



**Securities and Futures
Ordinance:
investigations**
HKSI 27 August 2002



Different powers

◆ Investigations

- crimes under SFC administered laws or regulated financial products, insider dealing, acts contrary to public interest (s 33 SFCO/s 44 LFETO)

◆ Market surveillance

- Client and transaction details (s 31 SFCO/s 41 LFETO)

◆ Listed company inquiries

- fraud or misconduct in listed company (s 29A SFCO)

◆ Intermediary inspections

- routine inspection to check ongoing compliance (s 30 SFCO/s 42 LFETO)

◆ Search warrants

- available for investigations and listed company inquiries (s 36 SFCO/s 47 LFETO)



Regulatory gaps

- ◆ Gaps in existing powers
- ◆ Listed corporation inquiry power too restricted to be effective
 - third parties and explanations
- ◆ Unclear and insufficient intermediary inspection power
 - third parties, questions, exempt intermediaries, associated entities
- ◆ No express disciplinary or collective investment scheme investigation powers



SFO highlights

- ◆ Main themes continuity and evolution
- ◆ Part VIII re-enacts SFC powers
- ◆ Filling gaps and more effective powers:
 - listed company inquiries
 - Intermediary inspections
 - compulsory disciplinary investigations
 - compulsory collective investment scheme investigations



Listed company inquiries

- ◆ Limited power to require **production of documents**
 - ◆ from **listed company or group companies**
 - ◆ and have produced documents **explained**
 - ◆ Only very limited powers against **3rd parties**
 - ◆ Explanations only of **content** of document (s 29A SFCO)



Listed company inquiries: third parties

- ◆ Presently limited reach of power seriously hampers inquiries as information cannot be verified
- ◆ SFO will give SFC power to go to third parties (banks, auditors and transaction counterparties)
- ◆ These chosen because limited range of people with closest connection with corporations under inquiry
- ◆ Goal to extend power prudently only as far as necessary



Listed company inquiries: banks

- ◆ SFC powers originally intended to extend to banks of listed/group company
- ◆ Existing unclear drafting frustrates this
- ◆ SFO will give SFC clear power to obtain documents from banks and explanations of them (ss 179(1)(iii) & (2))



Listed corporation inquiries: banks

- ◆ Person inquiring must have reasonable cause to believe:
 - bank has document relating to affairs of listed/group company
 - document sought:
 - + relates to the affairs of or transaction with such corporation and
 - + is relevant to inquiry (s 179(6))

- ◆ Commission (more senior officer) must certify that these requirements met (s 179(6))



Listed company inquiries: auditors

- ◆ SFO will extend SFC powers to auditors of listed/group company (s 179(1)(iv))

- ◆ Person inquiring must have reasonable cause to believe:
 - auditor possesses “audit working papers” relating to listed/group company
 - audit working papers sought:
 - + relate to the affairs of such company and
 - + are relevant to inquiry (s 172(9))

- ◆ Commission must certify that these requirements met (s 179(7))



Listed corporation inquiries: auditors

- ◆ SFO defines “audit working papers”:
 - document prepared by or on behalf of auditor or
 - obtained by or on behalf of auditorfor or in connection with audit (s 178)

- ◆ Based on definition from Statement of Auditing Standards 230 concerning documentation

- ◆ Expanded “auditor” definition in SFC made rules currently on public consultation

Listed company inquiries: transaction counterparties



- ◆ SFO will extend SFC power to those who deal with listed/group company (s 179(1)(v))
- ◆ Person inquiring must have reasonable cause to believe:
 - person from whom document sought dealt with listed/group company
 - document sought:
 - + relates to the affairs of or transaction with such company and
 - + is relevant to inquiry...



Listed company inquiries: transaction counterparties

- ◆ Person inquiring must have...(cont'd):
 - document can't be obtained from listed/group company or auditor or bank of such company (s 179(8))

- ◆ Commission must certify that these requirements met (s 179(8))



Listed company inquiries: explanations

- ◆ Suggestions that existing power to require an explanation of a document limited to an explanation of the document's content
- ◆ If correct, would severely limit power
- ◆ Intended that power extends to circumstances surrounding document's creation or the making of an entry in it
- ◆ SFO will give SFC clear power to ask for explanation of surrounding circumstances (s 179(2)(a)(ii))



Intermediary inspections

- ◆ Power to routinely supervise licensed intermediaries:
 - ◆ entry to premises
 - ◆ inspection & copying documents and
 - ◆ requiring others to produce them (s 30 SFCO/s 41 LFETO)



Intermediary inspections: banks' securities business

- ◆ SFO generally equalises regulation and licensed intermediaries and banks' securities business (“exempt persons” now “registered institutions”) (Pt V-VII)
- ◆ Inspection power will extend to banks' securities businesses (s 180 and Sch 1 Pt 1 “intermediary” def'n)
- ◆ HKMA will inspect banks (s 180(17) “relevant authority” def'n)



Intermediary inspections: associated entities

- ◆ SFO extends client asset and money, record keeping and audit regulation to entities which hold assets or money on behalf of intermediaries' clients and there is some control relationship between the 2 (“associated entities”) (Pt VI and Sch 1 Pt 1 “associated entity” def'n)
- ◆ Consistently, inspection power will extend to associated entities (s 180)
- ◆ HKMA will inspect banks' associated entities (s 180(15) “relevant authority” def'n)



Intermediary inspections: 3rd parties

- ◆ Power to obtain info from 3rd parties disputed before margin financier regulation and courts upheld power (*Mansion House* case)
- ◆ SFO clarifies power (s 180(1)(c)(iii) & (3)(c))
- ◆ Inspector must have reasonable cause to believe information not available from intermediary or its associated entities or a group corporation of either (ss 180(7) & (8))



Intermediary inspections: questions

- ◆ Presently no clear power to ask questions during inspection
- ◆ Questions routinely asked though
- ◆ Inspections meaningless without power to ask questions
- ◆ SFO grants express power (s 180(1)(c), (3)(ii) & (4)(b))
- ◆ Powers don't override privilege against self-incrimination



Investigations

- ◆ Power to compel:
 - documents
 - explanations of documents
 - interviews and
 - any other reasonable assistance (s 33(4) SFCO/s 44(4) LFETO)

- ◆ For investigation of:
 - crimes under SFC administered laws
 - fraud or misconduct involving SFC regulated products
 - insider dealing
 - acts contrary to public interest (s 33(1) SFCO/s 44(1) LFETO)



Investigations: discipline

- ◆ No power to compel info to investigate grounds for intermediary discipline except LFETO (s 12)
- ◆ If other investigation (eg insider dealing) can use info if relevant
- ◆ Otherwise, must rely on voluntary co-operation
- ◆ SFO will give SFC express power to investigate grounds for discipline against licensed corporations and registered institutions, their staff, officers and those involved in their management (s 182(1)(e))
- ◆ But must consult HKMA 1st if investigating registered institution etc for disciplinary purposes (s 182(4))



Investigations:

investment products and promotion

- ◆ SFC largely regulates investment products and promotion (CISs etc) through conditions (s 15 SO & s 4 PIO)
- ◆ SFO Pt IV preserves this approach
- ◆ But, no express power to investigate breach of conditions
- ◆ SFO will give express power to investigate collective investment scheme and ads, invitations and documents relating to investment products (s 182(1)(f))



Miscellaneous changes

- ◆ Thresholds to start listed company inquiry clarified (ss 179(1) & 179(17) “relevant time” def’n)
- ◆ Threshold to start investigation generally raised to “reasonable cause to believe” (s 182(1))
- ◆ Further clarification of abrogation of common law privilege against self-incrimination and use immunities (ss 179(16), 184(4) & 187)
- ◆ 3-tier escalation of seriousness of offences for non-compliance (s 179(13)-(15), 180(14)-(16), 181(7)-(9) & 184)



Transition

- ◆ If powers exercised before SFO commences, old SFCO etc provisions continue to apply (s 62 Sch 10 Pt 1, s 23 Cap.1)
- ◆ If circumstances giving rise to exercise of power arise before SFO, but discovered after SFO commences, old SFCO etc provisions continue to apply (s 62 Sch 10 Pt 1, s 23 Cap.1)
- ◆ One exception is listed company inquiry power, where new power may be used (s 63 Sch 10 Pt 1)