THE LAW SOCIETY OF HONG KONG 香港律師會

Consultation Paper on Proposed Amendments to the Securities and Futures Ordinance for Providing Assistance to Overseas Regulators in Certain Situations

The Law Society's Submissions

The Law Society provides the following response to a Consultation Paper entitled "Proposed Amendments to the Securities and Futures Ordinance for Providing Assistance to Overseas Regulators in Certain Situations" released by Securities and Futures Commission on 19 December 2014:

Question 1: Do you have any alternative suggestions to the proposals in this Consultation Paper which could also achieve the same objectives that the proposed amendments to sections 180 and 186 intend to achieve?

The Law Society's response:

1. The Law Society agrees with the underlying spirit of the proposals, subject to the comments below.

Question 2: Do you have any comments on the proposal that the purposes of supervisory assistance should be limited to those discussed in paragraph 25(b) above?

The Law Society's response:

2. As a general comment, the Law Society agrees that the purposes of the supervisory assistance should be set out and appropriate limits should be included in the draft legislation. At present, the proposals appear to envisage that if the Securities and Futures Commission ("**SFC**") decides to provide any supervisory assistance to an overseas regulator, it may require a licensed corporation to provide copies of documents or records which broadly relate to, or which may affect, its regulated activities. However, if the aim of the proposals is to facilitate supervisory cooperation and coordination, the SFC should only be able to request such information that is sufficient to satisfy the specific need of the requesting party.

3. Under Section 170(1)(g) of the Singapore Securities and Futures Act, the Singaporean regulator will only provide assistance to a foreign regulator if the material requested is of "*sufficient importance*" to the foreign regulator's carrying out of the supervision to which it applies. Additionally, under section 170(1)(h) of the Singapore Securities and Futures Act, the matter to which the request relates must be of "*sufficient gravity*". Similarly, the United Kingdom's Financial Services and Markets Act ("**FSMA**") prescribes that the regulator will consider the seriousness of the case in question when deciding whether to assist an overseas regulator.

4. We suggest that the proposed amendments include similar thresholds on gravity and materiality, both to limit unwarranted interference and to protect the SFC from "fishing" requests from the overseas regulators.

5. In this regard, we welcome the proposed limitation on the supervisory purposes for which an overseas regulator may request the information to (i) risks to and impact on the stability of the financial system in the overseas regulator's jurisdiction, and (ii) compliance with the legal and regulatory requirements relating to securities, futures contracts, leveraged foreign exchange contracts, collective investment schemes, over-the-counter derivative products and similar transactions within the responsibility of the overseas regulator. Having said that, we would suggest that the proposal in the current paragraph 25(b)(i) be revised as it is vague and could lead to unintended results.

6. Under the proposed paragraph 25(b)(i), it would be up to an overseas regulator to articulate whether a piece of information could be useful for "*ascertaining the risks to and impact on the stability of the financial system in its jurisdiction*" – there are no objective criteria and no limits on the scope of information that could potentially be regarded as having a possible impact on / risk to a financial system's stability.

7. To enhance certainty and to guard against excessive amount of information being requested or provided, we would suggest that conditions be added to paragraph 25(b)(i) such that assistance is to be provided only if the SFC is satisfied that a failure to do so would likely pose a threat to a financial system's stability / if the matter is of sufficient importance to the stability of the financial system (similar to the concepts in sections 165A(3) and (4) of the FSMA and sections 170(1)(g) and (h) of the Singapore Securities and Futures Act).

8. We would also suggest adding: (i) a definition of the "financial system", similar to that in section 169A(5) of the FSMA; and (ii) a provision setting out the types of overseas regulators that the SFC may assist, similar to the requirements in section 186(5) and section 378(6) of the SFO.

9. In respect of paragraph 25(b)(iii) we assume it should read "(iii) A licensed corporation, that is regulated by the SFC or regulated by both the SFC and the overseas regulator; and/or".

10. In addition to the above, we also have reservations about extending the assistance to information concerning a Hong Kong licensed corporation simply because its "*related corporation is regulated by the overseas regulator*" (paragraph 25(b)(iv)). This

proposal may cause unfairness as it could, in effect, subject a Hong Kong licensed corporation to the extraterritorial jurisdictions of the overseas regulators, even though it is not supposed to be regulated by them. It could also exert excessive compliance burden on the corporation, especially given that "*related corporation*" is widely defined in the SFO. We suggest that limits be added in paragraph 25(b)(iv) (e.g. by adopting a narrower interpretation of "related corporation" for this purpose) to address these concerns.

11. We also assume that the SFC's scope of enquiry will be of the licensed corporation and not a related corporation with a presence in Hong Kong that the SFC doesn't regulate (and has no need to). We assume that the SFC will have previously sought confirmation from an overseas regulator that it is unable to access the information being requested directly from the regulated presence in its jurisdiction.

Question 3: Do you have any comments on the proposal that the power to gather information for supervisory assistance purposes should be limited to those discussed in paragraphs 25(a) and (c) above?

The Law Society's response:

12. The scope of the type of information that may be requested under the Consultation Paper (paragraph 25(a)) is extremely broad, for example, the SFC may react to a request for assistance from an overseas regulator in non-enforcement-related matters by requiring a licensed corporation to provide any record or document relating to regulated activities or to "*any transaction or activity which was undertaken in the course of, or which may affect, any regulated activity*" carried on by the licensed corporation (paragraph 25(a) and (c)) and to make related enquiries. The Law Society acknowledges that (under existing sections 180(1)(b) and 180(4)(b) SFO) the SFC has broad powers to (i) require licensed corporations to provide the SFC with copies of records or documents that relate to transactions or activities undertaken in the course of, or which may affect, the business conducted by such licensed corporation, and (ii) make inquiries concerning such records or documents. However, these powers relate to the SFC's own investigations, and similar powers should not derive from a situation in which the SFC is acting at the behest of an overseas regulator.

13. The language used should be specific and objective, to avoid the drafting being open to subjective interpretation. In particular, the words in paragraph 25(c) of the Consultation Paper "*which may affect*" could be ambiguous in the context of a request from an overseas regulator. The SFC may not have the same level of direct knowledge as to why certain records are required as it would if it were acting on its own initiative in respect of its own obligations, and the language should therefore be clearer and more specific as to the purpose of the request and the intended use of the information required. To address these issues and to remove any ambiguity which may otherwise arise, we would suggest the words "*or which may affect*" be removed from paragraph 25(c).

14. In paragraph 25(c) which is a proviso contained in paragraph 25(a), please clarify if the "regulated activity" confined to those activities regulated under the SFO. Please

also specify what kind of records or documents will be obtained from the related corporation, e.g. whether such records and documents have to be in relation to the activities associated with the licensed corporation and being conducted within or outside Hong Kong jurisdiction. It is important to clarify the extent of information to be obtained from the related corporations so that they can keep proper and up-to-date record from time to time and provide the same upon SFC's request.

Question 4: Do you agree that there is a need to have the legal pre-requisite of obtaining written undertakings from the overseas regulators? Do you have any comments on the scope of the undertakings discussed in paragraph 25(d) above?

The Law Society's response:

15. Yes, the Law Society strongly agrees. We strongly welcome the proposed codification of safeguards, including that the SFC be satisfied that the overseas regulator is subject to "*adequate secrecy provisions*" (paragraph 19(b)) and the requirement of a written undertaking from overseas regulators to protect the information obtained under the proposed supervisory assistance.

16. There is no obligation in Hong Kong to provide information that is legally privileged but in practice licensed corporations may waive such privilege in some instances. A licensed corporation is afforded the same protections in this respect in overseas regulators' jurisdictions as are afforded in Hong Kong - where partial waiver of privilege is recognised (*Citic Pacific limited v Secretary for Justice & Anon 2012*); this is not the case in all jurisdictions.

17. The undertakings will require overseas regulators to commit that they will treat the information obtained as confidential and will not disclose it without the SFC's consent (paragraph 25 (d)(ii)), notify the SFC where they receive a legally enforceable disclosure demand and take all appropriate measures to maintain confidentiality (paragraph 25(d)(iii)) and cooperate with the SFC in any actions to preserve the confidentiality of the information (paragraph 25(d)(iv)). We understand this is intended to offer some degree of comfort to licensed corporations and related corporations, although, practically, it is uncertain to us as to how a breach of these undertakings would be remedied. In addition, we would appreciate if the SFC could also clarify whether the information requested under the supervisory cooperation would extend to client-related information of the licensed corporations/related corporations, and if so, please confirm it has considered how the client confidentiality and data privacy issues would be dealt with under the supervisory cooperation and clarify how the SFC would apply the tests in paragraph 25 to such information.

18. Although we are not given a chance to review the draft MOU to be signed by the relevant overseas regulators and the SFC, we trust there should be a mechanism by which the SFC, in case of any breach of the undertakings by the relevant authority, can take action.

19. With reference to SFC's powers as to whether to give consent to the overseas regulators under paragraph 25(d), in case the information requested under the

supervisory cooperation has been passed on to the overseas regulators by the SFC and the overseas regulators requests such information to be used in their domestic incoming recovery and resolution regime (such information is readily shared by those domestic resolution authorities), how would the SFC respond?

20. Under section 166 SFO, if a licensed corporation is required to notify the SFC of certain matters (e.g. information on financial resources, associated entities or client monies) and such data may be incriminating, then it may not be used against it in criminal proceedings (subject to certain exceptions). We are concerned however that the information that licensed corporations are required to provide to the SFC, acting on behalf of an overseas regulator, should be similarly protected. In this regard, it would be important to ensure that any self-incriminating information about the licensed corporations should not be passed onto the overseas regulators under the supervisory cooperation. It is suggested that the licensed corporations should be given the right to consider whether the kind of supervisory information that the SFC requested is ultimately potentially self-incriminating and if this is the case, they can challenge such request and refuse to provide such information.

21. We note the SFC's intention that the information obtained by the overseas regulators should not be used in an enforcement proceeding unless a specified process is followed (paragraph 26) – in practice, however, it would be very difficult (if not impossible) to control the overseas regulators' use of such information (especially if their domestic laws oblige them to use the information) and any damage caused would be irreversible once the information is passed. To address the above concerns, it is suggested that the SFC can only collect the supervisory information from the licensed corporations on condition that the licensed corporations will not be put into self-incrimination where such information is passed on to the overseas regulators under the supervisory cooperation. A further suggestion as a safe harbour will be adding an undertaking to be given by the overseas regulators to the SFC that they will not use any of the information obtained from the supervisory cooperation which may as a result become self-incriminating nature (to the licensed corporations) in any proceedings commenced in their respective jurisdiction.

Due to the importance of the proposals the Law Society would request that the SFC subsequently consult on proposed legislative drafting and we would be happy to contribute to such process.

The Law Society of Hong Kong
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