

CHAPTER 2

OVERVIEW OF THE REGULATORY REGIME AND THE ESSENTIAL APPROACH WHEN DEALING WITH AN SFC INVESTIGATION

1. THE SFC

[2-1] The SFC has responsibility under the SFO for supervising the securities industry in Hong Kong. Whilst the SFO confers upon the SFC a number of roles, key amongst them are the following:

- (a) **Policing the securities markets:** The SFC is responsible for investigating suspected breaches of securities laws and regulations and taking enforcement action. The laws and regulations which the SFC polices include the market misconduct¹ provisions of the SFO and the disclosure regime under Part XIVA of the SFO which requires listed corporations to disclose any inside information as soon as practicable. The SFC also supervises listed corporations and may take action in the event that managers of listed corporations misconduct themselves.
- (b) **Supervision of intermediaries:** The SFC is responsible for the licensing and supervision of intermediaries² who carry on regulated activities³ in the securities markets. In order to be licensed or registered, intermediaries and those of their staff who perform or supervise

1 The six forms of market misconduct are: insider dealing; false trading; price rigging; disclosure of information about prohibited transactions; disclosure of false or misleading information inducing transactions; and stock market manipulation.

2 Intermediaries include licensed corporations and registered institutions.

3 The 12 regulated activities are listed in Schedule 5 of the SFO and comprise: Type 1 Dealing in securities; Type 2 Dealing in futures contracts; Type 3 Leveraged foreign exchange trading; Type 4 Advising on securities; Type 5 Advising on futures contracts; Type 6 Advising on corporate finance; Type 7 Providing automated trading services; Type 8 Securities margin financing; Type 9 Asset management; Type 10 Providing credit rating services; Type 11 Dealing in OTC derivative products or advising on OTC derivative products; Type 12 Providing client clearing services for OTC derivative transactions. Note: the requirements in relation to Type 11 are not yet in operation, and the requirements in relation to Type 12 are only partially in operation.

regulated activities must meet certain criteria, including being fit and proper to be licensed or registered. In the conduct of their business, they must also comply with codes and guidelines issued by the SFC. Intermediaries who are guilty of misconduct or found not to be fit and proper to be licensed or registered may be subject to disciplinary action under the SFO. It should be noted that the SFC shares responsibility for supervising the regulated activities of banks⁴ with the HKMA, and the HKMA may also investigate and take disciplinary action.⁵

- (c) **Takeovers regulation:** The SFC issues and polices the Takeovers Code,⁶ which regulates takeovers and mergers of listed corporations in Hong Kong.
- (d) **Open-ended fund companies:** The SFC supervises the recently introduced open-ended fund companies regime, which allows open-ended investment funds to be established in corporate form.

[2-2] Although the SFC is the principal regulator of the securities and futures industry in Hong Kong, there are three other regulators who also have oversight of finance and investing as follows:⁷

Sector	Regulator	Major functions
Banking	The Hong Kong Monetary Authority	Regulates financial institutions (including banks and deposit-taking companies), conducts monetary policy operations and manages the Exchange Fund
Insurance	The Insurance Authority	Regulates and supervises the insurance industry
Mandatory provident fund system	The Mandatory Provident Fund Schemes Authority	Regulates and supervises provident fund schemes

4 'Banks' mean authorised institutions as defined in section 2(1) of the Banking Ordinance, which may register with the SFC under section 119 of the SFO to carry on business in a 'regulated activity' and thereby become a 'registered institution'.

5 It should be noted that the SFC is also a 'relevant authority' with responsibility for supervising compliance by licensed corporations with their obligations under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap 615), although this role is not covered in this book which focusses on the SFO only. It may be noted that the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap 615) confers investigation and disciplinary powers upon 'relevant authorities' which are similar in nature to those under the SFO, and many of the principles discussed in this book will be applicable to the exercise of powers under that Ordinance.

6 The full name of the Takeovers Code is the Codes on Takeovers and Mergers and Share Buy-backs, 13 July 2018, SFC. For simplicity, it is referred to throughout this book as the Takeovers Code.

7 Securities and Futures Commission, Our Role: <<https://www.sfc.hk/web/EN/about-the-sfc/our-role/>>.

2. POWERS OF INVESTIGATION

[2-3] To assist the SFC in performing its functions, the SFO confers various powers of investigation upon the SFC. In summary:⁸

- (a) Section 179 allows the SFC to investigate suspected misconduct relating to listed corporations. The SFC may authorise a person to exercise powers under the section where it appears to the SFC that there are circumstances suggesting that there has been defalcation, fraud, misfeasance or certain other misconduct in relation to a listed corporation,⁹ or the SFC decides to provide assistance to a foreign regulator to investigate similar matters. The authorised person is empowered to require persons to produce relevant records and documents and to provide or make explanations or statements in respect of those records or documents.¹⁰
- (b) Section 180 allows the SFC to authorise a person to exercise powers for the purpose of ascertaining whether an intermediary is complying with relevant requirements, including the SFC's codes and guidelines, and to assist a foreign regulator in respect of similar matters. The authorised person is empowered to enter the premises of an intermediary or associated entity, to inspect and make copies of records and documents, and to make inquiries of persons concerning records, documents, transactions and activities. If an authorised person cannot obtain relevant records or documents from the intermediary, the authorised person may also require other persons who have possession of those records or document to give the SFC access to them or to produce them, and to answer any questions regarding the records or documents.
- (c) Section 181 allows the SFC to obtain information in relation to transactions in securities and similar products for the purposes of enabling or assisting the SFC to perform its functions under the relevant provisions,¹¹ and for assisting a foreign regulator.

8 Sections 179 and 182 are considered in more detail in Chapter 15.

9 These terms accord with the circumstances in which the court may make orders under section 214 of the SFO. For explanation as to the meaning of the terms, see Chapter 30.

10 Requirements to produce records and documents are considered in more detail in Chapter 16. Requirements to provide explanations are considered in Chapter 17.

11 The term 'relevant provisions' is defined in Schedule 1 of the SFO. It appears frequently in provisions of the SFO and means the provisions of: (a) the SFO; (b) Parts II and XII of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) so far as those Parts relate, directly or indirectly, to the performance of functions relating to prospectuses; (c) Part 5 of the Companies Ordinance (Cap 622), so far as that Part relates, directly or indirectly, to the performance of functions relating to the buy-back by a corporation of its own shares or a corporation giving financial assistance for the acquisition of its own shares; (d) Parts II and XII of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32), for the purposes only of section 213 of SFO and

The SFC may authorise a person to exercise powers under the section to require persons who have transacted in securities or similar products to furnish¹² particulars of the transactions and any instructions given.

- (d) Section 182 allows the SFC to investigate suspected offences and other misconduct under the SFO. The SFC may appoint an investigator where it has reasonable cause to believe that there may have been an offence or other defined misconduct, or for the purposes of inquiring whether there may be grounds for disciplinary action against intermediaries and their staff, or for assisting a foreign regulator to investigate similar matters. The investigator is empowered under section 183 to require persons who are under investigation or whom the investigator has reasonable cause to believe have relevant information in their knowledge or possession to:
- (i) produce to the investigator any record or document specified by the investigator which is or may be relevant to the investigation and, if required, to provide an explanation or further particulars in respect of the record or document;
 - (ii) attend before the investigator and answer any question relating to the matters under investigation that the investigator may raise; and
 - (iii) give the investigator all assistance in connection with the investigation which the person is reasonably able to give, including responding to any written question raised by the investigator.

[2-4] Section 191 of the SFO further provides that, where on information laid by the SFC a magistrate is satisfied that there are reasonable grounds to suspect there is or is likely to be on specified premises any record or document which may be required to be produced under sections 179, 180 or 182/183,¹³

so far as those Parts relate, directly or indirectly, to an advertisement mentioned in section 38B(1) of that Ordinance; and (e) Part 2 (except section 6) of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap 615).

- 12 It should be noted that section 181 uses the word ‘furnish’, not ‘produce’. The SFC cannot therefore rely on section 181 as a basis for obtaining a search warrant under section 191 of the SFO, as a search warrant can only be obtained where there are reasonable grounds to suspect there is, or is likely to be on specified premises, any record or document which may be required to be ‘produced’ under Part VIII of the SFO.
- 13 More accurately, section 191 allows the SFC to obtain a search warrant where there are reasonable grounds to suspect there is or is likely to be on specified premises any record or document which may be required to be produced under ‘this Part’ of the SFO, but the provisions of Part VIII which allow the SFC to impose requirements to ‘produce’ records and documents are sections 179, 180 and 182/183.