

立法會
Legislative Council

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Legislative Council
Panel on Financial Affairs

Minutes of Meeting held on
Thursday, 29 March 2001 at 10:45 am
in the Chamber of the Legislative Council Building

- Members present** : Hon Ambrose LAU Hon-chuen, JP (Chairman)
Hon Henry WU King-cheong, BBS (Deputy
Chairman)
- Hon James TIEN Pei-chun, JP
Hon Albert HO Chun-yan
Hon Eric LI Ka-cheung, JP
Hon NG Leung-sing
Hon James TO Kun-sun
Hon Bernard CHAN
Hon CHAN Kam-lam
Hon SIN Chung-kai
Hon Jasper TSANG Yok-sing, JP
Hon Emily LAU Wai-hing, JP
- Non-Panel Members attending** : Hon CHAN Kwok-keung
Hon Audrey EU Yuet-mee, SC, JP
- Members absent** : Hon LEE Cheuk-yan
Dr Hon David LI Kwok-po, JP
Dr Hon Philip WONG Yu-hong
- Public officers attending** : For Item III
- Mr Stanley WONG
Deputy Secretary for Financial Services

Mr David CARSE, JP
Deputy Chief Executive, Hong Kong Monetary
Authority

Mr Vincent LEE
Senior Manager, Banking Policy Department, Hong
Kong Monetary Authority

For Item IV

Mr Esmond LEE
Principal Assistant Secretary (Companies),
Financial Services Bureau

Mr G W E JONES
Registrar of Companies

Mr John BUSH
Secretary, Standing Committee on Company Law
Reform

Mr Jeremy GLEN
Assistant Principal Solicitor, Official Receiver's
Office

Miss Peggy LAU
Development Manager, Companies Registry

For Item V

Ms Salina YAN
Principal Assistant Secretary (Securities), Financial
Services Bureau

**Attendance by
invitation**

: For Item V

Securities and Futures Commission

Mr Mark DICKENS
Executive Director (Supervision of Markets)

Mr Gerald GREINER
Senior Director (Supervision of Markets)

Mrs Irene TANG
Assistant Director (Supervision of Markets)

Clerk in attendance : Mrs Florence LAM
Chief Assistant Secretary (1)4

Staff in attendance : Mr KAU Kin-wah
Assistant Legal Adviser 6

Ms Connie SZETO
Senior Assistant Secretary (1)1

Matters arising

Overseas duty visit

Members noted that a delegation comprising members of the Panel and the Bills Committee on Securities and Futures Bill and the Banking (Amendment) Bill 2000 would visit London, Washington D.C. and New York from 4 to 13 April 2001.

Report of the Hong Kong Special Administrative Region of the People's Republic of China in the light of the International Covenant on Economics, Social and Cultural Rights

2. Members noted that extracts of the captioned report which covered issues relevant to the purview of the Panel were circulated to members via LC Paper No. CB(1) 782/00-01 on 8 March 2001.

3. Miss Emily LAU said that the United Nations Committee on Economic, Social and Cultural Rights would discuss the captioned report in April 2001. Although the current report had not addressed issues relating to the substantial amount of fiscal reserves maintained by the HKSAR Government, the Committee on Economic, Social and Cultural Rights had expressed concern about this subject at its meetings held in 1996. She suggested that the Panel should consider the subject of proper use of fiscal reserves in the near future.

Proposed purchase of the permanent accommodation
for the Hong Kong Monetary Authority
(LC Paper No. CB(1) 905/00-01)

4. Members noted that the Chief Executive of Hong Kong Monetary Authority (CE/HKMA) had informed the Panel at the meeting on 11 January 2001 of HKMA's plan to purchase office premises. HKMA provided the captioned information paper to update members on the latest development of the proposal. As the proposed purchase would involve a substantial amount of public money, members agreed that the Panel should consider the matter in detail. The Chairman said that members could enquire about the progress of the proposal under agenda item III of the meeting before deciding whether a special meeting should be convened for this purpose.

I Information papers issued since the last meeting
(LC Paper No. CB(1) 782/00-01 and 812/00-01)

5. Members noted that two information papers had been issued since the last meeting.

II Date of next meeting and items for discussion
(LC Paper No. CB(1) 906/00-01(01)-(03))

6. Members agreed to hold a special meeting on Thursday, 3 May 2001 at 4:30 pm to receive a briefing by CE/HKMA on the work of HKMA and its Annual Report 2000.

7. Members agreed to discuss the following items at the regular Panel meeting scheduled for Monday, 7 May 2001 at 10:45 am :

- (a) Review of Government Financial Reporting;
- (b) Re-ranking of a Deputy Secretary for the Treasury post on a supernumerary basis; and
- (c) Proper use of fiscal reserves.

8. On agenda item (c), members agreed that the Administration should be invited to provide an information paper to set out the Government's policy relating to fiscal reserves including the possible uses of fiscal reserves, the formula for determining the appropriate level of reserves, and practices of overseas jurisdictions in maintaining their reserves. The Legislative Council (LegCo) Secretariat Research and Library Services Division should also conduct a research on the practices of overseas jurisdictions in maintaining their fiscal reserves.

9. Members further agreed that the Panel should hold another meeting in June or July 2001 to invite experts and academics in relevant fields to give their views on the subject of proper use of fiscal reserves.

III Progress in the study on Commercial Credit Reference Agency (LC Paper No. CB(1) 906/00-01(04))

10. The Deputy Chief Executive, HKMA (DCE/HKMA) briefed members on the information paper which reported on the latest progress of the proposed establishment of a commercial credit reference agency (CCRA). He said that the results of the public consultation conducted in 2000 indicated that there was broad support for the establishment of a CCRA in Hong Kong. HKMA had convened a Working Group (WG) to study the design features of the scheme and to address the concerns expressed in the consultation exercise. HKMA had also started to draft a suitable legal framework for the scheme for the WG's consideration. DCE/HKMA took note of Mr SIN Chung-kai's suggestion that the Administration should consider consulting the public on the design features and related legal issues in the form of a White Bill.

HKMA

11. Mr James TIEN conveyed the Liberal Party's support for the proposal. The establishment of a CCRA would promote transparency in the business sector, improve the accessibility of small and medium-sized enterprises (SMEs) to credit facilities, and reduce the reliance of banks on collateral in their lending. Mr TIEN further opined that the membership of the WG should be expanded to include representatives from the business sector and SMEs.

12. DCE/HKMA advised that the WG comprised representatives of the corporate and banking sectors, the Government and HKMA. Nonetheless, he shared Mr TIEN's view that the WG should consult the SMEs as they would be the data subjects of the scheme at its initial stage.

13. Mr James TO was opposed to the idea of mandatory participation in the scheme by authorized institutions (AIs). He stressed the importance of safeguarding the confidentiality of information reported to CCRA and of protecting the privacy rights of borrowers. He further suggested that the proposed legislation should incorporate secrecy provisions comparable to existing provisions of the Inland Revenue Ordinance (Cap. 112). Mr Albert HO supported Mr TO's view that borrowers' consent should be sought before the disclosure of any information.

14. DCE/HKMA pointed out that there was general support for a degree of compulsion on AIs to participate in CCRA to ensure the comprehensiveness of the database and a level playing field. There were also suggestions that AIs should disclose both negative (e.g. defaults of borrowers) and positive (e.g. total indebtedness and repayment records) credit data to CCRA. In order to

strike a balance between maintaining a comprehensive database and protecting the privacy rights of borrowers, the WG considered it sensible to compulsorily require AIs to disclose negative credit data to CCRA where free access to such data would be allowed, and to seek borrowers' consent for the disclosure of positive data. DCE/HKMA added that the WG would continue to study issues including the relevant credit data to be collected, the period over which the data should be kept, measures to restrict access to the data for purposes unrelated to credit assessment, and arrangements to safeguard the confidentiality of the information.

15. Regarding the ownership of CCRA, Mr Albert HO considered that CCRA should be privately owned to prevent the Government from gaining direct access to CCRA's database.

16. DCE/HKMA said that there were divergent views on the ownership of CCRA. Those who supported a publicly owned CCRA opined that this would enhance confidence in the scheme and the integrity of the database. While those who favoured a privately owned CCRA argued that this would prevent the Government from interfering with the market. There was also support for a privately owned CCRA which would be subject to regulation by a competent public authority. Accordingly, the WG had been studying the feasibility of establishing an exclusive licensing framework for CCRA. The WG would take into account the fact that there should be only one licensed CCRA due to the compact size of Hong Kong's market and the administrative burden on AIs to provide information to more than one agency.

17. Responding to Mr TIEN's concern that a single licensed CCRA might abuse its monopolistic position and charge high fees for its services, DCE/HKMA said that the WG noted the need to put in place an effective regulatory regime for CCRA to provide for ongoing supervision of the agency, to specify the agency's powers and duties to ensure its proper functioning, and to impose a tariffs control scheme to ensure that fees charged would be reasonable.

18. Ms Audrey EU asked whether CCRA, other than compiling credit data, would take on an investigative role to verify the accuracy of the data. DCE/HKMA advised that while some credit reference institutions operating in France and Germany also took on an investigative function to conduct credit checks and to provide credit assessment on borrowers, the proposed CCRA in Hong Kong would not have such an obligation. It was envisaged that CCRA would have a passive role initially and would collect information from two major sources, namely the public domain (such as financial information contained in the annual report of a company) and lending institutions. However, as there was an increasing emphasis to enhance risk management in the banking sector, and given the fact that there was a lack of credit ratings for SMEs in Hong Kong, this would be a possible area in which CCRA would develop in the future.

Progress of the proposed purchase of permanent accommodation
for the Hong Kong Monetary Authority

19. Miss Emily LAU, Mr Albert HO and Mr SIN Chung-kai expressed serious concern over the proposed acquisition of permanent accommodation for HKMA. They questioned the rationale for HKMA to purchase permanent accommodation rather than to lease its offices. They also queried HKMA for acquiring extra space of 140,000 sq. ft in the new premises. As regards the proposal to use the Exchange Fund (EF) to purchase the premises, the members were of the view that the acquisition was unrelated to the purpose of EF which was to maintain the stability of the Hong Kong dollar. The cost of the purchase should be charged to General Revenue and be subject to the approval of LegCo.

20. In response, DCE/HKMA said that financial analyses suggested that it would be more economical to purchase rather than to lease offices for HKMA in the long run. It was also the Government policy to house all major financial regulators in one strategic location. DCE/HKMA also explained that the extra space to be acquired would cater for the future needs of HKMA. Any space which was not used immediately would be let to suitable tenants at market rate. Thus, the purchase would represent a profitable investment of EF.

21. As regards the concern about the legality of charging the cost of purchase to EF, DCE/HKMA advised that the decision to purchase the new premises was made by the Financial Secretary (FS) who was the controller of EF and was responsible for the management and operation of the Fund under the Exchange Fund Ordinance (Cap. 66). Hence, no approval from LegCo would be required. DCE/HKMA also pointed out that as the transaction was still under negotiation, details of the purchase which were commercially sensitive could not be disclosed at this stage. CE/HKMA would brief members on details of the purchase when he attended the Panel meeting scheduled for 3 May 2001.

22. In view of the fact that an agreement on the acquisition would be made soon, members agreed to hold a special meeting on 20 April 2001 at 4:30 pm to discuss the matter. They agreed that FS and CE/HKMA would be invited to the meeting to brief members on the details of the purchase.

IV Proposed legislative amendments to the Companies Ordinance as recommended by the Standing Committee on Company Law Reform and others to streamline the existing requirements or facilitate electronic transactions

(LC Paper No. CB(1) 916/00-01(02))

23. The Principal Assistant Secretary (Companies) (PAS(C)) briefed members on the information paper which set out the proposed amendments to the Companies Ordinance (CO) (Cap. 32) as recommended by the Standing Committee on Company Law Reform (SCCLR) to clarify the duties of directors and enhance the rights of shareholders. The opportunity was also taken to implement a list of improvements to CO such as streamlining the existing requirements or facilitating electronic communication between a company and its shareholders.

24. Mr Albert HO pointed out that the Consultancy Report on the Review of the Hong Kong Companies Ordinance had been published quite some time ago in 1997, but only a few of the recommendations made by SCCLR were covered in the current legislative proposal. He therefore urged the Administration to accelerate the process in reforming CO. He was particularly concerned about introducing amendments to CO to strengthen the corporate governance regime in Hong Kong, so as to enhance the protection of the interests of minority shareholders. Mr HO also enquired about details of the proposed consultancy study on corporate governance in Hong Kong to be undertaken by the Administration in 2001.

25. PAS(C) said that SCCLR's recommendations, which were released in February 2000, covered a wide range of issues and varying degree of changes to CO. On the basis of these recommendations, the Administration had identified a total of 62 items for legislative amendments or for further study. These items had been divided into four phases for implementation. The Phase I items, which were included in the current legislative proposal, involved amendments to specific sections of CO. The Administration aimed at introducing these amendments into LegCo in the current session. The items covered under Phases II and III would require further study. Consultation would commence in mid-2001. Relevant legislative amendments would be introduced into LegCo in the 2002-03 session. Phase IV would involve an overhaul of CO.

26. Regarding the review of the corporate governance regime in Hong Kong, the Registrar of Companies (R of C) advised that the work was proceeding at two levels, namely the consideration of specific issues and the commissioning of various consultancy studies. With regard to the former, SCCLR had established three subcommittees in 2000. Each subcommittee would be reviewing specific areas, namely directors, shareholders and corporate reporting. The subcommittees were finalizing their recommendations. Public consultation would commence around mid-2001.

The outcome of the consultation would form the basis for drafting legislative amendments relating to the corporate governance reform, which would be introduced into LegCo in the 2002-03 session. R of C further said that the decision to undertake the overall review on corporate governance in Hong Kong had been only announced by FS in his Budget Speech in March 2001. SCCLR and the Administration had already taken prompt action to pursue this complex task.

27. As to the consultancy studies on corporate governance, R of C said that SCCLR would soon commission the local tertiary institutions to carry out two major surveys and three researches on topics relating to corporate governance. The surveys would cover research on corporate governance standards in other comparable jurisdictions, including the UK, the US, Singapore, Malaysia, Taiwan, and Australia, and the attitudes of institutional investors towards these standards. The three projects would cover specific topics, such as examining the relationship between a company with dominant shareholders and its economic performance, communications between a company and its shareholders, and the value of audit, nomination and remuneration committees in promoting corporate governance. The consultancy studies were estimated to cost about \$4 million and were expected to be completed in six months.

28. On the protection of minority shareholders' interests, Ms Audrey EU pointed out that under the Memorandum and Articles of Association of a private company, a director would have an absolute power to refuse registration of a new shareholder. Moreover, while directors and responsible persons of a company could access corporate information and records easily, minority shareholders often found it difficult to obtain such information. She asked whether there were any plans to introduce legislative amendments to address these problems.

29. In response, R of C said that access to company information by shareholders was among the topics to be covered in the consultancy study on corporate governance. On the question of exclusive rights enjoyed by the directors of a private company, Mr John BUSH, Secretary, Standing Committee on Company Law Reform, said that this was one of the fundamental rules of a private company. However, he shared Ms EU's view that SCCLR should look into the matter. R of C suggested that Ms EU could forward her views in writing to the Administration for SCCLR to consider.

30. While expressing support for the Administration to expedite reform on CO to enhance the corporate governance regime in Hong Kong, Mr Eric LI stressed that the reform should also aim at reducing compliance costs for business and enhancing the competitiveness of the Hong Kong market. Mr James TIEN concurred that, while there was a need to enhance the protection of minority shareholders' interests, the Government should avoid over-regulating the market as this would damage Hong Kong's competitiveness.

Regarding the legislative proposals on company law reform and corporate governance, Mr LI suggested that the Administration should consider introducing them into LegCo by separate bills within the same term so as to facilitate their scrutiny by members.

V Proposed New Investor Compensation Arrangements
(LC Paper No. CB(1) 784/00-01 and 916/00-01(03))

31. The Principal Assistant Secretary (Securities) (PAS(S)) briefed members on the proposed new investor compensation arrangements for the securities and futures market in Hong Kong. She highlighted the salient features of the proposed new arrangements as follows :

- (a) A per investor compensation limit of \$150,000 would be set initially to replace the existing per broker compensation limit. This compensation level was expected to provide full coverage of losses for about 80% of the claims based on historical record.
- (b) The coverage of the new compensation arrangements would be extended to exchange participants, non-exchange participants, and exempted dealers (i.e. AIs carrying out securities business).
- (c) An independent Investor Compensation Company (ICC), to be recognized and regulated by the Securities and Futures Commission (SFC), would be established to manage the new single compensation fund (the new Fund). ICC would determine the validity of any claims for compensation.
- (d) Funding for the new Fund would come from a transfer of assets from the two existing compensation funds, United Exchange Compensation Fund (UECF) and Commodity Exchange Compensation Fund (CECF) (after retaining an amount required to pay outstanding claims and refunding deposits to brokers), plus additional funds from an increase of 0.002 percentage point in the levy on securities transactions. The proposed increase would be implemented at the same time with the proposed reduction of stamp duty on securities transactions from 0.225% to 0.2%. The existing \$0.5 levy for each side of a futures contract would remain unchanged.

32. PAS(S) supplemented that since the publication of the consultation paper by SFC on 7 March 2001, views expressed by the industry and investors were generally supportive of the proposed new arrangements, as these would enhance confidence in the market and increase protection for investors.

33. In response to Mr SIN Chung-kai's enquiry about whether "automated trading services" (ATS) activity would be covered by the new Fund, Mr Mark DICKENS, Executive Director (Supervision of Markets), SFC, explained that the intention was to extend compensation coverage to all covered intermediaries in relation to products traded on the Hong Kong Exchanges and Clearing Limited (HKEx). Hence, the new Fund would cover HKEx products traded by a licensed intermediary or an ATS provider. To ensure a level playing field, this would mean that special funding arrangements would be required in relation to ATS trading that was not done through HKEx facility. In line with the existing arrangements, trading of offshore products through an ATS was not proposed to be covered by the new Fund initially. Moreover, ATS might develop new products for trading in Hong Kong that were not offshore products. If these products were to be available to retail investors, investor compensation coverage would be appropriate. This could be done by expanding the coverage of the new Fund or devising an entirely new arrangement. In either case, funding would need to be provided for.

34. In view of the fact that ICC would be tasked with many important duties, Mr Henry WU expressed concern as to whether the estimated annual recurrent cost of \$3.5 million would be adequate for its operation. He also enquired about the proposed structure of the company.

35. In response, PAS(S) said that details of ICC were given in paragraphs 52 to 56 of the consultation paper. Initially, ICC would only have a skeleton staff of six comprising a Manager, a Claims Supervisor, three Claims Handlers/Clerks, and a Secretary. It was envisaged that the estimated annual recurrent cost of \$3.5 million would be sufficient to cover the necessary staff cost and costs for the accommodation and equipment. If the workload exceeded the staff capacity, ICC might consider expanding its structure or outsourcing claims processing.

36. On the funding for the new Fund, Mr Henry WU said that it could be unfair to securities dealers as the levy on securities transactions would be raised while the levy for futures contract would remain unchanged.

37. In response, Mr DICKENS advised that SFC had conducted detailed analyses to assess the risks and funding requirement of the new Fund. A model had been formulated for such purposes and the details were given in chapter IV of the consultation paper. The table under paragraph 47 of the consultation paper also provided details of the transfer of assets from UECF (\$581.43 million) and CECF (\$74.37 million) to the new Fund. ICC would keep the levy rates under review. The levy rates on securities and futures transactions could be adjusted to address any possible imbalance of levy contributions from securities dealers and futures commodity traders, and serious cross-subsidization in compensation.

38. As to the target amount which the new Fund should accumulate, PAS(S) said that the existing compensation funds had accumulated about \$655.8 million. In order to provide reasonable protection to investors, SFC recommended that the new Fund should build up reserves to a level of \$1 billion. The time required for the new Fund to build up the reserves would be affected by possible intervening default cases and market performance which would affect levy income of the new Fund. As announced by FS in March 2001, the proposed increase of 0.002 percentage point to the levy on securities transactions would last until such time as the new Fund had accumulated \$1 billion.

39. Mr Eric LI expressed strong reservation over providing compensation for investors, as this might promote imprudent and risky investments. The problem of moral hazard was inherent to any compensation arrangements. He was particularly concerned about the liability of the new Fund and whether there would be any insolvency arrangements for winding-up the Fund. The Chairman shared the same concern. Mr LI also pointed out that if the new Fund were to assume an unlimited liability, in the event of disastrous broker defaults and the new Fund were unable to compensate the losses, the Government would be forced to inject money to the new Fund or to provide a guarantee for it to obtain loans in the market. Overseas experience had demonstrated that public money had to be used to bail out insolvent compensation funds. Mr LI stressed that a mechanism should be put in place for LegCo to approve any funding request for the new Fund or to provide any guarantees.

40. Responding to the concern about moral hazard, PAS(S) explained that in formulating the present proposal, reference had been made to compensation schemes in overseas jurisdictions. While it was recognized that a compensation scheme was preventive in nature, it could not replace an effective regulatory regime. As such, the Administration had introduced the Securities and Futures Bill with a view to enhancing regulation over the securities and futures market in Hong Kong.

41. On the question of liability of ICC, Mr DICKENS said that theoretically the new Fund would have unlimited liability. Nonetheless, the liability would be moral rather than legal in nature. In an extreme scenario where there were catastrophic losses, and the new Fund were unable to pay the resultant compensation, it would be forced to go bankrupt. This would pose a serious systemic risk in the market. ICC would have no other choice but to raise the levy rates drastically. This would have a serious adverse impact on the market and intermediaries.

42. As regards funding for ICC, Mr DICKENS said that the model generated by SFC to simulate the condition of ICC over a ten-year period showed that under the scenario of catastrophic losses, there would be a need for contingency funding and additional compensation levy on transactions. SFC

was confident that ICC would be able to pay off the loan and interest after a few years. It was envisaged that an increase in the transaction levy would not have significant impact on the market. Analyses indicated that the proposed compensation levy at 0.002% for securities transactions only represented 0.53% of the overall transaction cost. When the levy was raised to 0.01%, it would represent 2.5% of the overall transaction cost.

43. On the approval for additional funding for the new Fund, Mr DICKENS said that ICC would need to seek approval of LegCo on government funding for this purpose. Rules on the levy rates for transactions were subsidiary legislation subject to negative vetting by LegCo.

VI Any other business

44. There being no other business, the meeting ended at 1:05 pm.