

19 February 2001

Mrs. Florence Lam
Clerk to LegCo
Legislative Council
Jackson Road
Hong Kong

Dear Mrs. Lam,

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

The Consumer Council was pleased to make a submission on the draft Securities and Futures Bill circulated for comment in June 2000. In general, the Council gave its support to the recommendations proposed in the Bill and made some comments for consideration of the Government.

The Council notes LegCo's recent concern over the need to ensure that the interests of small investors are protected. The Council is pleased to note that a number of its suggestions have been accepted in the drafting of the Bill, and considers that the measures proposed will improve the level of protection available to the investing community as a whole, including small investors.

The Council is also pleased with the constructive dialogue that exists between the Council and the Securities and Futures Commission, and the Financial Services Bureau, on ways to improve investor protection. As an example, the Council participated in the Securities and Futures Commission working groups on fining guidelines.

Attached is a summary of the Council's submission to the Bill and the Government's response, for the information of the Bills Committee.

The Council supports the passage of the Securities and Futures Bill 2000, and the Banking (Amendment) Bill insofar as it includes legislative amendments to provide for similar investor safeguards in relation to the involvement of banks in the securities and futures sector.

Yours sincerely

Mrs. CHAN WONG Shui
Chief Executive

cc. FSB (Mr. Stephen Ip, Secretary of FSB)

**Consumer Council
Submission to LegCo Bills Committee on the
Securities and Futures Bill and Banking (Amendment) Bill 2000**

Introduction

1. The Consumer Council made a detailed submission to the Financial Services Bureau (FSB) on the Consultation Paper issued in relation to the proposed Securities and Futures Bill, in June 2000, in which a number of observations and suggestions were made for the Bureau's consideration. To a large extent the Council gave its support to the suggestions proposed in the Bill, and made a number of observations. A summary is noted below for Members' information.

2. The Council notes LegCo's recent concern over the need to ensure that the interests of small investors are protected. The Council is pleased to note that a number of its earlier suggestions have been accepted in the drafting of the Blue Bill, and considers that the measures proposed will improve the level of protection available to the investing community as a whole, including small investors.

(A) Issues Proposed in the Bill

Market Misconduct

3. The Council welcomed the Government's action to take up its previous suggestion of setting up a Market Misconduct Tribunal (MMT). It has been incorporated as Part XIII of the Bill.

4. Another recommendation made by the Council was that anti-competitive provisions be included within the definition of market misconduct. This was in line with the Council's general position on the need for comprehensive competition laws in Hong Kong. While there was no response to this suggestion in the Bill, it is a matter that the Council will pursue for the future.

A civil regime to combat Market Misconduct

5. The Council had previously recommended, and therefore welcomed the provision of a civil regime as a basis upon which market misconduct would be challenged, rather than relying on a criminal onus of proof. The Council considered this approach would enable the MMT to deal more effectively with market misconduct, by easing the task in challenging behavior detrimental to the interests of consumers.

Private Right of Action

6. The Council supported provisions on the establishment of a right for private parties to seek compensation from a person for recovery of pecuniary losses as a result of the latter's market misconduct. It also welcomed the provisions that allow for a determination of MMT to be admissible as evidence; incorporated as Clauses 272 & 296. These provisions, in addition to the lower standard of proof now available under the MMT to challenge market misconduct, make worthwhile advances in the regulatory tools available to the Government to assist consumers.

7. Another recommendation suggested by the Council was the formation of a more focused investor support group by the Securities & Futures Commission (SFC) to provide assistance

on making claims. The Council was pleased to note that the SFC has a website (<http://www.hkeirc.org/main.asp>) for investor information which can serve as a suitable vehicle for the regulator to assist consumers now, and in the future.

Investor Compensation

8. The Council supported the proposal to establish a new and independent Investor Compensation Company (recognized under Clause 79). The Council trusts that its recommendation that both industry and public interest representatives are included in the make up of the company, will receive a favorable response.

9. On the proposed "per investor level" of compensation, the Council expressed the opinion that the new compensation arrangements should not reduce the overall level of protection available under the existing scheme. The FSB has responded that details of the new compensation scheme are yet to be finalised and would be subject to public consultation expected to begin in March 2001.

10. The Council proposed that the tapering method (i.e. a percentage met in full and further percentages met to a lesser amount) of setting compensation limits could be considered. The Council also welcomed Government's commitment to undertake a public consultation on various aspects of the new compensation scheme, including the level of compensation per investor. The Council understands that the SFC has commissioned consultants to advise it on the details of the operation of the compensation fund.

False Public Statements / Fraudulent and Deceptive Conduct

11. The Council welcomed the proposal to provide a claim for damages where a person has suffered pecuniary loss as a result of relying on false or misleading public communication, as an additional safeguard to protect investors. It has been incorporated as Clause 208.

12. The Council also urged the Government to consider introducing general legislative provisions that prohibit misleading and deceptive conduct generally in relation to all services regardless of the economic sector involved, given that the current Trade Descriptions Ordinance that prohibits misleading advertising only refers to goods. There was no response from the Government, however, the Council will soon be releasing a paper on the subject generally, where the issue can be further debated.

Protecting Clients Assets from Dissipation

13. The Council welcomed the initiative to require brokers to transfer custody of their client's property to an appropriate custodian, incorporated as Clause 199. This will ensure that client property is protected against dissipation, misappropriation or other improper handling.

Management Responsibility

14. The Council supported the proposal, incorporated as Clause 125, that a person seeking to become a "responsible officer" under the legislation should obtain approval from the SFC. In this regard, the Council also supported the proposal of bringing in the concept of "management liability", incorporated as Clause 378, to improve investor protection.

Access to Audit Working Papers

15. . The Council supported the proposal, incorporated as Clause 172, to enable the SFC to access audit working papers, as it would assist the SFC to effectively and efficiently fulfill its inquiry function, and provide an added safeguard to the investing public.

Fines

16. With regard to the proposal to set a maximum civil fine at the higher of HK\$10 million, or three times the profit made or loss avoided as a disciplinary action against misconduct of a regulated person, the Council suggested that where there is some uncertainty as to the ceiling, and there is no profit made or loss avoided, a "sliding scale" of penalty tied to another appropriate variable, could be considered. This was not taken up by the Government. However, the Council participated in the SFC "Disciplinary Fining Guidelines Working Group" to discuss the makeup of the guidelines. The Council comments were taken into account in preparing the guideline that indicated how the SFC would exercise its fining power and the major considerations that would be taken into account in determining a level of penalty.

Licensing regime

17. The Council welcomed the introduction of a single license regime to streamline the regulatory framework for intermediaries and upgrade the quality of intermediary services for better protection of investors. In particular, the Council noted that under the new licensing regime there would be more stringent requirements on the intermediaries in respect of training and business conduct.

Disclosure of interest in securities

18. The Council supported the proposals on tightening the disclosure threshold (from 10% to 5%) and time limit for disclosure (from 5 days to 3 business days), for enhancing quality of information disclosed and market transparency. Investors generally will have access to more timely information and be in a position to make better-informed investment decisions.

(B) Matters not Covered in the Consultation

Minimum Brokerage Commission

19. The Council urged the Government to remove the minimum scale prior to year 2002, in face of deregulation taking place in Singapore and Taiwan. The FSB in its response to LegCo, made the point that the consultation with the exchange participants on the subject is a matter for the HKEx and no follow up action on the part of the Government is required. The HKEx has decided to remove the rule by 2002.

Possible Future Entry of Competitors in Local Securities and Future Markets

20. The Council suggested that the issue of the monopoly status held by the HKEx should be kept open and the law should be flexible enough to allow for the possibility for a second market in the future when the market circumstances at the time permit. The FSB responded that, on balance, the status quo should be maintained in order to meet the competitive challenge presented by globalisation, but it will keep the subject under review in light of new market developments.

(c) Consolidation of financial regulators

Blurring of Financial Markets

21. The Council notes that in the recent debate on the Securities and Futures Bill and Banking Amendment Bill, there was some discussion on whether it was appropriate that banks that operate in securities and futures markets should be regulated separately from other market participants.

22. The Council notes that financial institutions are expanding beyond their geographic and traditional product boundaries to seek and exploit new market opportunities, to meet

intensified competition from other financial sectors and to meet customer demand for new products and services. The Council would be concerned if fragmentation of regulatory oversight, based not on the markets involved, but on the organisational characteristics of market participants compromised the effectiveness of protecting the interests of the investing public.

23. Reforms have been observed in the UK for example, where the regulation of banks, and insurance and securities firms have been put under one body, i.e., the Financial Services Authority. Germany is also apparently considering a similar regulatory re-organisation of its related finance sectors. The Council suggests that similar reforms could also be considered for Hong Kong.

Consumer Council
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