

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

**Securities and Futures Bill
Part I and Schedule 1**

INTRODUCTION

This paper outlines the major elements of Part I of and Schedule 1 to the Securities and Futures Bill. Part I sets out the long title and refers to the major interpretation provisions of the Bill which appear mainly in Schedule 1. In the following paragraphs, we will highlight the purposes of the provisions of Part I and the major definitions in Schedule 1.

PART I

Long Title

2. This establishes the twin themes of the Bill, namely, consolidation and amendment.

3. The Bill consolidates 10 existing Ordinances. These were listed in the LegCo Brief but include the Securities and Futures Commission Ordinance (Cap.24), the Commodities Trading Ordinance (Cap.250) and the Securities Ordinance (Cap.333).

4. In addition, the Bill seeks to update the regulatory regime for the securities and futures market, bringing it up to international standards where necessary, simplifying and rationalizing procedures where possible and enhancing the system of checks and balances.

Clause 1 : Short title and commencement

5. This is self-explanatory.

Clause 2 : Interpretation

6. As subclause (1) indicates, the definitions that are generally applicable to the Bill are set out in Part 1 of Schedule 1. This will be discussed shortly.

7. In addition, some Parts have their own definitions which are only applicable to those Parts of the Bill (see subclause (2)). Each of these will be discussed in the context of the Part to which it relates.

8. Subclause (3) would give the Securities and Futures Commission (SFC) the power to amend Parts 2, 3 and 4 of Schedule 1. Part 2 is a list of Specified Futures Exchanges and Part 3 is a list of Specified Stock Exchanges both of which are for the purposes of the definition of “leveraged foreign exchange trading” in Part 2 of Schedule 6 and will be discussed in that context. Part 4 specifies the qualifying credit rating for the purposes of the definition of “specified debt securities” in Schedule 1 and this also relates to leveraged foreign exchange trading.

SCHEDULE 1

9. Part 1 of Schedule 1 is the Rosetta stone for the Bill. It contains definitions of the key terms that are used in more than one Part of the Bill and is essential to a proper understanding of it. Rather than going through the list of definitions in alphabetical order we propose to present the more significant ones in four categories under the following headings: market, players, services and instruments. In this way it is hoped that the Bill will be more intelligible.

I. Market

10. As the long title indicates, the Bill is primarily about regulating the “securities and futures market” and the “securities and futures industry”. These terms are defined in Part 1 of Schedule 1.

11. The term “securities and futures industry” is a global concept encompassing the market operators, participants and users, the market where they carry out their activities, the services they provide and the instruments they use when doing so.

12. The term “securities and futures market” refers to the market, exchange, place or service which facilitates the bringing together on a regular

basis of persons who are parties to transactions related to financial products. This will be broken down further later on and it is worth noting that this definition is broad enough to encompass cyberspace as well as a traditional terrestrial marketplace.

13. Related terms are “stock market” and “futures market”. The definition of “stock market” is essentially the same as that in s.2 of the Securities Ordinance (Cap.333) and refers to a place where persons regularly meet to buy and sell securities or a place at which facilities are provided to bring together sellers and purchasers of securities. As under current law, “stock market” does not include the office of either an exchange participant or a clearing house. The definition of “futures market” replaces that of “commodities market” as used in the Commodities Trading Ordinance (Cap.250). It is a market on which “futures contracts” are traded. The above terms are further discussed in paragraph 18 below.

II. Players

14. We turn now to the persons involved in the securities and futures business. This is further sub-divided into four main groups: market regulators, market operators, market users and tribunals.

15. *Market Regulators* – Four regulators are involved. Clearly, the SFC is the key regulator in this context and it is defined as “Commission” in Schedule 1. Related definitions are “executive director”, “non-executive director” and “member” which are self-explanatory and mostly carried over from s.2 of the Securities and Futures Commission Ordinance (Cap.24). The objectives and functions of the Commission will be discussed in relation to Part II.

16. In addition, the familiar term “Monetary Authority” refers to the Hong Kong Monetary Authority (HKMA), which is the front line regulator for banks, including those involved in the securities and futures business. The interface between the HKMA and the SFC will be explained where necessary, such as in the context of discussion on Parts V and VI which provide for a new licensing regime for regulating market intermediaries. Two other regulators more peripherally involved in this business are also referred to in Schedule 1, namely, the “Insurance Authority” and the “Mandatory Provident Fund Schemes Authority”. Their roles will be considered as and when they arise in the Parts under discussion e.g. in the context of assessing whether or not a person is “fit and proper” under clause 128 in Part V.

17. *Market Operators* – The market operators and related institutions come in five types which will be dealt with in more detail in relation to Part III. Firstly, the definition of a “recognized exchange controller” is carried over from s.2 of the Exchanges and Clearing Houses (Merger) Ordinance (Cap. 555) (the “Merger Ordinance”). It refers to a company that controls a “recognized exchange company” or “recognized clearing house” and which is recognized as being permitted to do so by the Commission. At the present time this would only apply to the Hong Kong Exchanges and Clearing Limited (HKEx).

18. Secondly, a “recognized exchange company” refers to a company recognized by the Commission as being permitted either to operate a stock market or to operate a futures market. Related definitions are those of “recognized stock market” which is a stock market operated by a “recognized exchange company”, and “recognized futures market” which is a futures market operated by a “recognized exchange company”. Under current law, the Stock Exchange of Hong Kong Limited (defined as “Stock Exchange Company” in Part 1 of Schedule 1) enjoys a monopoly in operating a stock market in Hong Kong and this would continue under the Bill. Although there is no such monopoly in operating a futures market, at the moment only the Hong Kong Futures Exchange Limited (defined in Part 1 of Schedule 1 as “Futures Exchange Company”) operates one here.

19. The related term “exchange participant” was substituted by the Merger Ordinance for the term “member” in Cap.24, Cap.250 and Cap.333. It refers to a person who in accordance with the rules of a “recognized exchange company” may trade through that exchange company or on a “recognized stock market” or “recognized futures market” it operates and whose name is entered in a list, roll or register kept by such exchange company.

20. The third type of market operator is a “recognized clearing house”. This term is carried over from the Securities and Futures (Clearing Houses) Ordinance (Cap.420) and refers to a company that is recognized as a clearing house by the Commission and regulated accordingly. The related term “clearing house” is also retained from Cap.420 and essentially refers to a person who provides services for the clearing and settlement of transactions in securities or futures contracts.

21. An associated term is “clearing participant”, the substance of which appears in the definition of “participant” in Cap.420. It refers to a person who participates in providing clearing services and whose name is entered in a list, roll or register kept by a recognized clearing house.

22. The fourth member of this category is an institution related to market operators. It is a “recognized investment compensation company” which is defined as a company recognized by the Commission as being permitted to manage the “compensation fund”. The latter will be discussed in the context of Division 5 of Part III and Part XII. Suffice it to say here that it is envisaged as being a fund to replace in due course the existing Unified Exchange Compensation Fund and Futures Exchange Compensation Fund. The necessary details will be worked out in the formulation of draft subsidiary legislation to be made under Part XII.

23. Finally, another newcomer is a person authorized by the Commission to provide “authorized automated trading services”. This definition needs to be read with that of “automated trading services” the substance of which is in Part 2 of Schedule 6. In essence, it is meant to embrace persons running a business enabling online trading in securities and futures contracts in a manner resembling the operation of a stock market or futures market rather than the activities of a broker. It will be discussed in detail in the context of Division 7 of Part III.

24. *Market Users* – Several entities are involved in providing services related to the securities and futures market. The term “intermediary” replaces that of dealer, adviser, etc. under current law and refers to a “licensed corporation” or an “exempt person”. The term “licensed corporation” is defined as a corporation that is granted a licence by the Commission under Part V of the Bill. The term “exempt person” is defined as an “authorized financial institution” which has been granted a declaration of exemption by the Commission under clause 118 in Part V. The term “authorized financial institution” in turn is defined as meaning an “authorized institution” under the Banking Ordinance (Cap.155), including a bank. Other related terms here are “licensed person” meaning a “licensed corporation” or a “licensed representative”, the latter referring to an individual licensed by the Commission as an accredited representative of a “licensed corporation”. Another related term worth noting here is “licensed or exempt person”.

25. The term “associated entity” is worth emphasis as this is a new concept which will be discussed in the context of Part VI of the Bill. It refers to a company which is in a “controlling entity relationship” with an intermediary and receives or holds in Hong Kong client assets of that intermediary. The term “controlling entity relationship” is defined as meaning one in which an intermediary is a “controlling entity” of the associated entity, or *vice versa* or one where another person is a “controlling entity” of both the intermediary and the associated entity. The term “controlling entity” is also defined and includes a person who alone or together with associates controls 20% of the voting power

at general meetings of a corporation. The term “associate” is defined in Schedule 1 too and includes a spouse, children, any corporation of which the person is a director etc. It is drawn from s.2 of Cap.24.

26. There is a host of reasonably familiar corporate terminology applicable to intermediaries and associated entities which will only be touched upon here. Of those in relation to personnel, such as “executive officer” and “officer”, the innovative one is “responsible officer”. This will be discussed in the context of Part V and is significant in the disciplinary context of Part IX. Other personnel terms are “director”, “shadow director” and “substantial shareholder” (in clause 6 of Part 1 of Schedule 1). Other company law terms defined here are “group of companies”, “holding company”, “subsidiary” (in clause 2 of Part 1, of Schedule 1), “wholly-owned subsidiary” (in clause 5 of Part 1 of Schedule 1), “company” with a Hong Kong focus, “corporation” which is wider, “overseas company” and “related corporation” (in clause 3 of Part 1 of Schedule 1). Three terms refer to the constitutive documents founding companies, namely, “constitution”, “memorandum” and “articles”. Finally, various company instruments are referred to such as “share”, “debenture”, “prospectus” and “specified debt securities”.

27. As for those who purchase market-related services, the key term is “client”. This embraces not only retail investors but also intermediaries that are clients of another intermediary. A special type of client is a “professional investor” which will be expected to have a greater understanding of the market and so need less protection than a retail investor. They may be defined further in subsidiary legislation.

28. *Tribunals* – Two new tribunals are referred to in Schedule 1. First, the “Securities and Futures Appeals Tribunal” will replace the Securities and Futures Appeals Panel and will be discussed in the context of Part XI. Second, the “Market Misconduct Tribunal” will replace the Insider Dealing Tribunal and will be dealt with in the context of Part XIII. Of course the “Ombudsman” is also relevant as one of the checks and balances here.

III. Services

29. The generic definition of the sort of services that may be provided to the market and that are to be regulated by the SFC is “regulated activity”. This term is also picked up in clause 9 of Part 1 of Schedule 1 and refers to the list of 9 types of activity set out in Part 1 of Schedule 6 and elaborated upon in definitions in Part 2 of that Schedule. There are other cross-references in Schedule 1 to several items on this list of 9, such as “dealing in securities”,

“dealing in futures contracts”, “leveraged foreign exchange trading”, “securities margin financing” and “automated trading services”. The ones not referred to directly in Schedule 1 are advising on securities, advising on futures contracts, advising on corporate finance and asset management. Some of these are adapted from existing law but others are new. They will be discussed in detail in the context of Part V.

IV. Instruments

30. The final category comprises the instruments that are the subject of transactions by service-providers with or on behalf of their clients.

31. This category includes “securities” which is substantially as defined in s.2 of Cap.333, “futures contract” which builds upon a similar term in Cap. 250 and replaces the term “commodity”, to be discussed in the context of Part III, “leveraged foreign exchange contract” to be discussed as and when it arises such as in Parts VII and VIII and “collective investment scheme” to be discussed in the context of Part IV.

32. In addition, there is a clutch of defined items related to client property including “client assets” which comprises “client securities and collateral” on the one hand (which breaks down into “client securities” and “client collateral”), and “client money” on the other hand. The term “client collateral” is further broken down into “securities collateral” and “other collateral”. All these terms together with “financial accommodation” and “securities borrowing and lending” will be discussed in detail in the context of Part VI.

Securities and Futures Commission
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