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BY FAX (Total 11 pages)

Mr Kau Kin-wah
Assistant Legal Adviser
Legislative Council Secretariat
Legislative Council Building
8 Jackson Road
Central, Hong Kong

Dear Mr Kau,

Securities and Futures Bill

I refer to your letter of 30 November setting out your observations in relation to Part 1 of Schedule 9 of the Bill.

I attach our responses to your observations prepared in consultation with the Department of Justice and the Securities and Futures Commission.

Yours sincerely,

(Miss Emmy Wong)
for Secretary for Financial Services

Encl.

c.c. DoJ (Attn : Ms Sherman Chan
Mr Michael Lam
Mr K F Cheng
Ms Francoise Lam)

SFC (Attn : Mr Andrew Young)

HKMA (Attn : Mr Arthur Yuen)

Part 1 of Schedule 9

Transitional provisions relating to Part III

Clause 5(a)

The deeming effect of the paragraph seems not to have been extended to the issuing and serving of a notice under clause 19(2). This means that for the purposes of clause 19(2), no notice has been served. Please clarify whether this is the intention of the Administration. If not, please consider whether it would remove any ambiguities by deeming also that a notice under clause 19(2) has been served.

The object of clause 5(a) is to deem positively the Stock Exchange Company and the Futures Exchange Company each to be a recognized exchange company. The clause goes further to explain that such a deeming has the same effect as if each of them had been served a notice under clause 19(2) of the Bill recognizing it as an exchange company. Thus, once clause 5(a) is enacted, the Stock Exchange Company and the Futures Exchange Company will each become a recognized exchange company. As the clause is effective in achieving what is needed, it is not necessary to go backwards and deem that every step leading to the recognition has been done, and likewise every condition has been satisfied. Deeming all such steps as having been done and all such conditions satisfied would only make the provision unduly long and cumbersome without serving any useful purpose.

Clause 5(b), (c) & (d)

In section 5(b), (c) & (d), the respective rules, constitutions and appointments are not deemed to have been approved under the new provisions. The use of the term "as if" suggests that only the effect under the new provisions is desired but not the acts that give rise to such effect. In the circumstances, please clarify what the modifications necessary to make the new provisions applicable are.

Under clauses 24(1) and 26 of the Bill, those rules, constitutions and appointments would not have any effect unless they are approved in writing by the Commission. There are alternative ways of preserving them. Providing that they shall continue to have effect as if they had been approved under the proposed Ordinance is the usual way. Deeming them to have been approved under the proposed Ordinance is another alternative. But there is obviously no need to have provisions that give effect to both alternatives.

Clause 6

We have the same queries in respect of the deeming provisions vis-a-vis the HKSCC, HKFECC, and SEOCH.

Please see the response under section 5(a) above.

Clauses 7, 8, 11, 12, 14 & 15

We agree that the drafting of the provisions as they are, is effective to prevent any gaps from arising as a result of the repealing of the existing legislation. However, such general wording would leave the regulated persons and entities in a state of uncertainty because it would not be easy for them to find out whether any approval, licence, waiver, or permission would become invalid upon the commencement of the new provisions. Would the Commission please consider taking any measures to remove such uncertainty?

This is in usual transitional provisions and has generally been regarded acceptable. We would take complementary administrative measures as necessary and appropriate.

Clause 10

Please clarify why it must be that the deeming of HKEC under the existing section 19 of Cap 555 should be continued to be so deemed and not simply that a notice under clause 59(2) be deemed to have been served on it.

The same result is achieved by deeming once again the HKEC to be a recognized exchange controller. But given that the HKEC has already been deemed to be a recognized exchange controller under the Exchanges and Clearing Houses (Merger) Ordinance, it is more logical to provide that the HKEC should continue to be so deemed to achieve continuity in status. The provision goes further to clarify that such a continuance of deeming has the same effect as if it had been served a notice under clause 59(2) of the Bill recognizing the HKEC as an exchange controller.

Transitional provisions relating to Part IV

Clause 18

Please clarify why a nomination would need 6 months.

Six-month refers to the grace period that we consider reasonable and appropriate in the circumstances; and has nothing to do with how long a nomination takes.

Clause 19

Please clarify what the Commission would do if due to a change in the applicable statutory requirements, the submitted applications have not complied with the new requirements. To allay the concern of the application, please consider to provide expressly for such eventualities in the transitional provisions.

Please note that clause 19 is to extend the 6-month grace period for addressing the possibility that an applicant may submit a nomination at the end of the period, thus leaving the SFC with no time to consider the nomination. The SFC would apparently have to consider the nomination in accordance with the legislation enacted and already brought into operation.

Transitional provisions relating to Part V

General

(a) Please clarify whether the "licensed (or exempt) status" of persons or entities regarded as licensed or (as the case may be) exempt by virtue of sections 22, 24-27, 29-32, 39, 40, 42, 43, 46 and 47 could be revoked or suspended. It seems to us that the wording of the sections does not appear to contemplate the possibility of revoking or suspending the "licensed (or exempt) status". We are further of the view that the provisions empowering the relevant regulatory authority to revoke or suspend licences do not cover "licensed (or exempt) status".

(b) Similarly, please clarify the position of individuals regarded as approved persons and/or licensed representatives.

(a) & (b)

We have proposed a Committee Stage Amendment ("CSA") to clause 52(4) for making clear that the provisions of the SF Bill shall apply to persons transited into the new regime as appropriate.

(c) For similar reasons, please clarify the position of an individual regarded as a person whose name is entered in the register maintained by MA.

We have proposed a CSA to clause 52(5) for making clear that the provisions of the SF Bill shall apply to persons transited into the new regime as appropriate.

Please also clarity whether the names of persons so regarded would actually be entered in the relevant register or merely regarded as such without any record. Nothing in section 26 or 32 suggests that they would.

Under clause 4(e) of the Banking (Amendment) Bill 2000, the names of the persons so regarded may be recorded in the register maintained by the MA. In practice, the MA will gather such information from the authorized institutions and put it in the register for public inspection as soon as reasonably practicable during the transitional period.

(d) *The transitional provisions appear to assume that every person, who wishes to continue to carry on any regulated activities, needs to apply for a licence or an exemption at the end of the two year period at the latest. Their applications would be treated as that of any new comer. Please clarify the policy of the Administration in respect of existing registered persons and representatives' applications for licence or exemption under the new regulatory regime.*

It is indeed the policy intention that every person who intends to carry on a regulated activity after the two-year transitional will have to apply for a licence or registration as appropriate. This policy has been made known to and is generally accepted by the industry. On implementation details, the SFC will not require existing practitioners to take fresh examinations to prove their competence and will take into account their experience in considering applications made by them. The SFC envisages the majority of such applications would be approved in a very short period of time.

Clauses 22, 23, 24, 25, 26, 27, 28, 29, 30, 31, 32 & 33

Please clarify why dealers, investment advisers or commodity trading advisers and, in particular, representatives need to be regarded as licensed for asset management.

Currently, these persons are allowed to provide asset management service.

Clause 28

The making of every partner as responsible officer may force some partners, who do not want to take such a role in the business, to retire and dissolve the partnership. Please clarity –

(a) *whether the Administration would consider allowing some partners to opt out from being approved as responsible officer so long as there are not less than two partners being so regarded; and*

(b) *what would happen if there is a dissolution of the existing partnership because some partners do not want to continue while the remaining ones would like to do so.*

The current provisions do not seem to contemplate such eventualities.

(a)&(b)

By way of general background information, there is **at present only one partnership with two partners registered with the SFC**. Moreover, we do not envisage that any partnership would seek registration between now and the commencement of the SF [Ordinance] as it is widely known that only corporations would be eligible for being licensed to carry on a business in a regulated activity. As such, the circumstances outlined in the observations would not occur.

Moreover, under existing law, every partner of, for example, a securities dealing partnership, is already required to be registered as a dealer, instead of only as a dealer representative, under section 50A of the Securities Ordinance. We see no reason for lessening the requirement during the two-year transitional period.

Clauses 37, 41 & 44

(a) The sections seem to suggest that a person who is lawfully carrying on a business in excluded interests (and probably a sole proprietor), would have to cease to do so not later than six months after the commencement of Part V. Please explain the need for such special treatment. It is not apparent why a corporation should be favored in preference to an individual. In the event of insolvency, unsecured creditors may in fact have a better chance to obtain some payment from an individual than a corporation.

We believe there is a misinterpretation of the provisions referred to. The provisions make no differentiation between "individual" and "corporation". "Person" is defined in Cap 1 to include any public body, body of persons, corporate or unincorporate. The purpose of these provisions is to allow such persons to continue carrying on such activities, which are not currently regulated, for a period of 6 months to avoid disruption to the markets and to provide sufficient time to either wind down the business or to apply for the appropriate licence or registration.

We have not received any negative market comment on the proposed arrangements.

(b) *Please consider whether those entities to which the ordinance to be enacted pursuant to the Bill would not apply, should be required to make known this fact to their clients.*

As mentioned above, the relevant provisions of the SF [Ordinance] applies also to entities.

Clause 49

The same observations in respect of a person who deals only with excluded clients.

Same responses to the observations in respect of excluded interests.

Clause 52

(a) *Section 52(b) only contemplates a situation where all partners would be shareholders and together hold a majority of the shares in the corporation applying to be licensed. Please explain the reasons for excluding other possibilities, e.g. less than all partners become majority shareholders.*

(b) *Please explain the reasons for requiring the existing licensed person(s) to be majority shareholder(s) in the "succeeding corporation" before the existing partnership or sole proprietorship is allowed to continue business pending the licensing of the "succeeding corporation". It seems to us that so long as the current on-going business is being conducted by the existing owners, there would be no good reason to believe that it would presently be affected by what would happen in the future (i.e. new licence for a new corporation). The future as well as the present is securely under the control of the SFC.*

(a)&(b)

The general background information provided in response to the observations made on section 28, being that there is only one partnership with two partners currently registered with the SFC, is also relevant here.

The spirit of the transitional arrangements is to enable the smooth transition of existing business into the new regime. We take the view that a major change in the ownership of the business will have major bearing upon the fitness and properness consideration. Moreover, the corporation formed to take over the former business of the partnership/sole proprietorship, irrespective of whether all the former partners/sole proprietor become majority shareholder(s), can also apply to be licensed under clause 115 and the SFC in considering the application shall have regard to, among other things, the relevant experience.

We have not received any negative market comment on the proposed arrangements.

Clause 54

This section presumes that the conditions imposed prior to the commencement of Part V are legally neutral, i.e. unrelated to or affected by the existing regulatory regime and legal requirements. Please confirm whether this is so. If not, please consider whether any modification is necessary.

We confirm that all conditions imposed prior to the commencement of the SF [Ordinance] are legally neutral.

Clause 59 & Table (items 1(b), 2(b), 5(b) & 6(b)

The original applications are for registration permitting one to carry on business in relevant regulated activities. The conversion prescribed by the section would in each case be a de facto refusal of the original application and a substitution with an application of a different nature, i.e. to be licensed as a representative only. Please consider whether there is need to make explicit the policy of SFC.

The policy in this regard, i.e. only a corporation will be granted a licence to carry on a business in a regulated activity, is actually well known. Such policy has been highlighted in the consultation on the new licensing regime in 1999, and the White Bill consultation exercise in 2000.

Transitional provisions relating to Part XI

Clauses 68, 69 & 70

(a) *Sections 68 & 69 may only function if the relevant parts of SFCO and LFETO and related subsidiary legislation have not been repealed or have only been repealed subject to savings covering the legal basis of the matters mentioned in these sections. Clause 392(2) is inadequate to achieve this because clause 392(3) would repeal all subsidiary legislation which have not been expressly mentioned in sections 68 or 69. Section 70 is also insufficient because it only seeks to preserve the offices of the panel members, chairman etc. without also saving their powers etc. Please consider putting in express savings to achieve your purposes.*

Please note section 11 of Schedule 1 reads "For the avoidance of doubt, a reference to this or any other Ordinance, whether generally or specifically and whether by reference to the short title of the Ordinance or otherwise, shall, unless the context otherwise requires, be construed as including any subsidiary legislation made under this or that other Ordinance (as the case may be)".

Please note that section 70 reads "... without limiting the generality of sections 66, 68 and 69 (including the power to appoint any person as a member (whether as the chairman, deputy chairman or other member) of the Securities and Futures Appeals Panel ...". Sections 66, 68 and 69 provide that an appeal is to be disposed of in all aspects **as if the SF [Ordinance] had not been enacted**, as such, the powers of the panel members, chairman, etc should remain the same.

(b) *Please also confirm that an appeal to the Court of Appeal by way of case stated is still open to parties to such proceedings. This is not clear from the present provisions. This should also be covered by an express saving.*

Yes. This should have been implicit by "disposed of". Please see for example, section 64 of the Securities and Futures Commission Ordinance.

Transitional provisions relating to Part XII

Clause 72

(a) *Section 72(8)(a) provides that the amount of the repayments under subsection (8)(a) shall form part of the assets of the Stock Exchange Company. However, under the existing section 106 of SO, a holder of trading right, who has deposited the sum of HK$50,000 with the Exchange Company, would be entitled to the return of the deposit when he ceases to be such holder. This subsection (8)(a) appears to have deprived those holders of their entitlement to the deposit paid. Please clarify.*

The matter would be dealt with in the Exchange Rules which are subject to the approval by the SFC.

(b) *The word "default" does not appear in section 109(1) of SO but is defined in section 98 of SO. Please consider whether the definition of "default" in subsection (12) needs to be amended.*

We have proposed a CSA to replace "default" with "act".

Clause 73

I have similar observation on subsection (8)(a) as under the existing section 84 of the Commodity Trading Ordinance (Cap 250) a holder of trading right would be entitled to refund of the deposit that he has paid after he has ceased to be such holder.

The matter would be dealt with in the Exchange Rules which are subject to the approval by the SFC.

Clause 74

Please clarify whether the whole of Part I of the repealed Commodity Trading Rules is really necessary for the purposes under section 74. It seems that only rule 2 (interpretation provisions) is required. Please consider a modification.

We have proposed a CSA to remove the reference to Part I of the repealed Commodity Trading Rules.

Securities and Futures Commission
Financial Services Bureau
12 December 2001