

**立法會**  
**Legislative Council**

LC Paper No. CB(1) 2063/99-00  
(These minutes have been seen  
by the Administration and  
cleared by the Chairman)

Ref: CB1/HS/1/98/1

**Subcommittee on  
Securities and Futures Bill**

**Minutes of meeting  
held on Thursday, 27 April 2000, at 8:30 am  
in the Chamber of the Legislative Council Building**

- Members present** : Hon Ronald ARCULLI, JP (Chairman)  
Hon Eric LI Ka-cheung, JP  
Hon SIN Chung-kai  
Hon Jasper TSANG Yok-sing, JP  
Hon Ambrose LAU Hon-chuen, JP  
Hon FUNG Chi-kin
- Members absent** : Hon Albert HO Chun-yan (Deputy Chairman)  
Dr Hon Philip WONG Yu-hong
- Public officers attending** : Miss AU King-chi, JP  
Deputy Secretary for Financial Services  
  
Miss Vivian LAU  
Principal Assistant Secretary for Financial Services  
  
Mr Frank TSANG  
Assistant Secretary for Financial Services
- Attendance by invitation** : Mr Mark DICKENS  
Executive Director of Supervision of Markets,  
Securities and Futures Commission

Mr Paul BAILEY  
Executive Director of Enforcement,  
Securities and Futures Commission

Mrs Alexa LAM  
Chief Counsel, Securities and Futures Commission

Mr Eugene GOYNE  
Senior Manager, Securities and Futures Commission

**Clerk in attendance :** Ms LEUNG Siu-kum  
Chief Assistant Secretary (1)4

**Staff in attendance :** Mr KAU Kin-wah, Assistant Legal Adviser 6  
Ms Rosalind MA, Senior Assistant Secretary (1)6

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## **Meeting with the Administration**

### Parts VIII, XIII and XIV of the Securities and Futures Bill (the Bill)

The Deputy Secretary for Financial Services (DS/FS) gave an overall briefing on Parts VIII, XIII and XIV of the Bill. She said that Part VIII of the Bill dealt with the supervisory and investigatory functions of the Securities and Futures Commission (SFC). Most of the powers conferred on SFC for discharge of its supervisory and investigatory functions in the Bill were carried from the existing legislation, with a number of changes to clarify and enhance its powers so as to correct deficiencies identified during the operation of SFC in the past years. She drew members' attention to clause 165(1) of the Bill which enabled SFC in a preliminary inquiry into company misconduct to seek records and documents relating to the affairs of a listed company or its group companies from third parties, namely, such companies' auditors, bankers, transaction counterparties and persons in possession of such records and documents. She pointed out that in response to the comments of the Hong Kong Society of Accountants on SFC's power to gain access to auditors' working papers, a definition of audit working papers was included in clause 164 and the threshold for triggering SFC powers to gain access to the papers had been raised from "it appears to the authorized person that" the person was in possession of relevant records to a written certification by SFC that "the authorized person has reasonable cause to believe". Clause 172 empowered SFC to apply to the court for an order in the event of non-compliance with the direction for provision of documents and papers.

2. To combat market misconduct more effectively, the establishment of the Market Misconduct Tribunal (MMT) was proposed in Part XIII of the Bill.

A dual civil and criminal route to deal with cases of specified market misconduct would be established. DS/FS explained the operation of this dual route. SFC would make the recommendation on whether to refer a matter to the Financial Secretary for civil proceedings under MMT or to the Secretary for Justice for criminal prosecution. Such recommendation would be based on the "Department of Justice Prosecution Policy: Guidance for Government Counsel" as well as the supplementary guidelines to be issued by SFC. The Financial Secretary and the Secretary for Justice would have the power to re-direct that matter to the other regime if he or she disagreed with SFC's recommendation. To enable MMT to deal comprehensively and relatively swiftly with market misconduct, a range of civil sanctions would be made available to the MMT under clause 241.

3. On Part XIV of the Bill concerning offences relating to dealings in securities and futures contracts, DS/FS drew members' attention to the increased maximum penalties of fines of \$10 million and ten years' imprisonment. Clauses 268 and 295 created a right of civil action for persons who suffered loss as a result of market misconduct to seek redress against the person responsible for that misconduct.

4. The Executive Director of Enforcement/SFC (ED/E) highlighted the major enhancements to SFC's inquiry, supervisory and investigatory powers in Part VIII of the Bill-

- (i) Clause 165 of the Bill empowered SFC to ask for an explanation for an entry in a record or document, the reasons for which it was made, the circumstances under which it was prepared and the details of any instructions given in connection with the making of that entry.
- (ii) Clause 165 also empowered SFC to seek records and documents relating to the affairs of a listed company or its group companies from third parties, including the company's auditors, bankers, transaction counterparties and persons in possession of such records and documents. To address market concerns raised during the July 1999 consultation that the power to request documents from auditors should be sufficiently and clearly restricted, clause 165(9) provided that SFC had to have reasonable cause to believe that the auditors possessed the requested documents, the documents sought were related to the affairs of the company under inquiry and relevant to the grounds for the inquiry. Regarding the suggestion that SFC should be required to obtain a court order for access to audit working papers, the Administration considered this both unnecessary and inappropriate. There would be adequate safeguards in that a number of requirements had to be satisfied before SFC could exercise the power to require production of audit working papers.

Moreover, obliging SFC to apply for a court order as a first step would in fact be more restrictive than SFC's existing inquiry powers. This would also cause unnecessary delays in the preliminary inquiry process.

- (iii) Clause 166 of the Bill expressly empowered an SFC authorized inspector to enter the premises of not only the licensed or exempt person but also those of its related companies, and to make enquiries about transactions or activities which might affect the business of the person being inspected.
- (iv) Clause 168 contained a new provision empowering SFC to conduct an investigation into whether any licensed person or a person involved in the management of a licensed corporation had committed misconduct or was otherwise no longer fit and proper to remain licensed.
- (v) Apart from the avenues of redress available under the general law, such as judicial review and complaints through the office of the Ombudsman, there were a number of checks and balances incorporated in the Bill. These included preserving or raising the existing statutory thresholds for SFC to exercise its powers, enhancing a person's right to legal representation when interviewed by SFC, preserving the privilege against self-incrimination, subjecting SFC and its staff to secrecy and confidentiality obligations, requiring SFC to obtain Magistrate's warrants to enter any premises and establishing the Process Review Panel (PRP).

5. The Executive Director of Supervision of Markets/SFC (ED/SM) briefed members on offences relating to securities, futures contracts and leveraged foreign exchange contracts, which were contained in Part XIV of the Bill. He drew members' attention to a new offence created in clause 293 which outlawed the practice of "bucketing". Bucketing occurred when an intermediary represented that futures transactions executed through it were executed on a futures exchange or some form of regulated electronic trading system when they were not, or would not be, so executed. There were four groups of offences under Part XIV. Defences were also provided to protect those engaging in legitimate securities or futures trading as follows -

- (i) Most offences would require that a mental element be established. These included insider dealing (clause 279), false trading in securities and futures (clauses 283 and 288), stock market manipulation (clause 286), fraud and deception (clause 292);
- (ii) For offences relating to certain blatantly manipulative trading, for example, trading with no change in beneficial ownership, a

defence would be provided for the defendant to establish that none of his or her purposes was a prohibited purpose (clauses 283, 284 and 289);

- (iii) For offences concerning the disclosure of false or misleading information, including the offence against bucketing, there was a defence for the defendant to prove that he acted in good faith and did not know and could not have known that the information he disclosed was false or misleading (clauses 287, 291, 292 and 293); and
- (iv) For offences of disclosing information about illegal transactions in securities or futures (clauses 285 and 290), those innocently reporting or commenting on such transactions, or printing, publishing or transmitting such reports or commentary could defend themselves and prove that they had acted in good faith.

#### Discussion with members

##### *Power to require production of records and documents concerning listed corporations (clause 165)*

6. With reference to the information note provided by the Administration on comparison of powers to request audit working papers among local and overseas regulators (LC Paper No. CB(1) 1474/99-00), the Chairman sought information on whether similar power was given to the Hong Kong Monetary Authority under the Banking Ordinance.

7. Mr Eric LI said that there was a recent trend for authorities to seek access to audit working papers in the course of investigation. There was a provision in the Banking Ordinance enabling the authority to gain access to records and documents of the auditors of the financial institution under investigation. While auditors were willing to assist the authorities in their investigation, they had to uphold their professional integrity of respecting the privacy of their clients. It would be important to strike a balance between the discharge of the auditors' social responsibility to facilitate investigation and the protection of the interest of their clients. He urged the Administration to set a higher threshold for access to audit working papers, such as putting in place the requirement for SFC to obtain a court order before it requested for the production of documents. He sought clarification of the threshold for SFC to start an investigation under clause 165(1)(a) to (e). He noted that the wordings used were "it appears to the Commission that...." and not "has reasonable cause to believe that....". He opined that there were inadequate checks and balances on SFC's power to obtain papers and documents from auditors. The concern about criminal liability of auditors refusing to comply with SFC's request for production of documents was also an important issue.

8. DS/FS said that the Bill empowered SFC to seek records and documents relating to the affairs of a listed company under inquiry, from third parties including auditor, bankers and transaction counterparties of the company concerned. In the case of the auditors, it was noted that they performed an important role in corporate regulation. In particular, they were required to form an independent opinion on a company's financial affairs and in doing so would have performed certain verification checks. Access to an auditor's records and documents therefore could assist SFC in conducting a preliminary listed company inquiry. Regarding the concern about the checks and balances for the power to request for records and documents, she reiterated that adequate safeguards were in place. As mentioned earlier at the meeting by ED/E, there were a number of requirements which SFC had to satisfy before exercising the power. The power of SFC in this regard was in line with that of other local regulators such as the Inland Revenue Department and the Independent Commission Against Corruption. Moreover, a study on overseas jurisdictions had revealed that regulators in the United States (US), the United Kingdom and Australia had similar power to gain access to auditors' working papers. As explained earlier at the meeting, the Administration had considered it unnecessary and inappropriate to require SFC to obtain a court order permitting access to auditors' papers. However, the Administration considered that the court's involvement in this regard should be a last resort when SFC encountered unreasonable resistance or failure to comply with a proper direction for the production of papers. This should not be the first hurdle to SFC in fulfilling its inquiry functions.

9. The Chief Counsel/SFC (CC/SFC) added that the US Securities and Exchange Act of 1934 (the 1934 Act) stipulated that the US Securities and Exchange Commission could request production of documents and records from auditors by means of a subpoena. An auditor's non-compliance with the subpoena without a reasonable cause would constitute a criminal offence. She undertook to provide the extract of the 1934 Act for members' information. In response to Mr LI's enquiry on the threshold for starting an inspection, she explained that there were two levels of thresholds for starting and continuing inspection. A lower threshold was required for starting the inspection initially, thus "it appears to the Commission that...." was provided in clause 165(1). However, if SFC wished to request for records or documents from third parties during the inspection, a higher threshold of "(having) reasonable cause to believe that...." had to be met.

*(Post-meeting note: Extract of the 1934 Act was provided by the Administration and circulated to members vide LC Paper No CB(1) 1479/99-00.)*

10. The Chairman sought information on whether it would be a statutory requirement for SFC to notify the party concerned if it decided to apply for a court order against the non-compliance of that party with its request for production of records or documents. He also enquired about the possible

legal actions to be taken for preventing the party concerned from destroying the evidence. CC/SFC responded that in accordance with the common law practice, the concerned party should be informed for *inter parte* cases but not *ex parte* ones. ED/E added that to prevent destruction of evidence, SFC might apply for a search order to gain immediate access to the documents and records sought without informing the party concerned in advance.

11. Mr Eric LI said that auditors might have difficulties in providing the requested papers if the listed company under inquiry was an international company and the jurisdiction in which it was based outlawed such provision of the company's information to SFC. They would then commit an offence in that jurisdiction if they provided the requested information to SFC. However, if they decided not to comply with SFC's requirement, they would have to defend themselves in court and the offence would be a criminal one.

12. The Chairman said that one possible way to address Mr LI's concern would be to include in the Bill a provision which allowed auditors' non-compliance with SFC's request for documents if the provision of such documents would violate the law in overseas jurisdictions. DS/ES explained that if the provision of the requested information would violate the law in other jurisdictions, SFC would readily accept this as a reasonable cause for the auditors' refusal of complying with the request. The auditors concerned would not have any criminal liability for non-compliance in this case.

13. Mr SIN Chung-kai expressed concern over the possibility of some listed companies making use of the law in certain jurisdictions and intentionally setting up their head offices there so that they could prevent SFC from gaining access to their auditors' working papers. He was also concerned about the difficulties SFC might encounter in its inquiry of the listed companies if the requested documents could not be obtained from the auditors. The Chairman pointed out that SFC should be able to identify other sources to obtain the requested information, such as seeking assistance from its overseas counterparts so that the inquiry of the listed company would be able to continue.

14. Mr FUNG Chi-kin was concerned that the supervisory and investigatory powers given to SFC under Part VIII of the Bill would discourage companies from applying for listing. Moreover, SFC's power to request for production of records and documents from the listed companies' transaction counterparties might discourage other companies from trading with listed companies.

15. DS/ES explained that at present, inquiries conducted by SFC under section 29A of the Securities and Futures Commission Ordinance had been hampered by SFC's inability to verify the propriety or genuineness of transactions reflected in the books and records of a listed company by examining records or documents of its transaction counterparties. Clause 165

rectified this by empowering SFC to obtain documents from such parties. To address concerns about the ambit of this power and the need to set clear parameters, clause 165(10) had set out similar requirements for SFC as in the case of requesting for production of audit working papers. SFC had to certify in writing that the requirements had been satisfied. In addition, SFC was required to have reasonable cause to believe that the record or document sought could not be obtained from the listed company under inquiry or any of its group companies, or any bank or auditor of such a company (clause 165(10)).

16. ED/E supplemented that the purpose of clause 165 was to empower SFC to conduct inquiry into listed companies effectively. The information obtained would be kept confidential. The concept of obtaining information from third parties had existed in the legislation for years and the extension to request for production of records and documents from transaction counterparties was only for the purpose of rectifying the deficiency in existing legislation so that entries in the books and records of the listed company under inquiry could be verified.

*Other concerns*

17. In response to the Chairman's enquiry on the definition of associated entity in clause 166, ED/E said that this was provided in clause 137 of the Bill. DS/FS explained that the concept of associated entity introduced in the Bill was new. Its purpose was to protect the interests of the clients of intermediaries which put their clients' assets under the name of their associated entities. Under the current proposal, these associated entities, which were actually under the control of the intermediaries, would be subject to necessary regulatory requirements.

18. On offences of disclosure of false or misleading information inducing transaction in securities, the Chairman enquired whether the defence provisions under clause 287(3) and (4) for those who were issuing, reproducing or broadcasting materials and information provided by others would be available to financial analysts as well. He also sought information on whether there were equivalent provisions in other legislation in Hong Kong.

19. ED/SM explained that the defence provisions under clause 287(3) and (4) would not be available to financial analysts. A financial analyst who misrepresented the information and misled the public would be held liable for the offence of disclosure of false or misleading information under clause 287. However, a financial analyst who acted in good faith in disclosing the information and did not know and could not have been expected to know that the information was false or misleading, would be able to use the defence provision under clause 287(5). As such, a statement of genuine opinion made in good faith would be protected. He informed members that clause 287 was a new provision and there was no equivalent provision in other legislation in Hong Kong.

Date of future meetings

20. Members noted that the next meeting was scheduled for Friday, 28 April 2000 at 8:30 am. Members agreed that the Subcommittee should meet again around mid-June to receive oral representations from deputations.

*(Post-meeting note: The Subcommittee held a meeting on Tuesday, 20 June 2000 at 10:45 am to receive oral representations from deputations.)*

21. The meeting ended at 10:30 am.

Legislative Council Secretariat  
22 September 2000