

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

**Part XII of the Securities and Futures Bill  
Committee Stage Amendments**

Members examined on a clause-by-clause basis Part XII of the Securities and Futures Bill on 17 September 2001.

**Committee Stage Amendments**

2. We have since the above meeting made some amendments to Part XII in the light of Members' comments and to further refine the drafting. All the amendments are marked up in the **Annex** with explanations therefor in the footnotes.

**About the marked-up version of the Bill in the Annex**

3. All the proposed amendments shown in the annex to this paper are marked up against the Blue Bill, notwithstanding that they might have appeared in earlier marked-up versions issued to Members. Where the amendments are made since Members last considered the relevant Part of the Bill, such **new amendments are explained in the footnotes in bold type**, to distinguish them from the footnotes for amendments which Members have considered and proposed no further changes at previous meetings.

Financial Services Bureau  
Securities and Futures Commission  
23 November 2001

## PART XII

INVESTOR COMPENSATION<sup>1</sup>**228. Interpretation of Part XII**

In this Part, unless the context otherwise requires -  
"compensation" (賠償) means compensation payable out of the  
compensation fund under rules made under section 236;  
"default" (違責) means a default prescribed<sup>2</sup> by rules made  
under section 236;

"Futures Exchange Compensation Fund" (期交所賠償基金) means the  
compensation fund established under Part VIII of the  
repealed Commodities Trading Ordinance;

"Unified Exchange Compensation Fund" (聯交所賠償基金) means the  
compensation fund established under Part X of the  
repealed Securities Ordinance.

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<sup>1</sup> At the Bills Committee meeting on 4 May 2001, Members expressed the view that while accepting the need for a flexible approach, i.e. by way of subsidiary legislation, to prescribe investor compensation arrangements such that future market development can be accommodated, the primary legislation should set out as appropriate those major elements that have been decided upon. We accept this view and accordingly reflect them in this purpose clause having regard to the result of the consultation conducted in March/April 2001. (Please refer to Paper 11B/01 dated 31 July, 2001.) Any subsidiary legislation to be made under clause 236 has to be subject to the overall purpose of the investor compensation arrangements as stipulated in clause 229. **At the Bills Committee meeting on 17 September 2001, Members considered the amendments proposed to the various provisions of this Part for the purpose and did not object to the approach. We have since proposed further amendments to address the comments of some Members and the Legal Service Division of the Legislative Council on matters of drafting and detail. Please see footnotes (2), (3) and (14).**

## 229. Establishment of compensation fund<sup>1</sup>

(1) The Commission shall establish and maintain a compensation fund, to be known as the Investor Compensation Fund in English and "投資者賠償基金" in Chinese, for the purposes of this Part, providing, in accordance with rules made under section 236, a measure of compensation to clients of a specified person who sustain a loss by reason of a default committed by the specified person or any of his associated persons in connection with specified securities or futures contracts<sup>3</sup>.

(2) In this section - "associated person" (相聯者), in relation to a specified person, means -

- (a) an employee of the specified person;
- (b) a person ("first-mentioned person") who may under section 160 receive or hold client assets of the specified person, or an employee of the first-mentioned person; or
- (c) such other persons as may be prescribed by rules made under section 236;

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<sup>2</sup> We accept the drafting comment of a Member expressed at the Bills Committee meeting on 17 September 2001 that the reference to "to be prescribed" in the previous marked up draft annexed to Paper No.CE11/01, should be replaced with "prescribed".

<sup>3</sup> As mentioned at the Bills Committee meeting on 17 September 2001, we accept the comment of the Legal Service Division of the Legislative Council that the formulation of "in connection with trading in specified securities or futures contracts" in the previous marked up draft annexed to Paper No.CE11/01 is overly restrictive in that it may, for example, exclude securities held by an intermediary as a custodian. The provision, as further amended to delete "trading in", reflects better the policy intention.

"specified person" (指明人士) means -

- (a) an intermediary licensed or registered<sup>4</sup> for Type 1 or 2 regulated activity;
- (b) an intermediary licensed for Type 8 regulated activity; or
- (c) such other person as may be prescribed by rules made under section 236;

"specified securities or futures contracts" (指明證券或期貨合約)

means any securities or futures contracts listed or traded or to be listed or traded on -

- (a) a recognized stock market or recognized futures market; or
- (b) such other markets as may be prescribed by rules made under section 236.

### **230. Money constituting the compensation fund**

- (1) The compensation fund shall consist of -
  - (a) all amounts paid to the Commission or a recognized investor compensation company in accordance with rules made under this Part;

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<sup>4</sup> We accept the comment of some Members that the term "exempt person" is a misnomer and does not reflect the proposed regulatory framework whereby authorized institutions engaging in regulated activities are subject to a whole range of regulatory requirements and disciplinary sanctions. We informed Members at the Bills Committee meeting on 14 September 2001 that we would replace "exempt person" with "registered institution" and "exempt" with "registered" throughout the Bill to duly reflect our policy intention.

<sup>5</sup>(aa) all amounts paid by the Commission into the compensation fund under subsection (2)(b);

(b) all amounts paid into the compensation fund under sections 72(2) or (8)(b), 73(2) or (8)(b) and 74(11) of Schedule 9;

(c) ~~all amounts~~assets (whether in cash or otherwise)<sup>6</sup> recovered by the Commission or a recognized investor compensation company in exercise of a right of action conferred by section 87 or 235;

(d) all amounts borrowed under subsection (2)(a)<sup>7</sup>;

(e) any return or profit received on an investment made under section 233;

(f) all other amounts lawfully paid into the compensation fund.

(2) With the consent in writing of the Financial Secretary, the Commission may —

(a) for the purposes of the compensation fund, borrow from any authorized financial

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<sup>5</sup> The proposed new clauses 230(1)(aa) and 230(2)(b) work together to enable the SFC to inject money out of its reserves, which are derived primarily from transaction levies, as appropriate. **Members considered the amendment and did not propose further changes at the Bills Committee meeting on 17 September 2001.**

<sup>6</sup> **We accept the comment of a Member expressed at the Bills Committee meeting on 17 September 2001 that “amounts” may be unnecessarily restrictive. The amendment replaces the term with “assets (whether in cash or otherwise)” to cater for circumstances where assets other than cash are recovered in the exercise of the subrogation rights.**

<sup>7</sup> **Amendment consequential to changes to clause 230(2).**

institution on such terms and at such rates of interest as it considers acceptable and may charge any investments acquired under section 233 by way of security for any such loan;

<sup>5</sup>(b) pay into the compensation fund from its reserves such amount of money as it thinks fit.

**<sup>8</sup> 230A. Management of compensation fund**

Subject to this Part, the Commission shall be responsible for the management and administration of the compensation fund, including the determination of a claim for compensation.

**231. Money to be kept in account**

The Commission shall open at one or more authorized financial institutions one or more accounts and shall, pending their application in accordance with this Part, pay into or transfer to such account or accounts all amounts forming part of the compensation fund.

**232. Accounts of compensation fund**

(1) The Commission shall keep proper accounts of the compensation fund.

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<sup>8</sup> We accept the comment of the Legal Service Division of the Legislative Council that it should be made clear the SFC has the responsibility for management of the compensation fund and determining claims, which may then be transferred by Order under clause 80 to the recognized investor compensation company. The amendments to this clause and clause 236(2)(h) seek to reflect this.

(2) The Commission may, if it considers it necessary to do so -

(a) maintain separate accounts in respect of the amounts that are respectively paid into the compensation fund under sections 72, 73 and 74 of Schedule 9;

(b) maintain separate accounts in respect of the compensation fund -

(i) for different -

(A) recognized exchange companies;

(B) markets operated by recognized exchange companies;

(C) persons providing automated trading services; or

(D) classes of investors; or

(ii) for the better and more effectual management or administration of the fund;

(c) maintain sub-accounts in respect of the separate accounts referred to in paragraph (a) or (b) in such manner as it considers appropriate.

(3) The Commission shall in respect of the financial year beginning before and ending after the day on which this section commences, and in respect of each subsequent financial year, prepare -

- (a) a financial statement made up to (and including) the last day of that year; and
- (b) in the case where separate accounts are maintained under subsection (2)(a) or (b) or sub-accounts are maintained under subsection (2)(c) -
  - (i) a consolidated financial statement made up to (and including) the last day of that year, in respect of the separate accounts or sub-accounts (as the case may be); and
  - (ii) a separate financial statement made up to (and including) the last day of that year, in respect of each separate account or sub-account (as the case may be).

(4) A financial statement prepared under subsection (3) shall be signed by the chairman and at least one non-executive director of the Commission.

(5) The Commission shall appoint an auditor to audit the compensation fund.

(6) The auditor so appointed shall annually audit the accounts of the compensation fund and shall audit, and prepare an auditor's report in respect of, each financial statement prepared under subsection (3) and shall submit the report to the Commission.

(7) An auditor's report prepared under subsection (6) shall contain a statement made by the auditor as to whether in his opinion the financial statement gives a true and fair view of the matters to which the statement relates.

(8) The auditor appointed under this section may call for and inspect such books and records of the Commission or any recognized investor compensation company as he may require in order to perform his functions under this section.

(9) Not later than 4 months after the end of each financial year the Commission shall cause -

(a) a copy of -

(i) each audited financial statement in respect of that financial year; and

(ii) the auditor's report on each such financial statement,

to be sent to the Financial Secretary; and

(b) a copy of each such audited financial statement to be published in the Gazette.

<sup>9</sup>(9A) The Financial Secretary shall cause to be laid on the table of the Legislative Council any financial statement and report sent to him under subsection (9)(a).

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<sup>9</sup> We accept the comment of a Member made at the Bills Committee meeting on 17 September 2001 that the audited financial statements of the investor compensation fund should be laid before LegCo. The amendment imposes the requirement accordingly.

(10) In this section, "financial statement" (財務報表) means a statement which contains all of the following documents -

- (a) a revenue and expenditure account;
- (b) a balance sheet; and
- (c) a cash flow statement.

### **233. Investment of moneys**

(1) The Commission may invest any money which forms part of the compensation fund and is not immediately required for any other purposes provided for by this Part -

- (a) on fixed deposit with an authorized financial institution; or
- (b) in securities in which trustees are authorized by law to invest trust funds.

(2) Any return or profit on an investment of moneys by the Commission under subsection (1) shall be added to the compensation fund.

(3) A fixed deposit receipt and other document evidencing the investment of money under subsection (1) may be kept in the office of the Commission or deposited for safe keeping with an authorized financial institution.

#### **234. Payments out of the compensation fund**

(1) Subject to this Part, there shall from time to time be paid out of the compensation fund as required and in such order as the Commission may determine one or more of the following amounts -

- (a) all legal and other expenses incurred -
  - (i) in investigating or defending claims for compensation made under rules made under this Part;
  - (ii) in relation to the compensation fund;
  - (iii) in the exercise by the Commission of the rights, powers, and authorities vested in it by this Part or rules made under this Part in relation to the compensation fund;
  - (iv) in the exercise by a recognized investor compensation company of a function transferred to it under section 80 or provided for under rules made under this Part;
- (b) the expenses incurred in the management or administration of the compensation fund;
- (c) the expenses incurred in obtaining insurance, surety, guarantee or other security, or in making any financial arrangement, in respect of

claims for compensation made under rules made under this Part;

- (d) interest on any sum borrowed under section 230(2)(a)<sup>5</sup>;
- (e) the amounts of claims for compensation, costs of and incidental to the making and proving of such claims and interest on compensation, as allowed under rules made under this Part;
- (f) all other money payable out of the compensation fund in accordance with rules made under this Part.

(2) Where the Commission considers that the amount at credit in either the Unified Exchange Compensation Fund or the Futures Exchange Compensation Fund is insufficient to enable -

- (a) the payment of the amounts which the Commission considers to be necessary to meet any claims or likely claims against the Unified Exchange Compensation Fund or the Futures Exchange Compensation Fund (as the case may be); and
- (b) the repayment of the amounts deposited in cash with the Commission under section 104 of the repealed Securities Ordinance or section 82 of the repealed Commodities Trading Ordinance (as the case may be),

then the Commission shall, subject to subsection (3), pay into the Unified Exchange Compensation Fund or the Futures Exchange

Compensation Fund (as the case may be) out of the compensation fund such amount as it considers ~~equitable~~appropriate<sup>10</sup>.

(3) The aggregate amounts paid under subsection (2) to the Unified Exchange Compensation Fund or the Futures Exchange Compensation Fund shall not exceed the respective aggregate amounts paid into the compensation fund under section 72(2) or 73(2) of Schedule 9 (as the case may be).

~~<sup>11</sup>(4) In the event that the compensation fund is dissolved, the Commission may, in its absolute discretion, after the satisfaction of all outstanding liabilities against the compensation fund, pay—~~

~~(a) to the Stock Exchange Company or, if the Stock Exchange Company is in liquidation, to the liquidator of the Stock Exchange Company the whole or a portion of that part of the compensation fund which is derived from the Unified Exchange Compensation Fund under section 72(2) and (8)(b) of Schedule 9, and on any such payment being made those amounts shall form part of the assets of the Stock Exchange~~

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<sup>10</sup> We accept the comment of the Legal Service Division of the Legislative Council that “equitable” should be replaced by “appropriate” as the issue of equitability should not arise in the context of repayment of money.

<sup>11</sup> As explained to Members at the Bills Committee meeting on 17 September 2001, clause 234(4) should be deleted as on the repayment of deposits out of the Unified Exchange Compensation Fund or the Futures Exchange Compensation Fund and settlement of all liabilities in accordance with clauses 72 and 73 of Schedule 9, the Exchange Company should have no claim upon the amounts transferred to the new Compensation Fund.

~~Company or, if it is in liquidation, shall be available to the liquidator for distribution in accordance with the Companies Ordinance (Cap. 32); and~~

~~(b) to the Futures Exchange Company or, if the Futures Exchange Company is in liquidation, to the liquidator of the Futures Exchange Company the whole or a portion of that part of the compensation fund which is derived from the Futures Exchange Compensation Fund under section 73(2) and (8)(b) of Schedule 9, and on any such payment being made those amounts shall form part of the assets of the Futures Exchange Company or, if it is in liquidation, shall be available to the liquidator for distribution in accordance with the Companies Ordinance (Cap. 32).~~

**235. Subrogation of the Commission to rights,  
etc. of claimant on payment from  
compensation fund<sup>12</sup>**

(1) Where the Commission makes any payment out of the compensation fund in respect of any claim for compensation made under rules made under this Part -

(a) the Commission shall be subrogated, to the extent ~~of that payment, which that payment bears~~ to the loss sustained (without taking into account any compensation) by the claimant by reason of the default on which the claim was based, to all the rights and remedies of the claimant in relation to the loss ~~sustained by him by reason of the default on which the claim was based;~~ ; and

~~and~~

(b) ~~the claimant shall have no right~~ respectively ~~rights of the claimant and the Commission in~~ bankruptcy or winding up or by legal

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<sup>12</sup> As mentioned at the Bills Committee meeting on 4 May 2001, the amendments were proposed to reflect the High Court decision in the Forluxe case in interpreting the origin provision of clause 235(1)(a) (i.e. section 118 of the Securities Ordinance), being that the SFC should have no priority in the distribution of "assets" recovered over investors who have received compensation from the compensation fund; and to apply similar principles in clause 235(1)(b). As set out in Paper CE02/01 dated 7 June 2001 and considered by Members on 15 June in the context of Part III, we have already proposed similar amendments to clause 87, the equivalent of clause 235. Since then, we have made further technical refinement to clarify the intention as now incorporated in this proposed clause 235. **Members considered the amendment and did not propose further changes at the Bills Committee meeting on 17 September 2001. We have now adopted the same drafting in clause 87.**

proceedings or otherwise to receive in respect of the loss =

(i) any sum out of the assets of ~~the exchange participant or other~~ person concerned who is in default, ~~or where the loss was caused by the defalcation, fraud or misfeasance of an employee of that exchange participant or that other person, the assets of that employee, until the Commission has i or~~

~~been reimbursed the full amount of its payment~~

(ii) any property held on trust by that person for the claimant,

shall rank equally.

(2) All amounts recovered by the Commission under subsection (1) shall become part of the compensation fund.

#### **236. Rules by Chief Executive in Council and Commission**

(1) The Chief Executive in Council may make rules for the following matters -

- (a) the means of funding the compensation fund;
- (b) the maximum amount of compensation that may be paid to a person making a claim for compensation;

- (c) the maintenance of sub-accounts under section 232(2)(c), payments to be made from such sub-accounts and the apportionment between different sub-accounts of expenses incurred in relation to the compensation fund and of interest earned on the fund;
- (d) providing for the better carrying out of the objects and purposes of this Part.

(2) Without prejudice to section ~~384(9)~~384A(7) and ~~(10)(8)~~<sup>13</sup>, the Commission may, subject to subsection (3), make rules which are not inconsistent with rules made by the Chief Executive in Council under subsection (1), for the following matters -

- (a) the circumstances in which a person is entitled to claim compensation, including any matter referred to in section 228 or 229(2) which<sup>14</sup> may be prescribed by rules made under this section<sup>15</sup>;

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<sup>13</sup> **Technical amendment consequential to the relocation of provisions in Part XVI.**

<sup>14</sup> **We accept the drafting comment of a Member expressed at the Bills Committee meeting on 17 September 2001 and accordingly delete the reference to “is to be or” before “may be prescribed” in the previous marked up draft annexed to Paper No.CE11/01.**

<sup>15</sup> This is to make clear that the power to supplement the major elements referred to in clauses 228 and 229 falls within the coverage of clause 236(2)(a), the exercise of which has to be in consultation with the Financial Secretary as required under clause 236(3). **Members considered this amendment and did not propose further changes at the Bills Committee meeting on 17 September 2001.**

- (b) the manner in which the claim for compensation is to be made;
- (c) the payment of costs of and incidental to the making and proving of a claim for compensation;
- (d) the payment of interest on the amount of compensation;
- (e) the information or documents to be supplied to the Commission for the purpose of enabling the Commission to determine the application;
- (f) the persons or classes of persons who are not entitled to make a claim for compensation;
- (g) the circumstances and manner in which the Commission may call for claims for compensation;
- (h) ~~the circumstances and manner in which the Commission may determine, deal with and pay~~determination and payment of and the procedures for dealing with a claim for compensation;
- (i) enabling the Commission -
  - (i) to submit a claim for compensation as a proof of debt in any winding-up or bankruptcy proceedings;
  - (ii) to pay compensation in the form of securities and to purchase securities for that purpose; and

- (iii) to require the assignment of a claimant's rights of action as a pre-condition for the payment of compensation;
- (j) the functions of a recognized investor compensation company in relation to the management or administration of the compensation fund;
- (k) the formulation of proper accounting and auditing systems with respect to the management or administration of the compensation fund for which a recognized investor compensation company may be responsible upon a transfer of a function to it under section 80;
- (l) arrangements that are to be made when a recognized investor compensation company is wound up;
- (m) the obtaining of such insurance, surety, guarantee or other security or the making of such financial arrangement as may be necessary or appropriate for the better carrying out of the objects and purposes of this Part;
- (n) providing for the better carrying out of the objects and purposes of this Part.

(3) The Commission shall consult the Financial Secretary before making rules under subsection (2) for the matters specified in paragraphs (a) and (f) of that subsection.

<sup>16</sup>(4) In making any rules under subsection (1)(a), the Chief Executive in Council shall ensure that the funds of the compensation fund shall, so far as practicable, be derived from the securities and futures industry.

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<sup>16</sup> This amendment is to reflect the policy intention that as far as practicable, the funding of the investor compensation arrangements should follow the user-pay principle. **Members considered this amendment and did not propose further changes at the Bills Committee meeting on 17 September 2001.**