

立法會
Legislative Council

LC Paper No. LS25/06-07

Paper for the Panel on Financial Affairs

**The Obligation of
the Securities and Futures Commission
and the Hong Kong Exchanges and Clearing Limited
to Preserve Secrecy under section 378
of the Securities and Futures Ordinance (Cap. 571)**

At the meeting of the Panel on Financial Affairs on 23 November 2006, the Chairman has requested the legal adviser to the Panel to comment on the following questions:

- (a) whether the Securities and Futures Commission (SFC) has discretion under section 378 of the Securities and Futures Ordinance (Cap. 571) (SFO) to disclose information in the public interest; and
- (b) whether the Hong Kong Exchanges and Clearing Limited (HKEx) is bound by section 378 of SFO (the Section); and if so, which part of the Section is applicable.

The legal adviser has written to SFC and the Listing Division of The Stock Exchange of Hong Kong Limited (the Exchange) for an explanation of the views held by SFC and HKEx respectively. Both have replied in writing and the respective letters are attached as **Annex I** and **II** for members' perusal. The Administration has in the meantime also provided in written form the consolidated comments of SFC and HKEx in response to the list of follow-up questions dated 28 November 2006 (LC Paper No. CB(1)531/06-07(01)) (Consolidated Comments). This paper sets out the observations of the Legal Service Division on the explanation provided by SFC and the Exchange in their respective letters and in the Consolidated Comments.

General Observations on Section 378

2. The Section applies only to a "specified person", which term is defined in subsection (15). SFC is expressly mentioned in paragraph (a) of the definition, and its member, employee, consultant, agent and adviser are expressly listed in paragraph (b). Paragraph (c) of the definition includes another three classes of person as "specified person" for the purposes of the section. One of the classes is a

person performing any function under or carrying into effect any of the provisions of SFO (subparagraph (ii) of paragraph (c)) (class (ii) person). This suggests that a class (ii) person is only within this class when performing a function under or carrying into effect the provisions of SFO. Such person is not a specified person when the person is not performing a function under or carrying into effect the provisions of SFO.

3. The Section does not impose an obligation of total secrecy. The obligation is limited to preserving secrecy “with regard to any matter *coming to the knowledge*” of a specified person “*by virtue of his appointment*” under SFO, or “*in the performance of any function under or carrying into effect*” (emphasis added) any of the provisions of SFO (subsection (1)(a)). Moreover, the Section provides for general exception at the beginning of subsection (1) (subsection (1) exception), i.e. the obligation does not arise in the performance of a function under, or for the purpose of carrying into effect or doing anything required or authorized under any of the provisions of SFO. Hence, if the performance of a function of SFC requires the disclosure of matter within the scope of subsection (1)(a), there is no bar to the disclosure.

The application of the Section to SFC

4. Whether SFC may rely on the Section to withhold information depends, in the first instance, on how the information has come to its knowledge. When it is satisfied that the information has come to its knowledge as described in subsection (1)(a), the requirement to preserve secrecy may still not apply, if any of the exceptions provided in subsection (1), (2) or (3) applies.

5. In the answer provided to follow-up question 2(a) in the Consolidated Comments, SFC has set out its practice (in pages 4 to 5) with regard to the subsection (1) exception. There is no question that SFC as the regulatory authority of the financial markets in Hong Kong is entitled to, and indeed should, decide what could or should be disclosed and when so to do. It may also establish its own practices regarding such matter. However, when SFC wishes to rely on the Section to withhold information, it must be established that the circumstances do not come within the subsection (1) exception or any of the other exceptions. This is the operation of the Section against which the disclosure of the fact of investigation by SFC in the present case as contained in the Consolidated Comments (in pages 1 and 2) should be viewed.

The application of the Section to HKEx and its subsidiaries

6. In the letter of reply from the Exchange and the Consolidated Comments, HKEx has maintained that the Exchange comes within the definition of “specified person” as it is a class (ii) person. Its ground is that the Exchange has a statutory duty under section 21 of SFO to maintain an orderly, informed and fair market for the trading of securities and to act in the interest of the public in the discharge of such duty. Its functions performed with a view to maintaining an orderly, informed and fair market are therefore functions for the purpose of carrying into effect provisions of SFO.

7. It has been observed that a class (ii) person is not always a specified person (*vide* paragraph 2 above). Such person is only a specified person when performing a function under SFO. The Exchange may not become a specified person simply because it has a duty to discharge under SFO, but may so become to the extent of performing a function with regard to such duty. It may therefore be necessary to ascertain what function, if any, the Exchange was performing in relation to the sale of PCCW shares by PCRD to Fiorlante Limited (the Sale).

8. In the context of the Sale, the relevant function of the Exchange is enforcing the Listing Rules. Since the Sale was by a corporation listed in Singapore, it did not directly concern the Listing Rules of the Exchange. If so, the Exchange did not have to perform any function so far as the Sale was concerned, and would not have been bound by the Section as it did not come within the definition of “specified person” vis-à-vis the Sale. Our view is therefore that the Exchange might not be compelled by the Section not to comment on the Sale. For the requirement of preserving secrecy under the Section to apply, it must be clearly established that, in the first instance, any comment by the Exchange may involve disclosure of information within the meaning of subsection (1)(a) of the Section, and the Exchange is a specified person within the meaning of the Section, and further, that none of the exceptions provided in the Section applies.

Encl

Prepared by

Legal Service Division

Legislative Council Secretariat

28 December 2006

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BY FAX (2877 5029) AND POST

Our ref.: 444/CF/8

13 December 2006

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Dear Sir,

Re: Section 378 of the Securities and Futures Ordinance (Cap. 571) (“SFO”)

This letter responds to yours of 24 November. You have asked for an explanation of the basis on which the SFC may disclose information to the public under section 378 of the SFO. Section 378 is a complex provision but it comprises three main elements:

- (a) Section 378(1) contains the obligation to preserve secrecy. It provides that a specified person¹ “*shall preserve and aid in preserving secrecy with regard to any matter coming to his knowledge by virtue of his appointment under any of the relevant provisions,² or in the performance of any function under or in carrying into effect any of the relevant provisions, or in the course of assisting any other person in the performance of any function under or carrying into effect any of the relevant provisions*”. However, the *chapeau* to section 378(1) provides that the secrecy obligation applies “[e]xcept in the performance of a function under, or for the purpose of carrying into effect or doing anything required or authorized under, any of the relevant provisions”. I will return to this important exception below.

¹ A “specified person” is defined in section 378(15) as including the SFC, persons working for the SFC and anyone assisting such persons in the performance of any function under or carrying into effect any of the relevant provisions.

² The term “relevant provisions” is defined in Schedule 1 to the SFO as meaning the SFO, subsidiary legislation made under the SFO and certain provisions in Parts II and XII of the Companies Ordinance.

- (b) Section 378(2) provides that certain matters are not covered by the secrecy obligation at all. These include the disclosure of information in accordance with a court order.
- (c) Section 378(3) lists a number of persons to whom the SFC may disclose information despite the secrecy obligation. Such persons include a liquidator appointed under the Companies Ordinance and the Securities and Futures Appeals Tribunal.

It is the exception in section 378(1) that concerns us here. The SFC's key functions are specified in section 5 of the SFO. Section 5(1)(g) provides that it is one of the SFC's functions "*to maintain and promote confidence in the securities and futures industry in such manner as it considers appropriate, including by the exercise of its discretion to disclose to the public any matter relating or incidental to the performance of any of its functions*". Section 6(2)(d) of the SFO provides that in performing its functions the SFC "*shall have regard to...the importance of acting in a transparent manner, having regard to its obligations of preserving secrecy and confidentiality...*".

The SFC does not normally disclose the fact that it is conducting an inquiry or investigation into any matter. This is similar to the practice of other major regulators.³ The UK Financial Services Authority ("FSA") will make a public announcement that it is or is not investigating a matter where there has been public concern, speculation or rumour and it is necessary to make an announcement in order to maintain public confidence in the financial system, protect consumers, prevent widespread malpractice or help the investigation itself e.g. by bringing forward witnesses. The Australian Securities and Investments Commission ("ASIC") will make such an announcement when it is in the public interest to do so e.g. where there has been a major corporate collapse. Both the FSA and ASIC are subject to confidentiality requirements under their respective laws that are similar to those applicable to the SFC under section 378 of the SFO.⁴

In common with the FSA and ASIC, the SFC has on a number of occasions decided that the circumstances warranted the disclosure of the fact that it was conducting an inquiry

³ The US Securities and Exchange Commission is even stricter and does not disclose such information at all.

⁴ Section 349(1) of the Financial Services and Markets Act 2000 provides that the confidentiality requirement in section 348 does not prevent the disclosure by the FSA "of confidential information which is (a) made for the purpose of facilitating the carrying out of a public function; and (b) permitted by regulations made by the Treasury under this section". Section 127(3) of the Australian Securities and Investments Commission Act 2001 provides that "the disclosure of information by a person for the purposes of...performing the person's functions as...a member, staff member or ASIC delegate...is taken to be authorized use and disclosure of the information".

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Mr KAU Kin-Wah
Legislative Council Secretariat
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into a company⁵ under section 179 of the SFO or an investigation under section 182 of the SFO. It is important to appreciate that the SFC does not disclose details of ongoing investigations. This is to avoid prejudicing the inquiry or investigation or causing reputational damage to the company in question in circumstances where it may not yet have had an opportunity to be heard on the matter.

The SFC has disclosed the fact that it was conducting an inquiry on four occasions so far this year. It did so in general terms in relation to each of the three broker failures (Whole Win Securities, Tiffit Securities and Wing Yip Company) and regarding the listed Ocean Grand Holdings Limited and Ocean Grand Chemicals Holdings Limited. In each case, this was to reassure investors and the general public that appropriate action was being taken without revealing any of the details of the inquiry.

Such disclosure is decided on a case-by-case basis in the light of the following functions and objectives of the SFC:

- to maintain and promote confidence in the securities and futures industry (section 5(1)(g) SFO);
- to provide protection for members of the public investing in or holding financial products (section 4(c) SFO);
- to minimize crime and misconduct in the securities and futures industry (section 4(d) SFO); and
- to reduce systemic risks in the securities and futures industry (section 4(e) SFO).

Yours faithfully,

Brian Ho

⁵ The SFC would not disclose the fact that it was conducting an inquiry or investigation in relation to an individual.



The Stock Exchange of Hong Kong Ltd.

(A wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited)

8 December 2006

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Dear Mr Kau

Section 378 of the Securities and Futures Ordinance (Cap. 571)

Thank you for your letter of 24 November 2006.

Your letter raises an important point which has been the subject of some discussion with the Securities and Futures Commission and internally. The view has been taken that as the Exchange is exercising a regulatory function under the Securities and Futures Ordinance ('the Ordinance'), that the obligations of secrecy found in s.378 of the Ordinance attach to our work. The basis for this is set out below.

As you rightly point out in your letter, s.378 of the Ordinance does not expressly mention the Exchange in the context of secrecy and the statutory obligations created by that provision. However, s.378 applies to a "specified person" in the performance of a function under, or for the purpose of carrying into effect or doing anything required or authorised under, any of the "relevant provisions".

"Specified person" is defined in s.378(15) to include any person appointed under any of the relevant provisions, or performing any function under or carrying into effect any of the relevant provisions. "Relevant provisions" is defined in Schedule 1 to the Ordinance to include the provisions of the Ordinance.

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(A wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited)

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As you will be aware, the Exchange has a statutory duty under s.21 of the Ordinance to maintain an orderly, informed and fair market for the trading of securities, and to act in the interest of the public in the discharge of such duty. In furtherance of this, the Exchange is empowered by s.23 of the Ordinance to make rules for, inter alia, the proper regulation and efficient operation of the market. The functions performed by the Exchange with a view to maintaining an orderly, informed and fair market are therefore functions for the purpose of carrying into effect provisions of the Ordinance. The Exchange is therefore a "specified person" for the purposes of s.378.

For these reasons, the Exchange in performing its regulatory role is required to observe and is bound by the requirements of secrecy imposed under s.378 of the Ordinance.

Yours sincerely



Richard Williams
Head of Listing