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**Paper for the House Committee meeting on 23 October 2015**

**Report of the Bills Committee on Securities and Futures  
(Amendment) Bill 2015**

**Purpose**

This paper reports on the deliberations of the Bills Committee on Securities and Futures (Amendment) Bill 2015 ("the Bills Committee").

**Background**

**Allowing the Securities and Futures Commission to provide supervisory assistance to regulators outside Hong Kong**

2. Currently, the legal framework under the Securities and Futures Ordinance (Cap. 571) ("SFO") allows the Securities and Futures Commission ("SFC") to provide assistance to regulators outside Hong Kong for enforcement matters in line with international norms<sup>1</sup>. For supervisory matters, the relevant provisions in SFO do not meet international norms that have developed since SFO was enacted. Whilst SFC can obtain information for its own supervisory purposes<sup>2</sup> and may share information in its possession with regulators<sup>3</sup> outside

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<sup>1</sup> Under section 186 of SFO, if SFC receives an enforcement-related request from a regulator outside Hong Kong for assisting in investigating suspected contraventions of certain legal or regulatory requirements, SFC may, amongst other things, investigate the matter by exercising its relevant investigatory powers under sections 182 and 183 (for instance by obtaining information and documents requested by the regulator for enforcement purposes) provided that certain conditions are met.

<sup>2</sup> Under section 180 of SFO, SFC may enter the premises of licensed corporations ("LCs"), inspect and make enquiries of to ascertain compliance by an intermediary or an associated entity of an intermediary with the relevant Hong Kong requirements specified in section 180(2) of SFO. These Hong Kong requirements include the requirement not to contravene (a) any provision of SFO; (ba) any provision of Part 2 (except section 6) of the Anti-Money Laundering and

Hong Kong, it is not able to exercise its supervisory powers to obtain information that it does not need for its own supervisory purposes from a licensed corporation ("LC") or its related corporation for the purposes of assisting an overseas regulator in non-enforcement related matters .

3. According to the Administration, by enabling SFC to exercise its supervisory powers to provide supervisory assistance to regulators outside Hong Kong in certain circumstances upon request, SFC will be able to engage regulators outside Hong Kong to negotiate more supervisory memoranda of understanding ("MoUs") to enhance SFC's monitoring of the financial stability in Hong Kong, better adhere to international standards<sup>4</sup> and facilitate LCs in Hong Kong to have access to overseas markets<sup>5</sup>.

4. SFC launched a public consultation in December 2014 on "Proposed Amendments to the Securities and Futures Ordinance for Providing Assistance to Overseas Regulators in Certain Situations" and published the consultation conclusions in June 2015. The Administration advised that the majority of the respondents agreed with the proposals with comments on the details.

### **Refining certain provisions in SFO**

5. According to the Administration, errors and anomalies have emerged in the administration of certain provisions of SFO since commencement of SFO in 2003, and it is necessary to refine certain provisions of SFO for the purpose of:

- (a) dispensing with printed licences for licensed representatives;

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Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615); (b) any notice or requirement given or made under or pursuant to any of the relevant provisions; (c) any of the terms and conditions of any licence or registration under SFO; and (d) any other condition imposed under or pursuant to any provision of SFO.

<sup>3</sup> Under section 378(3)(g)(i) of SFO, if the requested information is already in the possession of SFC at the time of the request, SFC may disclose it to an overseas regulator provided that certain conditions as set out in sections 378(5), 378(6)(a) and 378(6)(b) of SFO are met.

<sup>4</sup> Enabling SFC to provide supervisory assistance to regulators outside Hong Kong in certain circumstances upon request will allow SFC to comply with the General Principles Relating to Cooperation in the International Organization of Securities Commissions under which authorities should share information to assist each other in fulfilling their respective supervisory and oversight responsibilities for regulated entities operating across borders, and information regarding entities of systemic significance or whose activities can have a systemic impact on markets.

<sup>5</sup> 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. SFC is unable to meet its full obligations under the AIFMD MoU unless the law is amended as proposed in the Bill.

- (b) enabling improved working of section 203 of SFO upon revocation or suspension of licences or registrations in relation to an LC or a registered institution under the purview of SFC;
- (c) enabling a recognized exchange company to grant consent to onward disclosure under section 378 of SFO;
- (d) enabling delegation of the function under section 5(4)(e) of SFO whereby SFC may publish materials indicating to intermediaries the manner in which it proposes to perform any of its functions;
- (e) making minor amendments to the levy provisions; and
- (f) amending Part XV of SFO relating to changes made by the new Companies Ordinance (Cap. 622) to voting shares.

### **The Securities and Futures (Amendment) Bill 2015**

6. To enable SFC to provide supervisory assistance to regulators outside Hong Kong in certain circumstances upon request ("the proposed supervisory assistance mechanism"), and to refine certain provisions in SFO as set out in paragraph 5 above, the Administration published the Securities and Futures (Amendment) Bill 2015 ("the Bill") in the Gazette on 12 June 2015. The Bill received its First Reading at the Legislative Council ("LegCo") meeting of 24 June 2015.

### **The Bills Committee**

7. At the House Committee meeting on 26 June 2015, Members agreed to form a Bills Committee to study the Bill. The membership list of the Bills Committee is in **Appendix I**. Under the chairmanship of Hon CHAN Kam-lam, the Bills Committee has held three meetings to discuss with the Administration, including one meeting to receive views from deputations. The Bills Committee has also received one written submission from a deputation. A list of the organizations which have provided views to the Bills Committee is in **Appendix II**.

## **Deliberations of the Bills Committee**

### **Part 2 of the Bill – Amendments relating to printed licences and certificates of registration**

8. Part 2 of the Bill amends SFO to dispense with issuing printed licences to individuals licensed under section 120 or 121 of SFO. Part 2 of the Bill also contains consequential and related amendments to the Securities and Futures (Licensing and Registration) (Information) Rules (Cap. 571S); the Securities and Futures (Miscellaneous) Rules (Cap. 571U) and the Securities and Futures (Fees) Rules (Cap. 571AF).

9. The Bills Committee notes that currently, where a licence is granted under sections 120 and 121 of SFO, SFC issues a certificate of licence to the representative concerned. Given that 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, and to reduce the compliance burden and associated costs to the industry, the Administration considers that the need for SFC to issue printed licences to licensed representatives can be dispensed with, whereas the existing requirements that LCs should maintain and exhibit their printed licences at their principal place of business will remain.

10. Part 2 of the Bill also amends the new Schedule 11 to SFO, which is not yet in operation, to provide for Schedule 11 printed licences and Schedule 11 certificates of registration for deemed licensing of corporations and deemed registration of authorized financial institutions under that Schedule. Under the Securities and Futures (Amendment) Ordinance 2014 ("the 2014 Ordinance"), which was passed by LegCo in March 2014, intermediaries that engage in dealing in, advising on or providing clearing agency services in over-the-counter ("OTC") derivatives as a business will be required to be licensed or registered by SFC. Two new regulated activities ("RAs") will be introduced under the 2014 Ordinance for this purpose. In addition, the existing Type 9 RA (asset management) and Type 7 RA (provision of automated trading services) will be expanded to cover OTC derivative portfolios and transactions respectively. To minimize disruption to the market, a new Schedule 11 (containing transitional arrangements for deemed licensing and deemed registration) will be added to SFO by the 2014 Ordinance for the new and expanded RAs.

11. The proposed Part 5A to be added under the Bill to Schedule 11 to the 2014 Ordinance will provide for the arrangements by SFC to issue printed licences and certificates of registration to intermediaries in the OTC derivative market to indicate the new and expanded RAs for which they are deemed to be

licensed or registered. This will allow the intermediaries to have a certificate in physical form for potential clients to see for better investor protection. The Schedule 11 printed licence/certificate of registration should be returned to SFC within seven days for cancellation after the date on which the deemed status ends as a result of withdrawal, refusal or approval of the normal licence application. The Administration has advised that an intermediary is required to return its printed licence/certificate of registration within seven days, but not seven business days, after the date on which the intermediary ceased to be deemed to be licensed/registered as it is considered more imminent for an intermediary to return its licence once it ceases to carry on the relevant RA.

#### Application of a new licence/certificate of registration due to change in particulars of an LC or registered institution

12. The Bills Committee notes that under the existing Item 9 of Schedule 1 to the Securities and Futures (Fees) Rules (Cap. 571AF), "substantial change" in the particulars of an LC or registered institution since the grant of the existing licence/certificate of registration will necessitate the grant of a new licence/certificate of registration in which a fee is payable for such an application. Clause 18 amends, inter alia, "substantial change" to "change" of particulars of an LC or registered institution in the triggering regime for the grant of a new licence/certificate of registration. The Bills Committee has sought the reasons for the amendment. According to the Administration, the policy intent is that a new licence/certificate is required if any information contained in the licence/certificate has been changed. Hence, it is appropriate to amend "substantial change" to "change" of particulars of an LC or registered institution to reflect the policy intent more accurately.

#### **Part 3 of the Bill – Amendments relating to supervisory assistance to regulators outside Hong Kong**

13. Part 3 of the Bill amends relevant provisions in Part VIII of SFO to enable SFC to provide supervisory assistance to regulators outside Hong Kong.

#### Provision of supervisory assistance by SFC to regulators outside Hong Kong

##### *Scope of supervisory assistance*

14. Clause 24 amends section 186 of SFO to enable SFC to provide a narrow form of supervisory assistance specified in clause 22 under the proposed section 180(4A) to regulators outside Hong Kong upon request by directing that the powers under new subsection (4A) of section 180<sup>6</sup> be exercised if certain

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<sup>6</sup> The new subsection (4A) of section 180 of SFO requires an LC or a related corporation of the LC to provide records or documents and answer questions relating to any RA carried on by the LC or

conditions are met. According to the Administration, such supervisory cooperation is not predicated upon suspected misconduct, and involves exchange of information which is not intended for enforcement purposes or use in legal proceedings. The Bills Committee notes that the request for supervisory assistance to obtain new information<sup>7</sup> must be in relation to an LC in Hong Kong that is also regulated by the regulator outside Hong Kong, or a related corporation of an LC which is regulated by the regulator outside Hong Kong. For providing supervisory assistance to a requesting regulator outside Hong Kong, SFC has to satisfy that the regulator performs any function similar to a function of SFC or the Registrar of Companies, or regulates, supervises or investigates banking, insurance or other financial services or the affairs of corporations, and is subject to adequate secrecy provisions<sup>8</sup>. The requested information must be in relation to the RAs supervised by SFC. Besides, SFC may only provide the supervisory assistance if it receives both a written statement and a written undertaking. The written statement must confirm that the regulator outside Hong Kong has not been and will not be able to obtain the information by any other reasonable means in order to fully ascertain the following matters: (a) whether the relevant corporation constitutes a risk to, or may affect, the financial stability of the jurisdiction of the regulator (i.e. proposed section 186(2B)(a)); or (b) compliance by the relevant corporation with legal or regulatory requirements that the regulator administers in relation to transactions or activities regarding securities and futures<sup>9</sup> (i.e. proposed section 186(2B)(b)). The written undertaking must confirm that the requesting regulator will -

- (a) use the information obtained from SFC because of the request for assistance solely for ascertaining supervisory matters as described above and will not use the information in any proceedings in the jurisdiction of the requesting regulator or elsewhere unless the regulator outside Hong Kong has made a separate request for investigation assistance and SFC has agreed to provide such information (i.e. proposed section 186(2E)(a) and (b));
- (b) treat the information as confidential and will not disclose it to any other person for any purpose without the consent of SFC

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any transaction or activity which was undertaken in the course of, or which may affect, any RA carried on by the LC.

<sup>7</sup> If the requested information is already in the possession of SFC at the time of the request, SFC may disclose it to a regulator outside Hong Kong through the existing gateway under section 378(3)(g)(i) of SFO.

<sup>8</sup> See section 186(5) of SFO.

<sup>9</sup> The transactions or activities cover securities, futures contracts, leveraged foreign exchange contracts, OTC derivative products, collective investment schemes, or other similar transactions or activities that the regulator outside Hong Kong regulates.

(i.e. proposed section 186(2E)(c));

- (c) inform 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 (i.e. proposed section 186(2E)(d)); and
- (d) cooperate with SFC in any action or proceedings which seek to safeguard the confidentiality of the information (i.e. proposed section 186(2E)(e)).

15. The Administration has advised that the existing conditions for providing assistance to regulators outside Hong Kong will also apply to SFC's provision of supervisory cooperation. Those conditions include SFC being satisfied that providing assistance to the requesting regulator is in the "public interest"<sup>10</sup>. In determining whether it will be in the "public interest", SFC is required 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.

16. The Bills Committee has enquired whether an authority or regulatory organization outside Hong Kong under the proposed section 186(2A) of SFO, which will seek supervisory assistance from SFC, refers only to the signatories to the multilateral MoU ("MMoU") of the International Organization of Securities Commission ("IOSCO") for enforcement cooperation. The Administration has advised that as stipulated in section 186(5) of SFO, SFC's counterparts in supervisory cooperation should be an authority or regulatory organization performing similar functions as those performed by SFC and be subject to adequate secrecy provisions. The scope will likely cover signatories to the IOSCO MMoU for enforcement purpose and a few others provided they have secrecy provisions comparable to SFC's.

17. As regards members' enquiry about the definition of "related corporation" of an LC for the purpose of the proposed supervisory assistance mechanism, the Administration has advised that "related corporation" is defined in section 3 of Part 1 of Schedule 1 to SFO, which includes a holding company, a subsidiary and a subsidiary of the same holding company. When an individual controls the composition of the board of directors of one or more corporations, controls more than half of the voting power at general meetings of

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<sup>10</sup> Under section 186(3) of SFO, SFC has to satisfy that the providing assistance to the regulator outside Hong Kong is in the interest of the investing public or in the public interest; or that 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.

one or more corporations; or holds more than half of the issued share capital of one or more corporations, each of the corporations and each of their subsidiaries will be regarded as related corporations of each other.

18. The Bills Committee notes the concerns of some depositions that the scope of information to be exchanged between SFC and regulators outside Hong Kong for supervisory purposes may be unduly broad, that the proposed supervisory assistance mechanism may be tantamount to a platform for regulators of different jurisdictions to gather evidence for investigation purposes. Some members opine that the scope of such information exchange will hinge on how SFC considers a request from a regulator outside Hong Kong, and it is important that SFC should prevent regulators outside Hong Kong from obtaining excessive information, i.e. fishing expedition. In connection with these concerns, the Bills Committee has sought clarification on the criteria for SFC to determine the scope of information that can assist a regulator outside Hong Kong in ascertaining whether a corporation constitutes a risk to the financial stability or may affect the financial stability of the jurisdiction of the regulator. The Bills Committee has also enquired the threshold of gravity or seriousness required that will be considered as constituting a risk to or affecting the financial stability of the relevant jurisdiction of the authority or regulatory organization.

19. The Administration has advised that the scope of information that may legitimately be sought from SFC by a regulator outside Hong Kong under the proposed supervisory assistance mechanism will depend on the circumstances of each case. For example, the information may be sought pursuant to international standards or guidance issued by the Financial Stability Board such as in relation to systemically important financial institutions. The Administration reiterates that the existing and additional safeguards, as set out in paragraphs 14 and 15 above, will serve to ensure that the scope and usage of information exchanged under the proposed mechanism is narrow and limited.

20. The Bills Committee has enquired whether a regulator outside Hong Kong will be considered as not being able to obtain the requested information by any other reasonable means if it is precluded by law or insufficient resources of the jurisdiction of the regulator from obtaining the information. Members have also sought clarification whether SFC, in considering a request for supervisory assistance from a regulator outside Hong Kong, will take into account whether the request is compliant with the domestic laws of the requesting regulator; and how SFC will deal with the situation where the requesting regulator circumvents legal requirements in its own jurisdiction and obtains information via the proposed supervisory assistance mechanism. There is a suggestion that the Administration should consider imposing conditions under SFO to the effect that SFC cannot provide supervisory



assistance to a regulator outside Hong Kong if the request is not compliant with the domestic laws of the regulator.

21. The Administration has advised that the proposed section 186(2D) of SFO aims to ensure that the regulator outside Hong Kong only seeks supervisory assistance from SFC where it is not able to obtain the information itself by any other reasonable means, i.e. the information is located in Hong Kong and within the regulatory jurisdiction of SFC, and outside the regulatory jurisdiction of the other authority. As regards the issue of resources, it will not usually be a factor on its own, rather the main consideration will be the practical accessibility of the information. If a regulator outside Hong Kong is precluded by law from obtaining the information, SFC may consider it not in the public interest to provide supervisory assistance to the regulator and decline its request for information.

22. The Administration has further pointed out that since the form of assistance to be provided will be limited to requesting an LC or its related corporation to provide documents or records relating to an RA and answer questions regarding the same, the scope is restricted and well defined. Also, under the proposed legislation, SFC cannot provide any assistance by any other means which are more intrusive (e.g. entering the premises of any corporation to obtain information). It is therefore difficult to envisage under what circumstances a requesting regulator can circumvent legal requirements in its own jurisdiction in order to obtain information via the proposed supervisory assistance mechanism. Since the counterparts which SFC is dealing with will all be internationally recognized fellow securities regulators, it is reasonable to assume that they will be in compliance with their domestic laws.

#### *Obtaining information from LCs and their related corporations*

23. Clause 22 adds the proposed section 180(4A) to SFO to provide for powers on authorized persons to require LCs or their related corporations to produce records or documents and answer questions, if SFC decides to provide supervisory assistance to regulators outside Hong Kong. As section 181 of SFO provides that an authorized person may require information from other persons specified in section 181(1) for the purpose of enabling or assisting SFC to perform a function under any of the relevant provisions, the Bills Committee has sought clarification on whether, for the purpose of providing supervisory assistance to regulators outside Hong Kong, SFC can seek information from persons other than LCs or their related corporations by virtue of section 181. The Administration has clarified that section 181, when read with sections 186(1) and (2), is used in relation to investigations, i.e. for enforcement purposes. Under the Bill, SFC will not be able to seek information by virtue of section 181 of SFO to provide supervisory assistance to regulators outside Hong

Kong. Under the proposed section 186(2A), SFC may only provide supervisory assistance to a regulator outside Hong Kong by directing that the power under the proposed section 180(4A) be exercised.

24. The Bills Committee further notes that an LC or its related corporation will be informed where SFC's request is on behalf of a regulator outside Hong Kong. This is because, in making the request, SFC will specify that the request is pursuant to the new section 180(4A) which will make it clear that this is in response to a request for assistance from a regulator outside Hong Kong. Upon receipt of the information from an LC or its related corporation, SFC will provide the same to the requesting regulator without further editing or processing the information. As regards a member's suggestion that SFC should also inform an LC or its related corporation of a relevant request for assistance even if the requested information is already in the possession of SFC at the time of request, SFC has advised that SFC may disclose such information to a regulator outside Hong Kong through the gateway under the existing section 378(3)(g)(i) of SFO, which does not require SFC's notification to the relevant LC or its related corporation.

25. The Bills Committee is aware of the concern expressed by some members of the securities sector that SFC's collection of information from LCs for providing supervisory assistance to a regulator outside Hong Kong may create undue operational burden to the LCs. SFC stresses that the amount of new information to be collected from LCs in addition to that not already in SFC's possession should be limited. Firms that are not regulated outside Hong Kong, which may include many small and medium sized firms, will not fall under the ambit of the proposed supervisory assistance mechanism.

### *Safeguards and protections*

26. Under the proposed section 186(2E)(d) of SFO, a requesting regulator is required to inform 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. The Bills Committee has sought the meaning of "a demand legally enforceable" under the laws of the jurisdiction of the authority or regulatory organization, i.e. whether it refers to or relates to any proceedings (including criminal or civil proceedings or enforcement-related proceedings) or pre-proceedings arising from matters concerning those set out in the proposed section 186(2B)<sup>11</sup>.

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<sup>11</sup> The matters set out in the proposed 186(2B) include (a) whether the relevant corporation constitutes a risk to, or may affect, the financial stability of the jurisdiction of the regulator (i.e. proposed section 186(2B)(a)); or (b) compliance by the relevant corporation with legal or regulatory requirements that the regulator administers in relation to transactions or activities

27. According to the Administration, "a demand legally enforceable" under the laws of a jurisdiction in the proposed section 186(2E) is intended to cover circumstances where a third person has obtained a court order in the jurisdiction of the other authority for discovery of information that is obtained by that authority pursuant to a request for supervisory assistance. The provision is meant to enable SFC to participate in measures to resist such disclosure such as by claiming public interest immunity before the relevant court, and is a standard provision in supervisory MoUs.

28. With a view to safeguarding the confidentiality of personal data within the meaning of the Personal Data (Privacy) Ordinance (Cap. 486), the Bills Committee has requested the Administration to consider spelling out specifically the maintenance of the confidentiality of such personal data in the undertaking set out in the proposed section 186(2E) to the effect that a regulator outside Hong Kong should take all reasonable precautions and exercise all due diligence to ensure that personal data contained in the information provided by SFC will not, in the jurisdiction of the regulator, be collected, held, processed or used in any manner which will contravene a requirement under Cap. 486. The Administration has advised that the proposed section 186(2E)(c) already provides for an undertaking to be given by a regulator outside Hong Kong to preserve the confidentiality of information obtained pursuant to supervisory assistance. This will also cover any information that constitutes personal data though it is anticipated that most information obtained pursuant to supervisory assistance will be business information of the relevant LCs or their related corporations, rather than personal data.

29. Members are concerned about the legal rights and protections affordable to LCs and the actions LCs may take if, for legitimate reasons or practical difficulties, they cannot provide information to SFC for rendering supervisory assistance to a regulator outside Hong Kong upon request; or they feel aggrieved by SFC's decision to provide information to the requesting regulator. Members have also enquired about the penalty, if any, where an LC refuses to provide information to SFC under the proposed supervisory assistance mechanism. Some members have suggested the Administration consider making reference to the tax information exchange regime in Hong Kong and introducing a mechanism to allow LCs to seek a review, if necessary, of SFC's decisions to provide information relevant to the LCs to regulators outside Hong Kong ("the Review Mechanism").

30. The Administration has responded that if an LC considers that it has a legitimate reason for not providing information to SFC pursuant to a

supervisory assistance request from a regulator outside Hong Kong, it may set out its response for SFC to consider on a case-by-case basis. Possible reasons may include where the LC claims that the information attracts legal professional privilege or where the LC wishes to claim privilege against self-incrimination in relation to the answer to a question about a transaction. If SFC considers that the reason constitutes a "reasonable excuse" pursuant to section 180(14)<sup>12</sup> of SFO, SFC will not pursue that information further in fulfilling the request.

31. The Bills Committee has queried the adequacy of protections affordable to an LC or its related corporation which has provided the requested information to SFC under the proposed supervisory assistance mechanism if legal exemptions or privileges are not available under the laws of the jurisdiction of the requesting regulator. The Administration has explained that the proposed section 186(2E)(d)(ii) states that the written undertaking from a requesting regulator must be to the effect that the regulator will, on receiving a demand legally enforceable for disclosure of information, assist in preserving the confidentiality of the information by taking all appropriate measures as may be available, including but not limited to asserting legal exemptions or privileges under the laws of the jurisdiction of the requesting regulator. By referring to "including but not limited to" in the proposed section 186(2E)(d)(ii), there can be other measures. The measures available will depend on the laws of the jurisdiction of the regulator. As advised by SFC, the legal provisions pertaining to legal privileges and exemptions in major jurisdictions like the United States and those in the European Union ("EU") are comparable to those of Hong Kong.

32. Regarding the Review Mechanism, the Administration has advised that there is no such review procedure in the securities laws of other major comparable jurisdictions such as Australia, Singapore and the United Kingdom ("UK"). The Administration considers that to have a Review Mechanism will run counter to the prevailing trend towards greater cooperation over the regulation of cross-border market participants. If a regulator outside Hong Kong decides that it does not have sufficient confidence in the degree of supervisory co-operation available under Hong Kong laws because of an appeal or similar procedure, Hong Kong will risk being excluded from global regulatory networks enabling greater cross-border market access.

33. The Bills Committee has explored whether it is necessary to add a provision under the Bill to the effect that documents or records covered by legal

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<sup>12</sup> Section 180(14) of SFO provides that a person who, without reasonable excuse, fails to comply with a requirement imposed on him by an authorized person under section 180 commits an offence and is liable-

(a) on conviction on indictment to a fine of \$200,000 and to imprisonment for one year; or  
(b) on summary conviction to a fine at level 5 (i.e. \$50,000) and to imprisonment for six months.

professional privilege will not be provided to a regulator outside Hong Kong under the proposed supervisory assistance mechanism without the consent of an LC concerned or its related corporation. The Administration takes the view that it is not necessary to add such a provision because section 380(4) of SFO already provides unequivocally that nothing in SFO affects any claims, rights or entitlements which will, apart from SFO, arise on the ground of legal professional privilege, and the Bill does not seek to amend section 380(4). If an LC or its related corporation makes a legitimate claim of legal professional privilege over a document sought by a regulator outside Hong Kong pursuant to supervisory assistance, this will amount to a "reasonable excuse" and will not incur any criminal liability under section 180(14) of SFO. SFC cannot compel its disclosure, and thus the issue of providing it to the requesting regulator will not arise.

34. The Bills Committee has also explored whether it is necessary to add a provision regarding the privilege against self-incrimination in the Bill to the effect that explanation or statement provided by a person who claims that such explanation or statement may tend to incriminate him will not be provided to the requesting authority outside Hong Kong for use in criminal proceedings against him in the jurisdiction of the requesting authority outside Hong Kong. The Administration considers that it is not necessary to add such a provision. The assistance to be provided under the proposed section 186(2A) is designed for supervisory but not enforcement purposes. The fact that the information cannot be used for enforcement purposes is reinforced by the requirement for the regulator outside Hong Kong to provide written undertakings to SFC that the information obtained under supervisory cooperation will not be used in any proceedings. In the event that the requested information indicates an apparent breach of the regulatory regime administered by a regulator outside Hong Kong and that regulator wishes to use the information in regulatory and/or criminal proceedings against the person from whom such information is obtained, it will have to separately satisfy the legal requirements that apply to enforcement assistance and to commence a separate information request pursuant to the existing SFO provisions governing enforcement-related assistance. In these circumstances, the usual protections under that separate process will apply. For instance, there are safeguards in section 186(6) of SFO enabling a person to claim privilege against self-incrimination, for example, with respect to an answer to a question.

35. Some members have expressed concern that the safeguards against onward disclosure or unauthorized use of information provided by SFC to a regulator outside Hong Kong may be ineffective if there is no legal sanction against the requesting regulator for breaching of its undertakings on the safeguards.

36. The Administration has advised that in the context of securities market supervision, international regulators can only enter into non-legally binding MoU with each other. Each such MoU sets out the agreed scope of cooperation and each party's duties and obligations. There is no scope for SFC to enter into legally binding MoUs as neither it nor its counterparts has treaty-making capacity. In practice, if a regulator breaches its undertakings or any terms of an MoU, its international reputation will be seriously damaged. That regulator will lose the trust of other regulators participating in the global network of supervisory cooperation which is built on reciprocity. It will likely result in other regulators refusing to co-operate with it in future. This will be a major deterrent factor because, given the interconnections between different markets and the global presence of financial groups, information obtained from one jurisdiction may be highly relevant to and have impact on multiple jurisdictions. It is therefore paramount for regulators to work together in overseeing the activities of globally active market participants, to identify and assess risks and to develop a coordinated response to mitigate those risks.

*Benefits of putting in place the supervisory assistance mechanism*

37. The Bills Committee has examined the positive and negative impacts, if any, on investor protection, operation of LCs and maintenance of financial stability in Hong Kong, etc. of the proposed supervisory assistance mechanism.

38. According to the Administration, given Hong Kong's open market architecture and the significant presence of international firms with group companies that are also regulated overseas, the ability to enter into supervisory MoUs to enable reciprocal supervisory assistance is particularly important for Hong Kong as it will enable SFC to seek information regarding entities of systemic significance or whose activities can have a systemic impact on the markets. The current limitation of SFC's powers can hinder SFC's ability to enter into supervisory MoUs with regulators outside Hong Kong, and thus undermine SFC's ability to seek assistance for the purposes of enhancing monitoring of the financial stability in Hong Kong and ensuring compliance of LCs. Furthermore, the proposed amendments will enable LCs to have greater access to overseas markets and allow regulators outside Hong Kong to grant market access to Hong Kong financial firms, which otherwise can be denied.

39. The Administration also points out that the proposed supervisory assistance mechanism is necessary to ensure that Hong Kong can take advantage of the benefits of greater cooperation amongst international regulators. The Administration believes that this objective is firmly in the public interest, i.e. enabling SFC to protect Hong Kong investors and its markets by obtaining more and better supervisory information from regulators

outside Hong Kong about globally active firms through reciprocal arrangements.

40. At the request of the Bills Committee, the Administration has provided information on the supervisory assistance mechanisms in Australia, Singapore and three member states of the EU (i.e. Germany, the Netherlands and UK) for members' reference. The Bills Committee notes that these states have mechanisms in place, similar to the one proposed in the Bill, which allow them to provide reciprocal supervisory assistance to their overseas counterparts.

#### Supervisory memoranda of understanding

##### *Mechanism for SFC to enter into supervisory MoUs with regulators outside Hong Kong*

41. According to the Administration, the proposed amendments to SFO under the Bill will provide the necessary and sufficient legal framework and safeguards to enable SFC to exchange information with regulators outside Hong Kong for supervisory purpose and it is not a prerequisite for SFC to enter into supervisory MoUs with the regulators. However, while supervisory MoUs are optional and have no extra-territorial effect on regulators outside Hong Kong, they are customary and useful for building trust and dealing with operational issues between the signatories. SFC stresses that it will not ordinarily exercise its powers to provide supervisory assistance to a regulator outside Hong Kong unless it has entered into a relevant MoU or equivalent protocol with the regulator.

42. Members have sought information on the mechanism and process for SFC to enter into supervisory MoUs with regulators outside Hong Kong. The Administration has advised that with the proposed amendments in the Bill, in considering whether a request for supervisory assistance is to be entertained or not –

- (a) SFC must be satisfied that the regulator outside Hong Kong performs similar functions as those of SFC and that it is subject to adequate secrecy provisions (under section 186(5) of SFO).
- (b) SFC must be satisfied that it is desirable or expedient that the assistance should be provided in the interest of the investing public or in the public interest (under section 186(3) of SFO).
- (c) SFC should take into account whether the regulator outside Hong Kong will pay the costs and expenses incurred in providing the assistance and be able and willing to provide

reciprocal assistance within its jurisdiction in response to a comparable request for assistance from Hong Kong (under section 186(4) of SFO).

43. The Administration has further explained that SFC will identify and approach regulators outside Hong Kong that also regulate LCs or their related corporations with a view to entering into, or updating, supervisory MoU arrangements with them. During the MoU discussion process, each regulator will propose its own terms and negotiate alternative wording where necessary. The MoU will then be scrutinized by SFC clause-by-clause. When the text of an MoU is agreed, this will normally be considered by SFC's Executive Committee and approval will be sought to execute the MoU. MoUs are normally executed by the Chief Executive Officer or one of the other Executive Directors of SFC under delegated authority.

44. Some members are concerned how SFC can ensure that a regulator outside Hong Kong will be able and willing to provide reciprocal assistance in response to a comparable request from Hong Kong via the proposed supervisory assistance mechanism, in particular if the regulator refuses to provide certain requested information on the ground of confidentiality obligation (e.g. the information is pertaining to state secrets) within its jurisdiction. The Administration has advised that the proposed mechanism will only give the SFC a discretion to provide supervisory assistance to an overseas regulator and will not impose an obligation to do so. Further, SFC will not enter into bilateral MoU that will enable the supervisory assistance with any jurisdiction or authority which will not provide reciprocal assistance in response to an equivalent assistance request made by SFC. The Administration has emphasized that supervisory MoUs in the securities field are expressly subject to exceptions, i.e. supervisory assistance can be denied by the signatories of the MoU for circumstances where providing assistance will be in breach of domestic law. That said, it is expected that regulators of comparable jurisdictions with which SFC enters into supervisory MoUs will use reasonable endeavours to provide the supervisory assistance with the fullest cooperation permissible, and such exceptions will not ordinarily apply.

#### *Terms of supervisory MoUs*

45. The Administration has provided for members' information a reference document which SFC has been working on for use when SFC engages in any supervisory MoU negotiation with regulators outside Hong Kong, and aims to set out some usual terms that SFC will generally be looking for in an MoU ("the Reference Document")<sup>13</sup>. According to the Administration, the Reference Document has taken into account, inter alia, the following –

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<sup>13</sup> For details of the Reference Document, please refer to the Annex to the Administration's paper issued for



- (a) the Final Report on Principles Regarding Cross-Border Supervisory Cooperation issued by IOSCO in October 2010, which includes a set of principles and a sample supervisory MoU to assist securities regulators to develop and maintain supervisory cooperation arrangements;
- (b) the relevant rules and regulations in Hong Kong, including the proposed amendments to sections 180 and 186 of SFO in the Bill, in particular section 186(5) under which the regulators outside Hong Kong are subject to adequate secrecy provisions;
- (c) SFC's statutory function to cooperate with and provide assistance to regulatory authorities or organizations, whether formed or established in Hong Kong or elsewhere (under section 5(1)(h) of SFO);
- (d) SFC's goal to enhance supervision of LCs or their related corporations that operate and conduct similar business activities in other jurisdictions;
- (e) resource considerations if requested to provide supervisory assistance by regulators outside Hong Kong in the light of SFC's statutory duty to make efficient use of its resources (under section 6(2)(e) of SFO); and
- (f) similar supervisory MoUs that have been entered into by SFC and other regulators in the past.

46. The Bills Committee notes that under the Reference Document, "cross-border on-site visit" is defined to mean any regulatory visit by one authority to the premises of a cross-border regulated entity located in the other authority's jurisdiction, for the purposes of ongoing supervision and oversight. The Bills Committee has requested the Administration to clarify the source of power for conducting such cross-border on-site visits in Hong Kong and to elaborate the nature of such cross-border visits, in particular, the activities and actions to be undertaken by the regulatory authority outside Hong Kong or SFC during such cross-border on-site visits in Hong Kong. The Administration has also been requested to consider whether the term "cross-border on-site visit" is appropriate and enforceable given that SFC or the regulator outside Hong Kong is not empowered under the Bill to enter the premises of an LC or its related corporation for the purpose of supervisory cooperation.

47. The Administration has explained that some authorities outside Hong Kong such as the US have extra-territorial powers under their domestic laws to conduct cross-border on-site visits on entities which are under their jurisdictions or have otherwise submitted themselves to their jurisdictions. Such extra-territorial powers will not extend to an LC in Hong Kong which has no nexus to an authority outside Hong Kong. These visits are conducted for supervisory purposes only and they are distinguished from cross-border enforcement enquiries that are governed by a separate regime. Upon completion of such on-site visits, the non-Hong Kong regulators usually inform SFC of their key findings and observations. An authority outside Hong Kong will usually notify the LC of the inspection in advance so that appropriate arrangements can be made. Such cross-border on-site visits in Hong Kong are arranged directly between the regulator outside Hong Kong and the LC concerned. SFC does not facilitate cross-border on-site visits for regulators outside Hong Kong.

48. According to the Administration, clauses about cooperation amongst international regulators on "cross-border on-site visits" are commonly found in supervisory MoUs. In some jurisdictions, authorities have extra-territorial powers under their domestic law to conduct on-site visits outside their jurisdictions. Their powers to conduct such visits therefore are not derived from SFO or the Bill, but their own legal powers in their jurisdiction. SFO is silent on cross-border on-site visits and LCs cannot be compelled under Hong Kong law or by SFC to accept such a visit. The Administration has advised that "cross-border on-site visits" clauses in MoUs are long standing arrangements and are considered appropriate so as to encourage better cooperation between regulatory authorities. In fact, notwithstanding that regulators with extra-territorial powers under their domestic laws are not seeking SFC's supervisory assistance in any way and SFC's consent is therefore not required, with the "cross-border on-site visits" clauses in the MoUs, these regulators are required to consult SFC first and follow certain procedures before they carry out any on-site visits in Hong Kong.

#### *Vetting of supervisory MoUs*

49. The Bills Committee notes that some depositions are concerned about the extent of transparency in SFC's administration of the proposed powers to provide supervisory assistance to regulators outside Hong Kong. Some members consider that, compared to the existing legal frameworks for information exchange pertaining to tax matters or mutual legal assistance (e.g. surrender of fugitive offenders), the proposed supervisory assistance mechanism is not sufficiently stringent if the MoUs to be signed by SFC with its overseas counterparts are not subject to negative vetting by LegCo. There is also a suggestion that SFC should make available for public inspection in future

a list of regulators outside Hong Kong with which SFC enters into supervisory MoUs.

50. The Administration has responded that both the regime for information exchange on tax matters and the regime for mutual legal assistance are different in nature from the system for international supervisory co-operation in the securities field. Arrangements for exchange of tax information are provided for under binding bilateral international agreements or arrangements that are entered into between the Government of the Hong Kong Special Administrative Region ("HKSAR") and the governments of territories outside Hong Kong. Before these bilateral intergovernmental agreements or arrangements can have domestic legal effect in Hong Kong, it is necessary for the Chief Executive in Council to declare by orders as required under the Inland Revenue Ordinance (Cap. 112) to give effect to them. These orders have to be enacted as subsidiary legislation, which are subject to negative vetting by LegCo. As regards the regime for mutual legal assistance, it is analogous to the regime for information exchange on tax matters outlined above<sup>14</sup>. In substantial contrast, arrangements for supervisory co-operation are entered into between securities regulators (not governments) usually in the form of MoUs which are not legally binding and are expressly subject to each party's domestic law. There is no scope for SFC to enter into legally binding MoUs as neither it nor its counterparts has treaty-making capacity. Moreover, the narrow power to provide supervisory assistance under the Bill, when exercised, will be in relation to LCs, but not licensed individuals. As such the other information exchange mechanisms mentioned above are not relevant in the context of the proposed supervisory assistance mechanism.

51. As regards the issue of transparency, the Administration advises that SFC is required under section 186(5) of SFO to publish in the Gazette the names of the regulators outside Hong Kong with which it enters into supervisory MoUs. SFC will usually publish the full texts of signed supervisory MoUs on its website.

52. Noting the Administration's stance that it will not be appropriate to subject the process of entering into supervisory MoUs to negative vetting by LegCo, some members are concerned about how LegCo can be assured of and monitor SFC's full compliance with the relevant legislation and guidelines when entering into supervisory MoUs.

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<sup>14</sup> For details of a comparison between the proposed supervisory assistance mechanism and the regime for mutual legal assistance, please refer to paragraphs 11 to 17 of the Administration's paper issued for the meeting of the Bills Committee held on 5 October 2015 (LC Paper No. CB(1)1274/14-15(02)).

53. The Administration has explained that as SFC is a statutory body and all its relevant regulatory powers are derived from SFO, SFC must act within its powers at all times and its decisions must be consistent with its statutory objectives and functions and reasonable as a matter of administrative law. Decisions by SFC to enter into supervisory MoUs are subject to judicial review by the Courts. In addition, the Chief Executive of HKSAR appoints the Process Review Panel ("PRP") which is an independent body comprising mainly non-officials to provide checks and balances to ensure that SFC exercises its regulatory powers in a fair and consistent manner. In particular, PRP is tasked to review and advise SFC upon the adequacy of SFC's internal procedures and operational guidelines governing the actions taken and operational decisions made in the performance of SFC's regulatory functions.

54. As regards whether PRP is vested with the powers to look into individual cases of information exchange between SFC and its overseas counterparts, and if so, the circumstances that may trigger a case review by PRP, the Administration has advised that the cases that PRP may look into will include any completed requests for supervisory information from regulators outside of Hong Kong. In the review process, PRP may also consider the provisions of the relevant MoUs as well as the relevant sections of SFO in order to assess the extent to which SFC has complied with its procedures in exercising this power. Annually, PRP submits its reports to the Financial Secretary and publishes the reports for information by LegCo Members and the public. The Administration assures members that, to further enhance transparency, SFC will provide regular updates to the public on its work regarding supervisory assistance and communicate more closely with the industry to understand their concerns. The Administration will also consider how to keep LegCo informed of new supervisory MoUs reached between SFC and regulators outside Hong Kong.

#### **Part 4 of the Bill – Amendments relating to carrying on business operation upon revocation or suspension of licence or registration**

55. Part 4 of the Bill amends section 203 of SFO to empower SFC to permit an intermediary and an individual named by SFC in the permission to carry on essential business operations after the revocation/suspension of the intermediary's licence or registration.

56. The Bills Committee notes that under the existing section 203 of SFO, SFC may give permission to a person whose licence or registration is revoked or suspended to carry on business operations for the purpose of closing down the business connected with the revocation or protecting clients' interests. In applying section 203, SFC found that the legislation does not provide clearly

that the LC or registered institution and the personnel involved are obliged to comply with the relevant provisions as defined in section 1 of Schedule 1 to SFO when carrying on such business operations. The proposed amendments under the Bill are meant to clarify the above aspect. The Bills Committee has not raised any queries on the proposed amendments.

**Part 5 of the Bill – Amendments relating to disclosure of information by recognized exchange company**

57. Part 5 of the Bill amends section 378 of SFO so that if a specified person is a recognized exchange company, SFC and the company may consent to onward disclosure of the information which is disclosed by the company.

58. The Bills Committee notes that currently, only SFC may consent to onward disclosure of information that has been disclosed under section 378 of 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 SEHK. This has resulted in SEHK and their interlocutors frequently approaching SFC for consent to disclose information relating to SEHK matters, although there is no regulatory need for SFC otherwise to be involved in the process. The proposed amendments to section 378 of SFO will provide that the recognized exchange company that made the initial disclosure of information may consent to onward disclosure of the information to improve administrative efficiency. The proposed 378(9A) provides that a recognized exchange company may impose conditions in granting consent for onward disclosure of information.

59. The Bills Committee has enquired about the factors to be considered by a recognized exchange company in granting the consent for onward disclosure of information, and suggested the Administration consider if these factors and the purposes for the onward disclosure of information should be stated in the Bill. The Administration takes the view that as the issue involved is routine in nature, it is not necessary to state such factors or purposes in the Bill, which are consistent with the existing provisions for SFC.

60. The Bills Committee has considered whether it is necessary to require that the conditions imposed by the recognized exchange company for onward disclosure of information will not be less stringent than those imposed by SFC on the recognized exchange company. The Administration has advised that such an addition is not appropriate because the sort of information covered by the proposed section 378(9A) will relate to non-statutory matters such as

investigation by a recognized exchange company of suspected breaches of its rules. This is different from the sort of information covered by section 378(9) which may relate to the exercise of statutory powers by SFC where disclosure is compulsory. Therefore, it is not unlikely that the conditions SFC may impose under section 378(9) will be more stringent than those that will be necessary for a recognized exchange company to impose under section 378(9A).

## **Other parts of the Bill**

### Part 6 – Amendment relating to delegation of function

61. Part 6 of the Bill amends section 2 of Part 2 of Schedule 2 to SFO to remove SFC's function under section 5(4)(e) of SFO from the list of non-delegable functions. Under section 5(4)(e), SFC may publish or otherwise make available 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 the materials are technical and often temporary, the proposed amendments seek to enable delegation of the function so that SFC can carry out the function more effectively. The Bills Committee has not raised any queries on the proposed amendments.

### Part 7 – Amendments relating to rounding of levy amounts

62. Part 7 of the Bill adds new provisions to the Securities and Futures (Levy) Order (Cap. 571Z) ("the Order") and Securities and Futures (Investor Compensation – Levy) Rules (Cap. 571AB) ("the Rules") to provide for the rounding of levy amounts to the nearest cent, and amends the fixed levy amount for a sale and purchase of certain futures contracts.

63. The Administration has explained that the Order prescribes the levy rates payable in respect of trading in securities and futures/options contracts. Certain percentages are specified in the Order for the calculation of levy, which may result in a fraction of a cent that cannot be collected. Currently, securities transactions are subject to a percentage levy (0.0027%) and the resulting amount is rounded to the nearest cent administratively. The Administration considers it necessary to add a provision via the Bill to the effect that a reference in the Order to the levy payable for a sale and purchase, whether expressed as a percentage or a dollar figure, means an amount rounded to the nearest cent. The Administration has pointed out that similar provisions can be found in other Ordinances (e.g. Exchanges (Special Levy) Ordinance (Cap. 351)). The Bill also amends the Rules, which prescribe the levy rates payable in respect of sale and purchase of securities to fund the Investor Compensation Fund, for the same reasons.

64. The Bills Committee further notes that the Order has been amended recently to reduce the levy payable for a sale and purchase of mini futures and options and stock futures contracts by 10% from \$0.12 to \$0.108 per contract, with effect from 1 November 2014. Prior to the implementation of the reduced levy of \$0.108 per contract, SFC has noted that the systems of the Hong Kong Exchanges and Clearing Limited ("HKEx") and some brokers' systems can only support the collection of levies up to 2 decimal places. SFC has adopted a temporary arrangement to collect the levies for mini futures and options and stock futures contracts at \$0.10 per contract. The arrangement is to facilitate HKEx and brokers to collect the SFC levies. To rectify the problem, the Bill incorporates amendments to the Order by substituting "\$0.10" for "\$0.108". The Bills Committee supports the relevant amendments as they will help minimize operational burden on the industry.

#### Part 8 and the Schedule to the Bill

65. Part 8 of the Bill amends section 307(1) of SFO and section 11(6) of the Securities and Futures (Contract Notes, Statements of Account and Receipts and Rules) (Cap. 571 Q) to correct minor errors, whereas the Schedule to the Bill amends certain references to "shares" in Part XV of SFO and the Securities and Futures (Disclosure of Interests-Exclusions) Regulation (Cap. 571 AG). Those references are intended to be references to "voting shares" as defined by section 308 of SFO. The Administration has advised that the Companies Ordinance (Cap. 622) abolished the nominal value of shares. Part XV of SFO 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 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 SFO and the relevant subsidiary legislation. However, there are still a number of references to "shares" in existing provisions which are intended to mean "voting shares". In order to enhance clarity of the legislative provisions, the Bill seeks to make further amendments to some existing provisions of SFO. The Bills Committee has not raised any queries on the proposed amendments.

#### Committee Stage amendments

66. The Bills Committee and the Administration have not proposed any Committee Stage amendments to the Bill.

**Resumption of Second Reading debate**

67. The Bills Committee supports the Administration's proposal to resume the Second Reading debate on the Bill at the Council meeting of 4 November 2015.

**Advice Sought**

68. Members are invited to note the deliberations of the Bills Committee above.

Council Business Division 1  
Legislative Council Secretariat  
22 October 2015



**Bills Committee on Securities and Futures (Amendment) Bill 2015**

**Membership list**

**Chairman** Hon CHAN Kam-lam, SBS, JP (Chairman)

**Members** Hon James TO Kun-sun  
Hon Andrew LEUNG Kwan-yuen, GBS, JP  
Hon Starry LEE Wai-king, JP  
Hon Kenneth LEUNG  
Hon Christopher CHEUNG Wah-fung, SBS, JP  
Hon SIN Chung-kai, SBS, JP

(Total : 7 members)

**Clerk** Ms Angel SHEK

**Legal Adviser** Ms Vanessa CHENG

**Bills Committee on Securities and Futures (Amendment) Bill 2015**

**List of organizations/individuals from which the Bills Committee  
has received views**

1. Calf Company Limited
2. Hong Kong Securities Professionals Association
3. The Alternative Investment Management Association Limited
4. The Lion Rock Institute