

**立法會**  
**Legislative Council**

LC Paper No. CB(1) 1805/00-01  
(These minutes have been seen  
by the Administration)

Ref: CB1/BC/4/00/2

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

**Minutes of meeting  
held on Friday, 19 January 2001 at 8:30 am  
in Conference Room A of the Legislative Council Building**

- Members present** : Hon SIN Chung-kai (Chairman)  
Hon Margaret NG (Deputy Chairman)  
Hon Albert HO Chun-yan  
Hon NG Leung-sing  
Hon Bernard CHAN  
Hon Mrs Sophie LEUNG LAU Yau-fun, SBS, JP  
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 Eric LI Ka-cheung, JP  
Dr Hon David LI Kwok-po, JP  
Hon James TO Kun-sun
- Public officers attending** : Miss Vivian LAU  
Principal Assistant Secretary for Financial Services  
  
Miss Emmy WONG  
Assistant Secretary for Financial Services

Ms Beverly YAN  
Senior Government Counsel

Mr K F CHENG  
Senior Assistant Law Draftsman

Ms Francoise LAM  
Government Counsel

Ms Sherman CHAN  
Senior Government Counsel

Mr Michael LAM  
Senior Government Counsel

Mr YUNG Lap-yan  
Government Counsel

**Attendance by invitation** : Securities and Futures Commission

Mr Mark DICKENS  
Member of the Commission & Executive Director

Mr Andrew PROCTOR  
Executive Director, Intermediaries and Investment Products

Mr Gerald D GREINER  
Senior Director, Supervision of Markets

Mr Gary HO  
Assistant Manager, Investment Products

Mr Joe KENNY  
Consultant

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

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## **I Matters arising from the last meeting**

### Overseas duty visit

The Chairman informed members that since the last meeting, eight members had indicated their interest in participating in the proposed visit to London and New York in April 2001. A paper had been submitted to the House Committee and would be considered at the meeting on 19 January 2001.

### Invitation of submissions

2. The Chairman informed members that ten individuals/organizations had responded to the Bills Committee's invitation. Six of them had indicated that they would make submissions and attend the meeting to be held on 3 February 2001.

### Further information provided by the Administration

3. The Chairman informed members that the Administration was preparing a checklist of issues requiring their action. This would be updated and circulated to members from time to time.

## **II Meeting with the Administration**

Part III and Schedule 3 of the Securities and Futures Bill (SFB)  
(LC Paper No. CB(1) 413/00-01(01) and LC Paper No. CB(1) 413/00-01(02))

### *Automated trading services (ATS)*

4. With reference to the international comparisons of the regulation of automated trading services (ATS), the Chairman enquired whether the

Administration could anticipate how the structure of ATS in Hong Kong would develop. Mr Mark DICKENS, Member of the Commission and Executive Director, Securities and Futures Commission (SFC), replied that the exact course of development was difficult to predict. However, he believed that the ATS in Hong Kong would not follow the same route as in the United States (US), where the ATS providers were in direct competition with the stock exchanges and performed the function of filling a gap in the core equities markets. Given that the operation of the Hong Kong Exchanges and Clearing Limited (HKEx), he predicted that the ATS in the Hong Kong market would not develop in the same manner. He further indicated that there were only a limited number of ATS providers operating in Hong Kong. The proposed regulatory framework would cover a wider range of ATS and all possible contingencies, thereby allowing for the rapid development of the market in Hong Kong.

5. Referring to the Administration's statement that the position of ATS in Hong Kong was not adequately addressed under the current legislation, Mr Henry WU enquired how the position of ATS would be clarified following the passage of the Securities and Futures Bill (SFB). He also asked whether there was a particular model in the international markets that would be appropriate for Hong Kong, and specifically whether the Administration believed Hong Kong would follow the US model. Mr Mark DICKENS replied that the current legislative framework provided two "boxes" i.e. recognised exchanges and licensed dealers. This regulatory framework was not sufficient to cover the wide-ranging activities carried on by intermediaries. The Administration was thus proposing to create a "third box" i.e. the ATS. This was consistent with the general approach being taken overseas towards such activities. The US model was most comparable to the proposed structure in Hong Kong, while the European and UK models were developing along the same lines. The Administration would publish a set of principles, procedures and standards for regulating the various forms of ATS, with different guidelines and criteria being applied to each specific case. It was necessary to note that the international markets were regulated under rather different legal structures. However, the main aim of all the regulatory frameworks was to set up a system that would be sufficiently flexible to cover a wide range of ATS and their impact on the primary markets.

6. The Chairman noted that clause 95(2)(b) of the SFB was related to the powers of the SFC to authorize overseas stock or futures exchanges to provide ATS in Hong Kong. He enquired about the circumstances under which this clause would be applied. In particular, he asked whether this clause was targeted at those stocks that were not traded in their home countries but would be allowed to trade in Hong Kong. Furthermore, he wished to clarify the position of those overseas exchanges that dealt in stocks other than those listed on the HKEx and specifically, whether they would be in conflict with the HKEx if they chose to trade Hong

Kong stocks by ATS in the overseas markets after the Hong Kong market had closed.

7. Mr Mark DICKENS replied that there were already a number of overseas exchanges operating in Hong Kong. The Administration had reviewed their rules and ensured that there was sufficient regulation by their home regulators. Following the passage of the SFB, such overseas exchanges would fall within clause 95(2)(b), and thus be dealt with in a more formal manner. With regard to the second question, he confirmed that the overseas exchanges currently operating in Hong Kong were not trading Hong Kong stocks. If an ATS wished to do so, it would have to satisfy the legal criteria that its activities were not an infringement of the HKEx's monopoly. If this were fulfilled, the Administration would then be required to consider the effects of such trading. Firstly, the degree of market fragmentation ought to be examined. Secondly, adequate co-ordination and surveillance arrangements between the ATS and the HKEx would need to be established. However, he stressed that the central question was whether Hong Kong stocks could be traded outside of the HKEx without infringing its monopoly. Regarding those service providers that chose to target the trading of Hong Kong equities in overseas markets following the closing of the Hong Kong markets, the Administration would assess whether they should be regulated on a level playing field with the HKEx if they chose to register as an ATS.

8. In relation to investor protection, Mr Henry WU asked how the Administration proposed to secure an adequate level of protection should a problem arise that did not fall within the responsibility of the ATS provider. Moreover, he wished to know whether the SFC would assist the investor if he wished to seek redress from the ATS provider's overseas regulator. In particular, he asked how the process of liaising and working with the overseas regulators would operate. In response, Mr Mark DICKENS stated that the first point to be examined would be the regulatory structure in its entirety. There would have to be an exactly level playing field so that both the ATS and the HKEx were regulated on a similar regime. This would be aimed at achieving the same degree of investor protection and market integrity as in the HKEx. In the event that an investor wished to seek redress from the overseas regulator, the SFC would first ask the overseas exchange to address the problem. Failing that, the SFC would then rely on the Memoranda of Understanding (MOU) with their overseas regulatory counterparts. He further emphasised that the need for proper and competent supervision by a respectable regulator, with whom there existed an adequate MOU, was a particularly stringent requirement for allowing overseas exchanges into the Hong Kong market. In relation to the exact operation of the liaison with the overseas regulatory bodies, he stated that there would be detailed market surveillance measures. These were likely to include full data feeds that would be analysed to spot irregularities.

9. Following on from Mr Henry WU's enquiry relating to investor protection, the Chairman asked whether the ATS providers would be covered by the new Investor Compensation Companies (ICC). In the event that the amounts involved in such transactions were substantial, he wished to know how the SFC would ensure that there were sufficient funds to compensate investors if the ATS were to be covered under ICC. He also enquired whether this would in any way detract from the resources intended for the HKEx itself. Mr Mark DICKENS responded that the ATS providers were not necessarily excluded from the ICC. It was proposed in the SFB that the ICC would cover all products traded on the HKEx. If an ATS wished to offer those products on its own exchange, it would be required to establish independent compensation arrangements. Alternatively, the SFC would consider extending the ICC to cover the ATS or establishing a new one to provide compensation specific to the ATS in question. In either scenario, the SFC would ensure that there was adequate investor compensation. Regarding the need to ensure adequate funds for compensation, Mr DICKENS stated that there would be a number of funding options. The degree of compensation would depend both on the nature of its activities and the market that it was servicing. Ultimately, the funds would come from the market and its transactions.

10. Mr Bernard CHAN wished to clarify whether ATS providers still needed to access Hong Kong markets through intermediaries. Given that an ATS provider could either be an authorized exchange or a licensed broker, he enquired how the SFC would track the source of the transactions. Mr Mark DICKENS replied that the overseas exchanges were required to do so. However, some of the proposed ATS would be accessible only by professionals in those particular markets. As such, these would not pass through intermediaries.

11. In relation to clause 99, the Chairman asked whether the rules that were to be made by the SFC were subsidiary legislation subject to negative vetting by the Legislative Council. Mr Mark DICKENS confirmed that this was the case. He went further to clarify that the Administration would conduct consultation with various bodies such as the ATS working group before issuing guidelines and standards.

12. Ms Audrey EU asked whether the SFB had extra-territorial effect, specifically whether overseas exchanges were subject to its regulation. Mr Mark DICKENS indicated that overseas exchanges that were operating within their own jurisdictions would not be subject to the provisions of the SFB. The focus of the SFB was on those overseas exchanges that chose to enter the Hong Kong market, this being based on the factual test of whether they had specifically targeted Hong Kong investors. Moreover, the Administration would not have the ability to prosecute offshore, thus rendering the applicability of the provisions immaterial. He stressed that it would be easier to address many issues by relying

on the MOU with the overseas regulators rather than by resorting to general criminal law.

13. Citing the ability for overseas exchanges to enter the Hong Kong market as an ATS, Mr Henry WU asked whether it was possible for Hong Kong persons to offer ATS to overseas markets. He also enquired whether the Administration could predict how beneficial this would be to Hong Kong in future. Mr Mark DICKENS replied that the possibility of entering an overseas market as an ATS depended on the particular person's ability to comply with the regulations of that jurisdiction. The benefits associated with the development of ATS were twofold. Firstly, it would be easier for local service providers to provide a range of global services to the investors. Secondly, it would assist in consolidating Hong Kong's position as an international financial centre.

14. To conclude the discussion on Part III of the SFB, the Chairman asked the Administration to provide a list of ATS operators currently operating in Hong Kong and those expected to be regulated under Part III of the SFB.

*(Post-meeting note: The list of ATS operators was issued to members under LC Paper No. CB(1) 575/00-01(01) on 12 February 2001.)*

#### Part IV and Schedule 4

(LC Paper No. CB(1) 485/00-01(01))

15. Mr Andrew PROCTOR, Executive Director, Intermediaries and Investment Products, SFC, took members through the discussion paper on Part IV and Schedules 4 and 5 of the SFB which dealt with the regulatory framework for the offering of investment products.

16. Ms Audrey EU asked about the new types of investment products classified as collective investment schemes and the conditions to be imposed on these schemes. Mr Andrew PROCTOR said that the new types of products were available in some jurisdictions particularly the European jurisdictions where the unit trusts and mutual fund corporations structure was not always tax efficient. These products were essentially contractual arrangements between an investor and those who were responsible for the pooling and management of a fund in which the investor held an undifferentiated share in the whole of a pool of investments. These types of contract-based arrangements would be allowed under the SFB. The conditions to be imposed on these arrangements were primarily related to the question of disclosure i.e. whether the investor had been adequately briefed about his rights and liabilities under the contract, and the risks involved in the arrangements. In terms of investment restrictions, more flexibility had been

provided for these new types of contract-based investment products. The requirements in respect of investor rights and redemption of interests were broadly similar to those of unit trusts and mutual funds but were different in terms of description.

17. Ms Audrey EU also enquired whether some of the scams and pyramid schemes identified in Hong Kong recently would also be covered by the definition of “collective investment scheme”. Mr Andrew PROCTOR pointed out that as these schemes were operated with complete disregard to the law, they would not be covered under the regulatory framework.

18. Noting that the Administration’s paper had only made reference to the practices in the United States (US) and the United Kingdom (UK), Mr Henry WU asked whether the models in other jurisdictions had been considered. Mr Andrew PROCTOR pointed out that Hong Kong had followed both the US and UK models which were fairly representative of those in other jurisdictions. The only exception was Australia. In fact, the differences between the US and UK models in terms of the content of regulation were not material. Every year, these jurisdictions including Hong Kong would conduct a joint exercise to review the regulatory framework for international fund management. Under the proposed regulatory framework, Hong Kong would be ahead of these two jurisdictions as there would be more flexibility in its approach to some of the issues and there would be minimal barriers to entry.

19. Noting that the SFC had been given a wide range of discretionary powers under the proposed regulatory framework, Mr Albert HO asked whether there would be any guidelines for the exercise of these powers and whether these guidelines would be made available to the Bills Committee. Mr Andrew PROCTOR agreed that SFC had been vested with certain flexibility in exercising its authorization power under the existing law and the SFB. To inform the market of how these powers were exercised, the SFC had issued some key documents, the most important of which was the Code on Unit Trusts. It covered a wide range of collective investment products and set out the restrictions and requirements for the regulation of these schemes. Any departure from the Code could be referred to a special committee comprising industry representatives of very senior positions. This committee would make judgements on whether the SFC had properly exercised its discretion in relation to the Code.

20. The Chairman asked whether the proposed regulatory framework had included any new measures for regulating hedge funds. Mr Andrew PROCTOR pointed out that typically, a hedge fund was a subject of limited offering i.e. it was not offered to the public at large but to high net-worth individuals. Under the proposed regulatory framework, if a fund was not targeted at the public, pre-



approval from the SFC was not required, irrespective of whether it was a hedge fund or not. If the fund were targeted at the public at large, then the SFC would have to consider the whole range of investor protection issues. The SFC would probably allow such offers to be made subject to it being satisfied that the disclosure was adequate as to the nature of the investment and the risk. Furthermore, the people who made recommendations in respect of investments in these funds would have to be regulated.

21. Mr Henry WU noted from paragraph 8(c) of the discussion paper that the SFC had been expressly empowered to authorize collective investment schemes and to withdraw the authorization where the requirements were not complied with. In this regard, he asked whether any checks and balances had been provided under the proposed regulatory framework to protect the interest of investors. Mr Andrew PROCTOR pointed out that from time to time, those who had been authorized as fund managers to offer collective investment products failed to live up to the SFC's expectation and the SFC had to consider withdrawing the authorization. The effect of such withdrawal was that the product could no longer be offered to the public. This power had been rarely used because the withdrawal could have some consequences on the value of the product and hence adverse impact on investors. The SFC would usually insist, through the trustees or the governing mechanism, on a change of fund manager to improve the quality of management. In cases where the size of the funds had shrunk, the SFC would insist on a waiver of fees. Experience showed that the fund managers would usually co-operate to avoid any possible withdrawal of authorization. As regards Mr WU's concern about the availability of checks and balances, Mr PROCTOR pointed out that an appeal mechanism was actually available under Part 2 of Schedule 7 to the SFB.

22. The Chairman said that the discussion on Part IV of the SFB would continue at the meeting to be held on 9 February 2001.

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