has been assured that (i) it is unlikely that the SFC would be able to grant third party access to correspondence or records of discussions with auditors held under cl 172, and (ii) the general immunity provisions under cl 368 are adequate to ensure that unintended liabilities would not be incurred by auditors co-operating with the SFC under cl 172.	Whether audit papers are the property of auditors is irrelevant in the face of a lawful request for them. The SFC and, on a judicial review or action to enforce compliance with a request for documents, the courts, are the only arbiters of whether they are relevant to an investigation. The secrecy provisions under clause 366 prohibit the disclosure of non-public information by the SFC or any of its officers except in the performance of a function or in the limited circumstances specified therein (e.g. criminal proceedings or in civil proceedings to which the SFC is a party). Disclosure in all these circumstances is proper and in the public interest which must prevail over any conflicting interest of an individual. Further, cl 368(3) also provides that a person complying with a requirement under the Bill will not incur civil liability by reason only of that compliance. This provision is applicable to auditors who are complying with a requirement of the SFC under clause 172.
172(1) and (9)	HKAB	The SFC will be able to characterise almost any misconduct or fraud in a listed authorised institution as involving inadequate disclosure to members allowing it to conduct an inquiry under cl 172. The SFC should not be allowed	The SFC can only start an inquiry into a listed authorised institution when the suspected misconduct goes directly to the nature of the corporation as a <u>listed entity</u> in that the corporation's members had a reasonable expectation that the information be disclosed to them. If an authorised institution seeks listed status, it must accept the greater scrutiny and regulatory controls that accompany that status to protect the

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		to conduct cl 172 inquiries into listed authorised institutions or should be obliged to seek the HKMA's approval in every instance.	investing public. The SFC would in practice consider whether any conduct would be better dealt with by the HKMA in deciding whether to start an inquiry under cl 172. The SFC has the power to apply to court for various orders to remedy misconduct in a listed corporation after a cl 172 inquiry and the ability to apply for those remedies should be available in the case of a listed authorised institution. In any event, under cl 172(10), the SFC may only issue a direction to the authorised institution itself, any of its group corporations or associated corporations or a corporation which controls the authorised institution, after consulting the HKMA.
172(1)(iii), (iv) and (v)	HKAB	Under these clauses, the SFC can seek documents from third parties in relation to the affairs of a listed authorised institution without first consulting the HKMA and also when the inquiry has nothing to do with inadequate disclosure to that listed authorised institution's members. Either these provisions should not apply to a listed authorised institution; or the SFC should have to first seek the HKMA's approval before getting documents about a listed authorised institution's affairs.	<p>The SFC is the agency charged with investigating possible crime or misconduct in the securities and futures markets and it is the only public body with the power to conduct a limited preliminary inquiry into possible crime or misconduct in a listed corporation. It has expertise in these areas. We understand that any investigatory action on a bank would have an impact on its reputation, which goes hand-in-hand with the public's confidence on the bank. In these instances, the SFC's exercise of power is already subject to adequate safeguards and prior consultation with the HKMA (subclauses 172(6), (9) and (10)). In all instances, the SFC's inquiries on banks or with others seeking information about the affairs of a listed bank are secret.</p> <p>In respect of third parties (other than banks) related to a listed bank which may be required to produce the information under the clause, adequate safeguards are already in place to ensure that the inquiry powers are not exercised lightly. Authorised institutions should not be ring fenced from the SFC's inquiry powers under cl 172 simply because of their status, nor do we see strong reasons why the powers should be subject to prior consultation with the HKMA in these cases, as these third parties are not regulated by the HKMA.</p>
172(1)(iii)	HKAB	This clause undermines a bank's obligation of confidentiality to its customers. The HKMA should first have to approve the SFC obtaining documents from a bank and should only give it's approval if the document is necessary for the SFC's inquiry.	A bank's duty of confidentiality to its clients arises under common law and can be overridden by statute. The SFC is granted its inquiry powers under cl 172(1)(iii) so that it can in the public interest determine whether crime or other misconduct has occurred in a listed corporation so that appropriate action can be taken. Owing to the central roles banks play in business, it is often necessary to obtain a customer's banking records from a bank in the course of an inquiry (eg to trace funds). The SFC's exercise of this power under cl 172(1)(iii) is already subject to adequate safeguards under cl 172(6) that exceed those that the SFC usually has to meet before exercising its inquiry or investigatory powers. We believe that additional restrictions are

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			unnecessary.
172(1)(iv)	Consumer Council	Supports the proposal to give the SFC power to access audit working papers, as it would assist the SFC to effectively and efficiently fulfil its inquiry function and provide an added safeguard to the investing public.	We welcome the Consumer Council's support for the proposals.
172(7)(a)	HKSA	<p>It is reasonable to expect the SFC to seek access to audit working papers only after it has commenced an investigation into a listed company and has determined that the audit working papers would be relevant from inspection of the company's documents.</p> <p>It would be inappropriate for audit working papers to be used by the SFC as the starting point of an investigation or as a means of 'fishing expeditions'. The HKSA has been assured by the Administration and the SFC that it is not intended that audit working papers would be so used. However the HKSA is concerned that the inclusion of the words 'or may be given under subsection (1)(i) or (ii)' in cl 172(7)(a) suggests that the SFC could require the production of audit working papers without having first given any direction to the subject corporation. This appears to be contrary to the assurances which we have been given. The words 'or may be' in this sub-clause should be deleted.</p>	<p>The SFC does not intend to use audit working papers to go on "fishing expeditions" and cannot under the Bill in that the documents sought must be relevant to the grounds for the inquiry.</p> <p>The SFC's inquiries under cl 172 are limited in scope and are conducted quickly to establish quickly whether more serious action needs to be taken. So they are as focussed as possible.</p> <p>However, the SFC needs flexibility in how it plans its inquiries. Different matters need different inquiry strategies. Usually the SFC will seek auditors' working papers to verify information obtained from the listed corporation under inquiry or one of its group corporations. This will necessarily be after obtaining information from such a corporation.</p> <p>But, sometimes the SFC will seek information from an auditor first to close off avenues of inquiry that the auditor has already sufficiently examined. It would unnecessarily inhibit the SFC's inquiries if it was prohibited from doing this.</p>
172(9)	HKISD	Please explain the reason for the difference in the SFC's authority in enquiring into listed companies and authorised financial institutions.	There is <u>no</u> difference in SFC's authority in enquiring into an authorised financial institution as a listed corporation for the protection of the interests of its shareholders. The HKMA as the frontline regulator of authorized financial institutions has primary responsibility for the day-to-day supervision of authorized financial institutions in regard its regulated activities under the Bill and is equipped with the necessary

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			investigatory powers. The Bill already puts in place adequate safeguards and restrictions on the SFC's power to exercise of its inquiry powers on authorised institutions.
172(13)	HKSA	The HKSA is concerned that auditors should be subject to criminal sanctions under cl 172(13) for failure to produce working papers or give explanations. The HKSA notes the 'reasonable excuse' proviso. But the threat of heavy criminal liabilities could nonetheless be used to enforce onerous or unreasonable request by the SFC. Considerations could be given on whether the penalties set out in this sub-clause are appropriate for use against third parties (such as auditors) who are called upon to assist in an investigation.	<p>The offences in clause 172 are standard provisions in similar regulatory powers both in this jurisdiction and other major international financial centres. Their objective is to deter non-compliance and they are adapted from existing law. They are not targeted at auditors. They apply to any person from whom SFC may request information under clause 172. To secure a conviction for a failure to produce documents, the prosecution must prove beyond reasonable doubt that an auditor has failed to produce the required documents and there should be no reasonable excuse for the failure to do so.</p> <p>In seeking assistance from auditors in an inquiry, the SFC's primary concern is to obtain relevant records and documents. In case of non-compliance, the SFC will usually first go to court for an order to compel compliance and it will be up to the court to decide what amounts to a reasonable excuse. If a person fails to comply with a court order compelling compliance after the SFC has certified non-compliance to the court, the court may punish non-compliance as if it were contempt of court. Similar systems for dealing with non-compliance are found in the regulatory regimes of the US, UK and Australia.</p>
173	HKAB	There appears to be a drafting flaw in that cl 173(9) and (10) do not apply where an authorised institution is exempt. The protections in those clauses should apply when an exempt authorised institution receives an inquiry under cl 173(1)(c)(iii) or (3)(c) in relation to its dealings with another entity rather than in relation to its own regulated business.	We recognise HKAB's comments that the safeguard should be given to all authorized institutions. We will work with the SFC, HKMA and the DoJ to further consider the comment and propose Committee Stage Amendments as necessary.
173	HKAB, Group of nine investment bankers	The privilege against self-incrimination should apply to explanations or statements given under cl 173 as it does under cl 172.	The right against self-incrimination is already guaranteed under Article 11(2)(g) of the Hong Kong Bill of Rights Ordinance, neither clause 173 nor clause 174 overrides the privilege either expressly or by necessary implication.
173	HKSbA	Clause 173 extends the SFC's power in an	This is not an extension. The existing law already provides that we may obtain "from

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		intermediary inspection to any other person whether connected with the intermediary or an associated entity or not. The SFC may also ask any person any question about any document of the intermediary or an associate entity. The FSA's inspection powers under the FSMA are limited to those connected with a licensed person. A connected person is clearly defined as being a member of A's group (where A is the person under inspection), or in the case of a body corporate, its officer, manager, employee or agent. The SFC's inspection powers should only extend to people who are connected with the licensed person under inspection.	any other person whom we reasonably believe is in possession or has under his control any record or other document" relating to the registered business and necessary for determining compliance with relevant Ordinances or the terms and conditions of registration – see SFCO section 30(2). The comment does not refer to the additional safeguard under clause 173(7)&(8) – we have to be satisfied that the information cannot be obtained from the intermediary or an associate.
174(3) to (7)	HKISD	Given the wide power of enquiry under these sub-clauses, is it appropriate that the SFC can authorise 'anybody' to be the authorised person under sub-clause (5)?	This is in line with existing legislation (s 30 and 31 of the SFC Ordinance). The existing practice is for SFC employees to be authorised to carry out inspection, usually in a team under the supervision of an experienced SFC officer at manager or senior manager level or above. Very occasionally, the SFC may wish to appoint an independent expert (such as an accountant) to carry out the inspection where specialist expertise is required.
178	Law Society	There is no need for the SFC to have the option to initiate certification proceedings to punish non-compliance with cl 172, 173, 174 or 176 by way of either Originating Summons or Originating Motion. The SFC should have to proceed by way of Originating Summons which must be supported by an affidavit.	It is important for the Commission to have the choice between the two procedures and hence both procedures must be referred to in the provision. This is because : (1) the expedited Originating Summons procedure would be appropriate in cases where there is reason to believe that the person who was the subject of the original requirement (upon which he defaulted) will comply with the requirement once certification proceedings are issued; (2) the Originating Motion procedure would be appropriate in cases where the defendant is likely to vigorously defend the application; and (3) in the case of an expedited Originating Summons, there is the additional benefit of saving costs as the first hearing (not being a hearing of the substantive application), is "in chambers" and may be attended by a Solicitor of the SFC's Legal Services Division.

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			It is appropriate for the SFC to have the option of initiating proceedings by way of originating motion in open court, particularly in cases which may involve a complicated or important point of law.
178(1)(b)	HKSA	A lawyer, as a bona fide legal adviser of persons being the subjects of SFC requirements, who advised a client that he was not compelled to comply with the request, should not be able to be punished for the failure to comply if the Court of First Instance held that the failure was without reasonable excuse.	<p>Clause 368 already recognises legal professional privilege, as in section 56 of SFC Ordinance. Reasonable excuse under cl 178 will be interpreted accordingly.</p> <p>If the person being the subject of an SFC request is able to satisfy the Court that he has received bona fide legal advice and has acted on such advice, it does not appear that the Court will take the view that the failure to comply is without reasonable excuse. If the person himself will not be punished, the legal adviser, as a person involved in the failure, will also not be punished.</p> <p>There are therefore no grounds on which to further exclude lawyers from punishment under cl 178(1)(b).</p>
180	Law Society	<p>The privilege against self-incrimination should be available under cl 173 inspections and requests for information about transactions in securities, futures or leveraged foreign exchange contracts or interests in collective investment schemes under cl 174.</p> <p>Alternatively, there should be restrictions put on the extent to which information gathered under those clauses can be used.</p>	<p>The right against self-incrimination is already guaranteed under Article 11(2)(g) of the Hong Kong Bill of Rights Ordinance, neither clause 173 nor clause 174 overrides the privilege either expressly or by necessary implication.</p> <p>The information sought under cl. 173 or cl. 174 is used routinely by the SFC to monitor trading on the securities and futures market and for the monitoring of SFC licensees in compliance with requirements under the licensing regime. A formal investigation will be instituted under cl. 175 where specified grounds are satisfied. Given that the privilege against self-incrimination has been guaranteed (see above), we believe that it is inappropriate to place restrictions on the use of such information.</p>
181	HKISD	Is this only a disclaimer? Need there be an acknowledgement by the police?	This means that the document or record must be produced to the authorized person or investigator by the person in possession regardless of the lien and at no charge. It also functions to preserve a person's lien vis-à-vis parties other than the SFC. Cl 181 is not a disclaimer. There would not be a need for an acknowledgement by the police.

Details of Submissions Referred to in the Comment / Response Table

Date received	Respondent
18 January 2001, 31 January 2001	Hong Kong Society of Accountants (“HKSA”)
23 January 2001	Hong Kong Association of Banks (“HKAB”)
23 January 2001, 15 February 2001	Linklaters & Alliance representing <ul style="list-style-type: none"> - Bear Stearns Asia Limited - Credit Suisse First Boston (Hong Kong) Limited - Dresdner Kleinwort Wasserstein - Goldman Sachs (Asia) L.L.C. - Merrill Lynch (Asia Pacific) Limited - JP Morgan - Morgan Stanley Dean Witter Asia Limited - Salomon Smith Barney Hong Kong Limited - UBS Warburg (“Group of nine investment bankers”)
23 January 2001	Law Society of Hong Kong (“Law Society”)
29 January 2001, 15 February 2001	Hong Kong Stockbrokers Association (“HKSbA”)
30 January 2001	Hong Kong Institute of Securities Dealers (“HKISD”)
14 February 2001	Hong Kong Bar Association
19 February 2001	Consumer Council

Securities and Futures Commission
Financial Services Bureau
9 March 2001