

For discussion on
13 April 2015

Legislative Council Panel on Financial Affairs

**Legislative Proposals to Allow the Securities and Futures
Commission to Provide Supervisory Assistance to Regulators Outside
Hong Kong and to Refine Certain Provisions
in the Securities and Futures Ordinance**

PURPOSE

This paper briefs Members on the legislative proposals to allow the Securities and Futures Commission (“SFC”) to provide supervisory assistance to regulators outside Hong Kong and to refine certain provisions in the Securities and Futures Ordinance (Cap. 571) (“SFO”).

**ALLOWING THE SFC TO PROVIDE SUPERVISORY
ASSISTANCE TO REGULATORS OUTSIDE HONG KONG**

Justifications

2. In Hong Kong, the legal framework under the SFO in respect of providing assistance to regulators outside Hong Kong for enforcement matters meets the international norms and has been in place for many years. However, for supervisory matters, while the SFC may share information in its possession with regulators outside Hong Kong under the SFO¹, it is not able to exercise its supervisory powers to obtain information for the purposes of assisting such a regulator in non-enforcement related matters.

3. We consider that there is a need to amend the SFO to empower the SFC to provide supervisory assistance to regulators outside Hong Kong in certain circumstances upon request for the reasons set out in paragraphs 4 - 7 below.

¹ If the requested information is already in the possession of the SFC at the time of the request, the SFC may disclose it to a regulator outside Hong Kong through the gateway under section 378(3)(g)(i) of the SFO.

(a) Enabling the SFC to engage regulators outside Hong Kong to negotiate more supervisory MOUs to enhance its monitoring of the financial stability in Hong Kong

4. International supervisory cooperation is built on mutual trust, mutual assistance and reciprocity. It is important for the SFC to be empowered to provide assistance to regulators outside Hong Kong on supervisory matters so that it could be in a position to enter into reciprocal supervisory cooperation arrangements with such regulators and obtain information concerning entities they regulate when this is necessary for supervisory purposes here. This is particularly important given the environment in which the SFC needs to perform its supervisory functions, including Hong Kong's open market architecture and the fact that many Hong Kong licensed corporations are part of international financial groups whose activities outside Hong Kong may be significant here. In view of this, the SFC attaches great importance to "group-wide" supervision which may affect Hong Kong licensed corporations and the financial stability of Hong Kong.

5. The proposal would achieve a better overall regulatory outcome and enable Hong Kong to meet international standards in relation to the supervision of regulated entities operating globally. To this end, the SFC expects that there will be more supervisory cooperation arrangements in future and the SFC may initiate more requests for information from other regulators about licensed corporations (or their group companies) that they regulate.

(b) Better adherence to international standards

6. As an international financial centre, Hong Kong has to ensure that our regulatory environment is on a par with international standards. The proposal will allow the SFC to comply with the General Principles Relating to Cooperation in the International Organisation of Securities Commissions Report ("General Principles") under which authorities should share information to assist each other in fulfilling their respective supervisory and oversight responsibilities for regulated entities operating across borders (such as intermediaries) and information regarding entities of systemic significance or whose activities could have a systemic impact on markets. Under these General Principles, authorities should also cooperate in the day-to-day and routine oversight of internationally active regulated entities, and undertake to address obstacles to supervisory information sharing.

(c) Enabling licensed corporations to have access to overseas markets

7. The proposal would facilitate, in certain cases, Hong Kong regulated entities gaining access to overseas markets which otherwise could be denied. For example, supervisory cooperation arrangements are required under the Alternative Investment Fund Managers Directive (“AIFMD”) for SFC-licensed asset managers to access the European Union market. The SFC is unable to meet its full obligations under the AIFMD Memorandum of Understanding without amending the existing law. The SFC has informed the relevant European authorities of such limitation and that it is seeking legislative amendments to give the SFC the statutory power to provide assistance for supervisory cooperation purposes.

Existing legal framework

8. The supervisory powers of the SFC as set out in section 180 of the SFO can only be exercised by the SFC for its own supervisory purposes of ascertaining compliance by intermediaries and their associated entities with specified Hong Kong legal or regulatory requirements. Section 186 of the SFO on assistance to regulators outside Hong Kong² does not extend to the SFC’s supervisory powers under section 180 of the SFO. As a result, while the SFC may obtain information for its own supervisory purposes under section 180 of the SFO, there are currently no provisions under the SFO that explicitly enable the SFC to exercise its supervisory powers to obtain information for the purposes of assisting regulators outside Hong Kong in non-enforcement related matters.

The legislative proposal

9. The SFC launched a public consultation in December 2014 on the legislative proposal of empowering the SFC to provide supervisory assistance to regulators outside Hong Kong in certain circumstances upon request. The SFC has received a total of eight written submissions. The majority of the respondents agree with the proposal, with some comments on the details of the proposal. Taking into account the views gathered, we

² Under section 186 of the SFO, if the SFC receives an enforcement-related request from an regulator outside Hong Kong for assistance in investigating suspected contraventions of certain legal or regulatory requirements, the SFC may, amongst other things, investigate the matter by exercising its relevant investigatory powers (for instance by obtaining information and documents requested by the regulator for enforcement purposes) provided that certain conditions are met.

are finalizing the legislative amendments to the SFO to implement the proposal. The major areas of the proposal are set out in paragraphs 10 – 13 below.

10. In formulating the legislative proposal, we are mindful of the need to strike an appropriate balance between providing supervisory assistance to a regulator outside Hong Kong in return for its assistance and guarding against obtaining excessive information and disclosing information without adequate safeguards. In this connection, we propose that the SFC may only provide assistance –

(a) where it receives a written statement confirming that the regulator outside Hong Kong has not been and will not be able to obtain the information (subject to paragraph 13 below) by any other reasonable means in order to ascertain the matters described in subparagraph (b) below;

(b) so that the regulator outside Hong Kong can ascertain –

(i) the risks to, or a risk which may affect the financial stability of, the jurisdiction of that regulator; and/or

(ii) compliance with legal or regulatory requirements that it administers in relation to transactions and activities regarding securities, futures contracts, leveraged foreign exchange contracts, collective investment schemes, over-the-counter derivative products or other similar transactions that it regulates;

in relation to –

- a licensed corporation, that is regulated by the SFC and the regulator outside Hong Kong; and/or
- a related corporation³ of a corporation licensed by the SFC where the related corporation is regulated by the regulator outside Hong Kong.

³ The term “related corporation” is defined in section 3 of Part 1 of Schedule 1 to the SFO. This includes a holding company, a subsidiary and a subsidiary of the same holding company.

11. Under the proposal, the existing conditions for providing assistance to regulators outside Hong Kong⁴ will also apply to the SFC's provision of supervisory cooperation, which include the SFC being satisfied that providing assistance to the requesting regulator is in the "public interest". In determining whether it would be in the "public interest", the SFC is required under section 186(4) of the SFO to take into account, inter alia, whether the requesting regulator is able and willing to provide reciprocal assistance within its jurisdiction in response to a comparable request for assistance from Hong Kong.

12. In addition to the existing legal safeguards, the proposal further requires written undertakings from the regulator outside Hong Kong to the SFC to the effect that –

- (a) it will use the information obtained from the SFC because of the request for assistance solely for ascertaining the matters described in paragraph 10(b) above and will not use the information in any proceedings unless the regulator outside Hong Kong has sought and the SFC has agreed to provide such information;
- (b) it will treat the information as confidential and will not disclose it to any other person for any purpose without the consent of the SFC;
- (c) it will inform the SFC as soon as reasonably practicable in the event that it receives a legally enforceable demand for disclosure of any of the information and assist in preserving the confidentiality of the information by taking all appropriate measures; and
- (d) it will cooperate with the SFC in any actions or proceedings which seek to safeguard the confidentiality of the information.

⁴ The key conditions are - (a) The SFC is of the opinion that (i) it is desirable or expedient that the assistance should be provided in the interest of the investing public or in the public interest; or (ii) the assistance will enable or assist the regulator outside Hong Kong to perform its functions and it is not contrary to the interest of the investing public or to the public interest; and (b) the SFC is of the opinion that the regulator outside Hong Kong performs a similar function and is subject to adequate secrecy provisions.

13. Subject to paragraphs 11-12 above, if the SFC decides to provide assistance to the regulator outside Hong Kong, it may require the licensed corporation or a related corporation of the licensed corporation to provide a copy of any record or document relating to any regulated activity carried on by the licensed corporation or any transaction or activity which was undertaken in the course of, or which may affect, any regulated activity carried on by the licensed corporation, and answer any question regarding any relevant record, document, transaction or activity. It should be noted that the SFC is not seeking the power to enter the premises of any corporation or to seek information from persons other than licensed corporations and their related corporations for this purpose.

REFINING CERTAIN PROVISIONS IN THE SFO

14. We propose to refine certain provisions in the SFO with a view to reflecting change of circumstances since the SFO was enacted in 2003 and addressing anomalies or correcting errors that have emerged in the administration of certain of its provisions (please see paragraphs 15 - 21 below).

(a) Dispensing with printed licences for licensed representatives

15. Currently, where a licence is granted under sections 120 and 121 of the SFO, the SFC issues a certificate of licence (“printed licence”) to the representative concerned. Given that the SFC maintains an online public register of licensed persons, which is more accessible, up to date and easier and less costly to maintain than issuing and amending printed licences, the proposed amendments seek to dispense with the need for licensed representatives to have printed licences. This will reduce the compliance burden and associated costs to the industry. The requirements that licensed corporations should maintain and exhibit their printed licences at their principal place of business will remain. The SFC has consulted several broker associations which all strongly support the proposal.

(b) Enabling improved working of section 203 of the SFO in licence revocation or suspension situations

16. Under the existing section 203 of the SFO (Permission to carry on business operations upon revocation or suspension of licence or registration), the SFC may give permission to a person whose license or registration is revoked to carry on business operations for the purpose of

closing down the business connected with the revocation. In applying section 203, the SFC found that it does not provide clearly that the licensed corporation is obliged to comply with the rules made under Part VI of the SFO (Capital requirements, client assets, records and audit relating to intermediaries) during such closing down period. The proposed amendments seek to clarify this in respect of both revocation and suspension scenarios.

(c) Enabling a recognized exchange company to grant consent to onward disclosure under section 378 of the SFO

17. Currently, only the SFC may consent to onward disclosure of information that has been disclosed under section 378 of the SFO (Preservation of secrecy). However, the Stock Exchange of Hong Kong Limited (“SEHK”), being a recognized exchange company, needs to disclose information in the course of carrying out its functions. For example, listed corporations may request onward disclosure of information to their insurers or auditors that they are under investigation by the SEHK. This has resulted in the SEHK and their interlocutors frequently approaching the SFC for consent to disclose information relating to SEHK matters, although there is no regulatory need for the SFC otherwise to be involved in the process. The proposal seeks to amend section 378 to provide that the recognized exchange company that made the initial disclosure of information may consent to its onward disclosure to improve administrative efficiency.

(d) Completing the amendments to Part XV of the SFO relating to changes made by the new Companies Ordinance to voting shares

18. The Companies Ordinance (Cap. 622) abolished the nominal value of shares. Part XV of the SFO (Disclosure of interests) used the nominal value of shares for the purposes of determining whether or not a person comes under a duty of disclosure. Amendments were then made by the Companies Ordinance to substitute the number of voting shares in Part XV of the SFO as the mechanism for calculating whether a duty of disclosure has arisen in place of the term nominal value of the shares in which a person is interested. As a result, the new terminology “voting shares” is currently used in many provisions in Part XV of the SFO and the relevant subsidiary legislation.

19. However, there are still a number of references to “shares” in existing provisions which are intended to mean “voting shares”. In order to add clarity to the legislative provisions, the proposal seeks to make further amendments to some existing provisions.

(e) Enabling delegation of the function under section 5(4)(e) of the SFO

20. Under the existing section 5(4)(e) of the SFO, the SFC may publish materials (e.g. circulars, frequently asked questions and answers) indicating to intermediaries the manner in which it proposes to perform any of its functions. Since according to Part 2, Schedule 2 of the SFO, the function under section 5(4)(e) is currently non-delegable (but the materials are technical and often ephemeral), the proposed amendment seeks to enable delegation of the function so that the SFC could carry out the function more effectively.

(f) Minor amendments to levy provisions

21. In the Securities and Futures (Levy) Order (Cap. 571 sub. leg. Z), certain dollar amounts of levies are specified to three decimal places. As a fraction of cents cannot be collected, it is proposed to replace these with amounts specified to two decimal places. Also, certain percentages are specified for the calculation of levy, which may result in fractions of cents which cannot be collected. It is proposed that the Order be amended to provide for the rounding of levy amounts to the nearest cent. Similar amendments are proposed for the Securities and Futures (Investor Compensation – Levy) Rules (Cap. 571 sub. leg. AB) for the same reasons.

WAY FORWARD

22. The Administration is working with the SFC on the legislative proposals. We aim to introduce the legislative amendments into the Legislative Council in mid-2015.

**Financial Services and the Treasury Bureau
Securities and Futures Commission
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