

立法會
Legislative Council

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by the Administration)

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**Bills Committee on
Securities and Futures Bill and Banking (Amendment) Bill 2000**

**Minutes of meeting
held on Friday, 12 January 2001 at 10:45 am
in Conference Room A of the Legislative Council Building**

- Members present** : Hon SIN Chung-kai (Chairman)
Hon Margaret NG (Deputy Chairman)
Dr Hon David LI Kwok-po, JP
Hon NG Leung-sing
Hon Bernard CHAN
Hon Jasper TSANG Yok-sing, JP
Hon Ambrose LAU Hon-chuen, JP
Hon Abraham SHEK Lai-him, JP
Hon Henry WU King-cheong, BBS
Hon Audrey EU Yuet-mee, SC, JP
- Members absent** : Hon Albert HO Chun-yan
Hon Eric LI Ka-cheung, JP
Hon James TO Kun-sun
Hon Mrs Sophie LEUNG LAU Yau-fun, SBS, JP
- Public officers attending** : Miss Vivian LAU
Principal Assistant Secretary for Financial Services
- Miss Emmy WONG
Assistant Secretary for Financial Services
- Mr K F CHENG
Senior Assistant Law Draftsman

Ms Francoise LAM
Government Counsel

Ms Beverly YAN
Senior Government Counsel

Miss Ada CHEN
Senior Government Counsel

Attendance by invitation : Securities and Futures Commission

Mr Mark DICKENS
Member of the Commission & Executive Director

Mrs Alexa LAM
Chief Counsel

Mr Gerald D GREINER
Senior Director, Supervision of Markets

Mr Andrew YOUNG
Legal Consultant

Clerk in attendance : Mrs Florence LAM
Chief Assistant Secretary (1)4

Staff in attendance : Mr LEE Yu-sung
Senior Assistant Legal Adviser

Mr KAU Kin-wah
Assistant Legal Adviser 6

Ms Connie SZETO
Senior Assistant Secretary (1)1

I Matters arising from the last meeting

Duty visit to London and New York

The Chairman informed members that further to the circular issued on 8 January 2001, seven members had indicated interest in participating in the proposed visit to London, New York and possibly to Washington D.C. in April 2001. A proposal would be submitted to the House Committee later in the month.

Invitation of submissions

2. The Chairman informed members that as decided at the meeting on 5 January 2001, an advertisement was placed in South China Morning Post and Hong Kong Economic Journal on 9 January 2001 to invite submissions from the public. Since the last meeting, the Institute of Securities Dealers Ltd. and the Hong Kong Bar Association had indicated that they would submit their views to the Bills Committee and attend the meeting to be held on 3 February 2001. The Chairman reminded members that the deadline for submissions was 27 January 2001.

Discussion on Part II and Schedule 2 of the Securities and Futures Bill (SFB)

3. In response to a member's concern about how outstanding issues of Part II of the SFB were to be pursued, the Chairman assured members that they would be given sufficient time at the meetings to consider the provisions in each part of the Bill. If necessary, the work schedule of the Bills Committee would be adjusted to allow members to consider those parts of the Bill that required in-depth discussions. The Administration, in consultation with the Clerk, would also prepare a checklist of the issues requiring the Administration's action. The Chairman suggested that members could put their views in writing and forward them through the Secretariat to the Administration for comments or follow-up at a later meeting.

4. At the request of Mr Henry WU, the Principal Assistant Secretary for Financial Services (PAS/FS), agreed to provide members with a copy of the existing Memorandum of Understanding which was signed between the Securities and Futures Commission (SFC) and the Hong Kong Monetary Authority (HKMA) concerning the regulation of exempt persons.

(Post-meeting note: The Memorandum of Understanding was issued under LC Paper No. CB(1) 507/00-01 on 23 January 2001.)

II Meeting with the Administration

Part III and Schedule 3 of the SFB

(LC Papers No. CB(1) 413/00-01(01) and CB(1) 413/00-01(02))

5. PAS/FS took members through the discussion paper on Part III and Schedule 3 of the SFB (LC Paper No. CB(1) 413/00-01(01)). The paper outlined the major provisions relating to the regulation of the five main types of market operators and related institutions. These were the exchange companies, clearing houses, exchange controllers, investor compensation companies (ICCs) and providers of automated trading services (ATS) (referred to collectively as "recognized companies"). Major changes proposed to the existing regulatory framework were primarily to cater for the emergence of new operators in the securities and futures market, namely ICCs and ATS, including overseas exchanges that provided electronic facilities in Hong Kong.

Exchange companies

6. Mr NG Leung-sing noted that in paragraph 7(b) of the discussion paper, the recognized companies had to perform certain statutory duties corresponding to their nature of operation. In discharging these duties, or acting under the rules of the company, each company and any person acting on its behalf enjoyed statutory immunity if they acted "in good faith". Mr NG asked about the circumstances under which a judgement could be made to decide whether a company or a person had acted "in good faith" or "with negligence" or "gross negligence".

7. PAS/FS pointed out that clause 22 of the SFB provided that no civil liability, whether arising in contract, tort, defamation, equity or otherwise, shall be incurred by a recognized exchange company or any person acting on its behalf in respect of anything done or omitted to be done in good faith in the discharge or purported discharge of the duties. Mrs Alexa LAM, Chief Counsel, SFC, explained that "in good faith" and "negligence" were two different legal concepts. If there were any doubts about a particular act, the court would make a judgement on a case by case basis.

8. In order to prevent cases in which a person who had acted with "gross negligence" would also claim statutory immunity on the grounds of "in good faith", Ms Audrey EU asked whether the relevant clause(s) of the SFB could be amended to include the term "with due diligence" where appropriate, as this had been commonly accepted as one of the grounds for claiming immunity. In reply, PAS/FS said that as far as the capability of the personnel was concerned, the recognized exchange company should provide suitable training to its employees to ensure that they would discharge their duties with competence and diligence. However, the Administration took note of the member's suggestion and would consider whether there was any need for amending the threshold for statutory immunity.

(Post-meeting note: Further information has been provided to members as requested vide LC Paper No. CB(1) 1420/00-01(01).)

9. In respect of the levels of penalty proposed under Part III of the SFB, Mr Henry WU asked whether these were different from those provided in the existing regulatory regime. PAS/FS replied that the penalty levels had been revised under the SFB because some of the provisions in the existing legislation were enacted as early as in the 1970s. The proposed scales of revision were not only based on the rate of inflation, but also according to the developments in the market since the 1970s and the degree of deterrence to be achieved in order to enhance investor protection. In order to give members an assurance that the penalties were set at such levels to the fairness of all interested parties, Ms Margaret NG proposed and the Administration agreed to provide the Bills Committee with a comparison of the penalty levels under Part III of the SFB between the existing and proposed regulatory regimes, and the principles on which these levels were worked out.

(Post-meeting note: Further information has been provided to members as requested vide LC Paper No. CB(1) 1246/00-01(01).)

10. Referring to paragraph 20 of the discussion paper regarding the legal monopoly of the Hong Kong Exchanges and Clearing Limited (HKEx) to operate a stock market in Hong Kong, Mr Henry WU asked, in respect of the voting power controlled by the HKEx, why 35% instead of the normally acceptable level of 51% or 50.1% was used. Mr Mark DICKENS, Member of the Commission & Executive Director, SFC, explained that 35% was a test for control used in the Takeovers Code for all changes of control of all Hong Kong listed companies. It was therefore considered appropriate at the time when the Exchanges and Clearing Houses (Merger) Ordinance (the Merger Ordinance) was enacted for the same threshold to be used. Controlling 35% of the voting power would enable the recognized exchange controller to exercise effective control of and to run the affairs of the companies.

11. Noting that under the proposed regulatory regime, the SFC would transfer certain regulatory functions concerning listed companies to the Stock Exchange of Hong Kong (SEHK), the Chairman asked whether any appeal mechanism would be provided for listed companies to appeal against the decisions of the SEHK in respect of listing matters. Mr Mark DICKENS advised that an appeal system had been built within the SEHK since 1991/1992. Appeals could be made to the independent Listing Committee and to the Board of the SEHK whose majority members were appointed by the Government. If a listed company was not satisfied with the decision of the Board of the SEHK, it could apply for judicial review as the final remedy. This system had been working effectively for ten years. In an extreme case, a company could approach the SFC to investigate whether the SEHK had discharged its duty properly. However, it was not a formal channel of appeal.

12. In order to enhance members' understanding of the various set-ups under Part III of the SFB, Mr Bernard CHAN asked the Administration to provide the Bills Committee with a flow chart setting out these various statutory bodies and their inter-relationships. PAS/FS undertook to forward this information in due course.

(Post-meeting note: The flow chart was issued to members under LC Paper No. CB(1) 489/00-01(01) on 18 January 2001.)

13. Mr Henry WU asked whether the organization structure of the recognized companies under Part III of the SFB would be streamlined under the proposed regulatory regime. Citing the appointment of the Chief Executive of the HKEx as the Chairman of SEHK as an example, he asked whether the recognized exchange companies were required by the existing legislation to maintain a certain structure. In respect of the appointment of the SEHK Chairman, PAS/FS said that the HKEx had full autonomy to make such decisions. There was no case for concern about conflict of interest. In respect of the HKEx and SEHK, Mr Mark DICKENS said that there was no provision in the Merger Ordinance or the SFB to prevent these companies from streamlining their structure. However, there was a requirement for the appointment of the Chief Executives of the Futures Exchange and SEHK to be approved by the SFC because these persons were vested with significant discretionary powers in relation to the conduct of the markets.

14. The Chairman noted that clause 21 of the SFB stipulated the duties of a recognized exchange company. He asked whether there was any provision under Part III of the Bill to enable the SFC to impose penalty on the company if it failed to perform any of the duties under clause 21. PAS/FS pointed out that no penalty was stipulated in the Bill. However, the recognized exchange company was expected to perform its duties according to a set of rules agreed by the SFC. If the company failed to perform its duty, the SFC could direct it to revise the relevant rules and take corrective action. Mr Mark DICKENS considered that there was not a need to stipulate any provision for imposing any penalty on the company as the SFC was already empowered under the Bill to issue restriction notices or suspension orders if necessary. At the Chairman's request, PAS/FS undertook to provide the Bills Committee with information on overseas practices as to whether any penalty would be imposed on a recognized exchange company if it failed to perform its statutory duty.

(Post-meeting note: Further information has been provided to members as requested vide LC Paper No. CB(1) 1174/00-01(02).)

15. With reference to the table prepared by the Legal Service Division of the Legislative Council (LC Paper No. CB(1) 413/00-01(02)), the Chairman noted that some changes to the provision in the existing legislation had been introduced under clause 29 of the SFB. He asked the Administration what

these changes were and why this was necessary. In relation to clause 29, Ms Margaret NG enquired whether there was any need for clause 11 of the SFB regarding the Chief Executive's power to give directions to the SFC, since the SFC had already been empowered under clause 29(2) to deal with various emergency situations. She reiterated her concern about the extensive power given to the Chief Executive under clause 11 and possible abuse of this power. In this regard, she asked whether any safeguards had been provided for in the Bill.

16. PAS/FS and Mrs Alexa LAM advised members that the new provision empowered the SFC to serve notice to direct a recognized exchange company to cease to provide or operate the specified facilities or services in emergencies. This replaced the previous provision of empowering the SFC to close a stock exchange. More flexibility had been built into the new provision to provide the SFC with an option to adopt appropriate measures to respond to the market situation at the time and to cater for the existence of different products in the securities and futures markets. The cessation of all facilities or services would amount to a closure of the exchange. Mr Mark DICKENS added that the provision under clause 29 would ensure that the decision to close the exchange was in the regulatory authority's hands because of the impact of the closure on every participant in the market and on Hong Kong's international reputation. However, it was a power that would be rarely used. Other measures would have been taken to address any problems before a notice was served. The power would be used only in extreme circumstances.

17. In reply to the Chairman's enquiry, PAS/FS confirmed that the Chief Executive and the SFC might, under clauses 11 and 29 respectively, close the exchanges in emergencies if the conditions for exercising such powers were met. Mr Mark DICKENS clarified that if the Chief Executive gave a direction to the SFC under clause 11, the SFC would not be required to form an opinion under clause 29(2) because a "public interest" opinion had already been formed by the Chief Executive. PAS/FS supplemented that the Chief Executive's power was a reserve one and would be exercised with utmost caution and only after the interest of every party concerned had been carefully considered.

18. Referring to the provision under clause 29(2)(b), the Chairman asked whether the SFC would direct the exchange company to cease to provide services in a situation where the transaction of business on the stock or futures market was orderly but the economy as a whole was adversely affected. He also queried whether it was necessary for the SFC to form an opinion on the existence of "an economic or financial crisis", since this situation would have been dealt with by the Chief Executive in the public interest under clause 11 of the SFB. Mr Mark DICKENS said that the SFC would be given a wider discretion if the words "an economic or financial crisis" were deleted from the clause. As the regulator of the securities and futures markets, the SFC should be in a position to exercise the discretion given under clause 29 and to form an

opinion. However, the power to close the market was not intended to be used lightly because the interests of the participants were at stake.

19. Ms Margaret NG was concerned that the Chief Executive's power was not a reserve power, but more of a supplemental power which could override the SFC's opinion in times of financial instability. PAS/ES pointed out that in times of economic crisis or financial instability, it was likely that the Chief Executive and the SFC would share a similar opinion on matters involving public interest. It should also be noted that the Chief Executive's power was a general provision in the SFB and its applicability should not be restricted to clause 29. Moreover, it would serve as a safeguard against the SFC's power.

20. To address members' concerns about the Chief Executive's and the SFC's powers under clauses 11 and 29, PAS/ES agreed to provide the Bills Committee with supplementary information on the following:

- (a) the rationale and circumstances under which the Chief Executive might give directions to the SFC under clause 11 of the SFB regarding the performance of its functions, with reference to overseas practices; and
- (b) a comparison with overseas practices as regards the closing of exchange facilities in emergencies.

(Post-meeting note: Further information has been provided to members as requested vide LC Paper Nos. CB(1) 1174/00-01(01) and (02).)

21. Mr NG Leung-sing noted that under clause 29(1) of the SFB, the SFC could direct a recognized exchange company to cease to provide facilities or services for a period not exceeding 5 business days, which could be extended under clause 29(3) for further periods not exceeding 10 business days. He asked whether there was any particular reason for stipulating these periods in the Bill. Mr Mark DICKENS said that the overall effect of this provision was similar to the existing legislation which permitted a total period of 15 days, with an initial period of 5 days but only one extension of either 5 days or 10 days. Clause 29 stipulated an initial period of 5 business days which could be extended for further periods not exceeding 10 business days in total. The only incident in which the market in Hong Kong was closed was in 1987. It was closed for 4 days. Closing the market or ceasing to provide facilities was such a serious matter that it was hoped that the problems leading to closure of the market should either be resolved or adequately defined as quickly as possible so that the market could resume operation. A period of 15 days in total was considered appropriate.

22. In respect of the restriction on the use of titles relating to exchanges, markets etc. under clause 34 of the SFB, the Chairman asked whether the scope

of the clause covered the use of domain names in the internet which were similar to those specified in that clause. PAS/FS undertook to look into this point and to provide the information after the meeting.

(Post-meeting note: The reply dated 18 January 2001 from the Secretary for Financial Services was circulated to members under LC Paper No. CB(1) 493/00-01 on 22 January 2001.)

Automated trading services

23. Referring to paragraph 21 of the discussion paper, Mr Henry WU enquired about the rationale for empowering the SFC under clause 98 of the SFB to withdraw the authorization for overseas stock exchange or future exchange to provide automated trading services (ATS) in Hong Kong, while the local exchanges would only be required to restrict or suspend their activities under certain circumstances. He was concerned whether a level playing field would be provided for the overseas exchanges operating their services in Hong Kong.

24. Mr Mark DICKENS explained that the position in relation to overseas exchanges that would be allowed to offer their ATS in Hong Kong was different from that of the HKEx itself. As the overseas exchanges were already subject to stringent regulation in their home markets, it would be appropriate for the SFC to be given the power to withdraw recognition, which would only be exercised in the most extreme circumstances. The existence of the detailed Memoranda of Understanding with the jurisdictions concerned allowed for much negotiation and co-ordination arrangements for any difficulties to be resolved prior to the advent of such extreme circumstances. The SFC could direct the company concerned to change its behaviour in relation to Hong Kong according to the standards adopted by the HKEx. As previous experience in dealing with overseas exchanges had shown, the power to intervene had rarely been exercised. Nonetheless, Mr DICKENS reiterated that overseas exchanges were expected to adhere to regulatory standards no less stringent than those imposed on markets operated by the HKEx.

Investor compensation companies (ICC)

25. From paragraphs 11 to 13 of the discussion paper, the Chairman noted that an independent company i.e. an ICC would be recognized by the SFC for dealing with investor compensation matters. In this regard, he asked whether the new company would take over the assets and liability from the two existing Funds administered by the SFC i.e. the Unified Exchange Compensation Fund and the Futures Exchange Compensation Fund.

26. Mr Mark DICKENS said that the new ICC would take over part of the assets because there were still outstanding claims to be settled and the two existing Funds would need to keep part of the funds to pay these claims. The

residue would form part of the assets of the new company. There would be sufficient flexibility in the provisions of the SFB to enable a smooth transfer of assets. A consultation paper would be issued shortly to seek the views of the market on the new investor compensation proposals. PAS/FS informed members that the new compensation arrangement was set out in Part XII of the SFB and the transitional provisions were set out in Schedule 9.

(Post-meeting note: The consultation paper entitled "Proposed New Investor Compensation Arrangements" was issued to members vide LC Paper No. CB(1) 784/00-01.)

27. Noting that the SFB allowed for the recognition of more than one ICC, Mr Henry WU enquired whether it was the intention of the Government to recognize more ICCs. If that was not the case, then the Bill should not allow so much flexibility and should stipulate clearly that there would only be one ICC. Mr Mark DICKENS said that the original intention was to provide an ICC for the securities market and another one for the futures market. The HKEx however considered that one ICC would be sufficient to deal with the claims arising from the two markets. The options would be worked out with the market in the consultation exercise. Hence, the SFB should allow adequate flexibility to enable the best option to be implemented. The Administration's intention was to have as few ICCs as possible, preferably one ICC that covered both the securities and futures markets operated by the HKEx.

28. Regarding the funding for the new ICC, Mr Mark DICKENS said that the initial source of funds would be from the existing Funds which was about \$600 million. Its operating expenses would be kept relatively low. If those funds were insufficient, the consultation paper being drafted would identify other funding options, including levies on the market. Public comments would be invited on the funding arrangements.

29. In response to the Chairman's concern about the independence of the new ICC and any potential conflict of interest between the company and the exchanges, Mr Mark DICKENS said that according to the consultation paper issued in 1998, the Board of the company would comprise members appointed by the Financial Secretary, the SFC and possibly the HKEx. Given that it was a public body controlling substantial assets, it would be tightly controlled and there would be rules governing its operation. Depending on where the funds would come from, there would be representatives from the exchanges or the securities and futures market on the Board. However, the intention was that they would not form the majority of the Board to ensure that the company was free from any conflict of interest in settling the claims. The detailed arrangements would be worked out during the forthcoming consultation exercise.

30. Mr Henry WU considered that there should be representatives from the market to sit on the Board because they would be in a better position to offer

advice on the operation of the market. The proposed composition would be acceptable as long as these representatives did not form the majority of the Board.

31. Mr NG Leung-sing noted that clause 86 of the SFB provided a mechanism for appeals to the Chief Executive in Council. He asked whether that was the only channel for appeals and whether any judicial review would be allowed under the proposed regulatory framework. PAS/FS clarified that the provision in clause 86 was restricted to notices served under clause 85(1) in relation to withdrawal of recognition of ICC, and the Administration was considering providing for an appeal mechanism for complaints against the decisions of the ICC under Part XII of the SFB.

32. The Chairman was concerned about the compensation arrangements for the consultation on the new ICC to be conducted in parallel with the scrutiny of the SFB by the Bills Committee. PAS/FS said that the focus of Part III of the SFB was on the institutional framework for implementing the proposed new compensation arrangements and on the regulatory relationship between the SFC and the ICC. Part XII dealt with the making of rules for implementing the compensation arrangement. The consultation to be conducted would not affect the proposed institutional framework and subsidiary legislation would be required to give effect to the detailed arrangements. It was hoped that the various issues would be resolved before the scrutiny of the Bill was completed.

33. At members' request, Mr Mark DICKENS agreed to provide the Bills Committee with detailed information on the new investor compensation scheme after the public consultation i.e. around May 2001.

34. PAS/FS also agreed to provide the Administration's response to the comparison table prepared by the Legal Service Division of the Legislative Council on Part III of the SFB.

(Post-meeting note: The Administration's response was issued under LC Paper No. CB(1) 489/00-01(02) on 18 January 2001.)

III Any other business

35. The Chairman reminded members that the next meeting would be held on Friday, 19 January 2001 at 8:30 am to continue the deliberations on Part III and Schedule 3 of the Securities and Futures Bill.

36. There being no other business, the meeting ended at 12:30 pm.