

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

**Summary of Public Comments and Administration's Response on
Part X of the Securities and Futures Bill**

| Clause no. | Respondent | Respondent's comments | Administration's response |
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| Part X – Powers of Intervention and Proceedings | | | |
| * 197 | HKSbA | The power to issue restriction notices should not extend to property owned by persons other than a licensed person. It is difficult to see how a licensed corporation can deal with property not owned by it. | <p>Clause 197 enables the SFC to impose prohibitions or requirements on dealing with property to preserve the property so as to protect investors' interests. It is based on existing law namely, section 40 of Securities and Futures Commission Ordinance (SFCO) (Cap. 24) and section 51 of Leveraged Foreign Exchange Trading Ordinance (LFETO) (Cap. 451). From past practical experience in protecting investors, it is important for the SFC to be able to impose restrictions on dealings with property which –</p> <p>(a) may be connected with the business of the licensed corporation but which may not be under the control of the licensed corporation, e.g. under the control of another corporation which may be related to the licensed corporation or a nominee or custodian. There may be a number of persons interposed between the licensed corporation and the third party holding the property and the property may be “removed” from the ownership or control of the licensed corporation by way of a sham transaction among these interposed persons; or</p> <p>(b) belongs to clients of the licensed corporation but may be at risk of being fraudulently disposed of by the licensed corporation.</p> <p>In the light of comments received, we propose a Committee Stage Amendment to restrict the definition of “relevant property” to the following –</p> <p>(a) held by a licensed corporation on behalf of clients, or held by a third party on the licensed corporation's behalf in its capacity as such; or</p> <p>(b) where the SFC reasonably believes the property is either owned or controlled by the licensed corporation, or connected with the corporation's regulated business.</p> |

* Response to comments not incorporated in Paper No. 9A/01 when last issued.

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|------------|---------------------------------------|---|--|
| | | | <p>The SFC's power is subject to numerous checks, e.g. it can only be exercised by the full board of directors of the SFC, written notice with reasons must be given, there is a right of appeal to the SFAT, the power is subject to judicial review and complaint to the Ombudsman, etc.</p> |
| 199 | <p>Consumer Council</p> <p>*HKSbA</p> | <p>The Council welcomes the proposed SFC power to require brokers to transfer custody of client assets to an appropriate custodian. This will ensure that client property is protected against dissipation, misappropriation or other improper handling.</p> <p>It is not clear how this provision can be applied to "any other person", apart from the licensed corporation. "Any other person" is not defined and there seems to be no link with the licensed corporation. Custody of land cannot be transferred – only the title deeds. Custody of intangible assets such as choses in action, obligations, easements cannot be transferred.</p> | <p>*Clauses 199 and 206 together are intended to enable the SFC to protect client property from being dissipated by persons holding such property. Clause 206 enables the SFC to apply for court orders and injunctions with respect to client property, whereas clause 199 empowers the SFC to transfer custody of such property to itself before applying to the court. Clause 199 attempts to reduce the risk of property dissipation during the time required for the SFC applying to the court.</p> <p>We note the concerns about the practical application of clause 199 and the extent of the powers conferred on the SFC. We have explored the possibility of classifying different types of property (e.g. land and intangible property) and stipulating the manner in which the SFC should handle their custody in the Bill, and come to the conclusion that this approach is overly complex, impractical and would probably have limited effect.</p> <p>We consider that clause 206 (combined with the powers under clause 197) already achieves the objectives behind clause 199, i.e. to take urgent action to prevent the dissipation of relevant property. The risks of property dissipation as a result of the time required to make an application to the Court under clause 206 would be minimal. As an administrative measure, the SFC will endeavour to expedite internal process as far as possible, to minimise any possible risks.</p> <p>Subject to Members' views on clauses 197 and 206, we are prepared to delete clause 199 and invite the SFC to rely on clause 206 to protect clients' property.</p> |
| *200 | HKSbA | <p>The Commission may impose prohibitions or requirements on licensed corporations in certain situations. It is debatable whether this power should be exercisable for the reasons set out in subsections (b), (c), (d) and (e).</p> | <p>It is important for the Commission to have the power to impose the restrictions under the relevant clauses in all of the circumstances stipulated under clause 200 to ensure that property (which may rightfully belong to investors) is preserved and not dealt with in a way that is contrary to investors' interests. The SFC can only exercise its discretion "in the public interest" within the boundaries of the policy and objects of the Bill.</p> |

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|------------|-------------|---|--|
| *202 | HKSbA | <p>The SFC should be obliged to publish in the Gazette a notice regarding the imposition, withdrawal, substitution or variation of a prohibition or requirement. The notice should also include a statement specifying the reasons for the imposition, withdrawal, substitution or variation to which the notice relates.</p> | <p>There are two matters of importance: first that the person affected by a notice is fairly dealt with and secondly, that investors are protected.</p> <p>The first matter is addressed by the requirements for a statement of reasons and service of notice, and the general right to be heard. For example, reasons will have been provided to the persons affected by the notice under clause 202(2).</p> <p>The second concern, investor protection, will generally be served by imposing the prohibition or requirement itself and publication of the fact of such prohibition or requirement. The SFC is committed to as much disclosure and transparency of its decisions as possible. Its invariable practice is to issue a press release upon making decisions of the type contemplated under this section. In many cases, it will also be appropriate to say something about the circumstances leading to the decision and the reasons for it. However, the facts in these cases can be very complicated and involve commercially sensitive information. It may also prejudice the commercial negotiations that are often entered into in situations such as those leading to decisions of this type. It is therefore important to allow the SFC some flexibility as to the publication of details of any prohibition or requirement.</p> |
| 204 | Law Society | <p>There is no need for the SFC to have the option to initiate certification proceedings to punish non-compliance with clause 196, 197, 198, 199 or 201 by way of either originating summons or originating motion. The SFC should have to proceed by way of originating summons which must be supported by an affidavit.</p> | <p>It is important that the Commission be given a choice between the two sets of procedures for the following reasons –</p> <ol style="list-style-type: none"> <li data-bbox="1048 932 2128 1050">(1) The originating summons procedure would be appropriate in cases where there is reason to believe that the person who was the subject of the original requirement (upon which he defaulted) will comply with such requirement once certification proceedings are issued. It is also a more expeditious process and saves costs. <li data-bbox="1048 1086 2128 1174">(2) The SFC should be given the option of initiating proceedings by way of originating motion in open court, in cases which may involve a complicated or important point of law, or where the defendant is likely to defend the application vigorously. |

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|------------|------------|---|--|
| 205 | HKSA | <p>This provision does not appear to restrict the SFC's power to petition for winding-up to listed and related companies (cf clause 207) which, on the face of it, would be a change in the Commission's remit which would need to be specifically justified.</p> <p>The Commission should be obliged to resolve, in communication with the participant, the issues that gave rise to the need for presenting the petition prior to making the application.</p> | <p>The SFC already has the power under s 45 of the SFCO. The SFC may need to use the power against licensees or related corporations which are not listed. An application to the Court for a winding-up order must be in the public interest and is only granted by the Court at its discretion on the well-established grounds of it being "just and equitable". A corporation that is the subject of such an application is adequately protected.</p> <p>In practice, the SFC would first seek to resolve the issues with the corporation and would only seek an order for winding-up as a last resort.</p> |
| *205 | HKSbA | <p>The Commission is empowered to petition for the winding-up of virtually any corporation other than an authorized financial institution in the public interest. This power should be restricted to licensed corporations or listed corporations and should not extend to all corporations in Hong Kong.</p> | <p>This is existing law (section 45 of the SFCO and section 59 of the LFETO). The SFC may need to exercise the power in relation to a company which is not a licensed or listed corporation but which has a relationship with the licensed or listed corporation.</p> <p>The SFC needs flexibility to deal with circumstances like –</p> <ul style="list-style-type: none"> (a) unlicensed corporations carrying out activities for which they should be licensed; (b) third parties that hold or have control over relevant property; (c) third parties holding the property on behalf of listed corporations; or (d) companies with ownership in common with listed corporations or corporations licensed by the SFC. <p>The provision merely gives the SFC the standing to apply for a winding-up order. The court has the discretion in making such an order and must be satisfied on the well established grounds of "just and equitable"</p> |

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| 205(3) | HKSA | There is a perceived risk that the trading licences of the exchange participant may be immediately suspended and if the petition for winding-up or bankruptcy is not subsequently granted, the defendant's business will potentially suffer. This section should be amended to govern the actions of the exchange company or clearing house. | The provision is designed to be an advance warning device for the benefit of the exchanges and clearing houses to prevent any possible impact on the operation of the market as a whole, if a petition against an exchange or clearing house participant is to be presented to the Court. In practice, the exchange or clearing house keeps a close eye on its participants which are on the brink of insolvency. They would act prudently to safeguard the orderly operation of the market in view of the possible insolvency of one of its participants. We do not consider it appropriate or necessary to govern the actions of the exchanges and clearing houses as suggested. |
| 206 | Bar Association | The Bar supports the extension of powers so that the SFC may obtain orders against any person who may have assisted in a contravention of any relevant law or regulation and so that a wider range of orders may be made. | We welcome the Bar's support. |
| 206(2)(d) | HKSA | It should be made clear that appointments (as administrator of property) made by the Court may be joint and several. | Clause 206(2)(d) stipulates that the Court of First Instance may make "an order appointing <u>a person</u> to administer the property of another person." Section 7(2) of the Interpretation and General Clauses Ordinance (Cap.1) provides that references to the singular include the plural which, together with the ancillary orders power, gives the Court sufficient power to deal with this issue. |
| 206(2)(d) | HKSA | There should be a power for a person appointed as administrator of another's property to approach the court for directions. | It is unnecessary to empower an administrator appointed by the Court to go to the Court for directions, as he may do so within the terms of reference given to him upon appointment. |
| 206(2)(g) | HKSA | The power of the court under clause 206(2)(g) to make any "ancillary order" which it considers necessary in consequence of the making of any other order, leaves too much to the interpretation and discretion of the court. | The provision is based on section 144 of the Securities Ordinance (Cap. 333) and section 13 of the LFETO. The Court of First Instance has ample experience of exercising fairly its jurisdiction in administration proceedings. We see no need for further detail and prefer the flexibility which the clauses lend the Court in crafting appropriate orders. |

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| 206(7) | HKSA | The SFC should be obliged to give an undertaking for damages in an application for interlocutory injunction. | The original intention of the clause is to avoid the SFC from being inhibited from enforcing the law in the public interest by applications that it should give undertakings as to damages. The common law position is that the Court has a discretion whether to require a public authority to give an undertaking if it seeks to enforce the law in application for interlocutory injunctions. Our intention is not to go beyond the common law position. In light of the comments, we consider that the matter should best be left to the Court's discretion in the circumstances of each case. We would therefore propose a Committee Stage Amendment to remove clause 206(7). |
| 207 | HKSA | It may be appropriate for the Commission to be empowered to make the application under this clause only following a complaint from a minority shareholder, given that the section seeks to protect the interests of minority shareholders. | The provision substantially reproduces the existing s 37A of the SFCO. There is no such restriction in the SFCO. The power is intended to allow the SFC to apply to court to remedy unfair prejudice to a listed corporation's shareholders, or fraud or misconduct in a listed corporation. In practice, the SFC may apply for such an order following a clause 172 inquiry, the grounds of which will often stem from, but are not limited to, a complaint from such a corporation's minority shareholders. It is important that the SFC retain independent authority to act in various circumstances. The requirement for prior consultation with the Financial Secretary and that the Court has discretion to refuse an order are sufficient protection. |
| 207(2)(c) | HKSA | <p>The provisions of clause 207(2)(c) are not sufficiently self-contained in terms of the powers and duties of the persons appointed as a receiver or manager of the property or business of the listed corporation concerned.</p> <p>The appointments under clauses 206 and 207 could expose appointees to significant risk. Under the circumstances, the legal framework governing them should be more substantial. It is likely that practitioners would be reluctant to take up this work without adequate indemnities from the Commission.</p> | Administrators have been appointed under the predecessor provision of section 37A of the SFCO without any problem. The provisions are sufficiently detailed but allows flexibility for the Court to craft appropriate orders to suit the circumstances of each case. The analogous provisions of section 15 of the Bankruptcy Ordinance and section 216 of the Companies Ordinance support this approach. |

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|------------|------------------|---|---|
| 207(2)(c) | HKSA | Provision could also be made for remuneration of the receiver or manager appointed by the court to be agreed between the SFC and the appointee (as an alternative to the Court fixing the remuneration). | The discretionary power of the Court to fix the remuneration of the receiver or manager appointed is an appropriate concomitant of the Court's jurisdiction in making the appointment for the benefit of minority shareholders in the first place. Under the analogous provision of section 15 of the Bankruptcy Ordinance, the court may fix the remuneration of a special manager. We consider that the Court is a better position to fix the remuneration than the SFC. |
| 207 | HKSA | The inter-changing of terminology in this clause is confusing. Clause 207(1) refers to "a listed corporation", although clause 207(1)(d) indicates that the company needs no longer be listed at the time that the SFC petitions the Court. Clause 207(2) reverts to using, "a listed corporation". Clause 207(5) on the other hand refers to "a company", possibly to limit the effect of this specific provision to Hong Kong-incorporated companies (see the definitions in Schedule 1). | <p>The policy intention of the clause is to allow orders to be made in relation to a corporation which was listed at the time of the misconduct, even if it is no longer so listed. This is to enable issues of misconduct which come to light (for example, during an inquiry initiated under clause 172) to be remedied. The mere fact of delisting should not prevent this. Shareholders in a delisted corporation may be at worse risk of prejudice as they may no longer have a ready means to exit the corporation at a fair value and are just as in need of protection. We will study the clause in detail in view of the comment and identify room for improvement in drafting to enhance clarity.</p> <p>Clause 207(5) is restricted to "a company" as it is the intention to restrict the application of the sub-clause to Hong Kong incorporated companies.</p> |
| 208 | Consumer Council | The Council welcomes as an additional protection for investors the incorporation of clause 208 in the Bill. | We welcome the Council's support. |

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| | Group of nine investment bankers & HKAB | <p>Clause 208 is too broad. It should be deleted. It seems to apply to any communication to the public, when it should only apply to announcements to the public at large (eg through public media) and to communications to listed corporation shareholders. It also imposes liability on too wide a range of persons.</p> <p>If the provision is to stay, it should be limited to situations where the person who disseminated the information knew that the information was likely to have a material effect on the price of specific securities. It should not apply to the futures market.</p> | |

Details of Submissions Referred to in the Comment / Response Table

| Date received | Respondent |
|---|---|
| 18 January 2001, 31 January 2001 | Hong Kong Society of Accountants (“HKSA”) |
| 23 January 2001 | Hong Kong Association of Banks (“HKAB”) |
| 23 January 2001 15 February 2001 *7 June 2001 | Linklaters & Alliance representing <ul style="list-style-type: none"> - Bear Stearns Asia Limited - Credit Suisse First Boston (Hong Kong) Limited - Dresdner Kleinwort Wasserstein - Goldman Sachs (Asia) L.L.C. - Merrill Lynch (Asia Pacific) Limited - JP Morgan - Morgan Stanley Dean Witter Asia Limited - Salomon Smith Barney Hong Kong Limited - UBS Warburg (“Group of nine investment bankers”) |
| 23 January 2001 | Law Society of Hong Kong (“Law Society”) |
| 14 February 2001 | Hong Kong Bar Association |
| 19 February 2001 | Consumer Council |
| *10 May 2001 | Hong Kong Stockbrokers Association (“HKSbA”) |

**Securities and Futures Commission
Financial Services Bureau
7 September 2001**