

For discussion on  
24 October 2002

Paper No. 36/02

**Subcommittee on Draft Subsidiary Legislation to be made  
under the Securities and Futures Ordinance**

**Securities and Futures (Investor Compensation – Claims) Rules**

Members considered the draft Securities and Futures (Investor Compensation – Claims) Rules at the Subcommittee meeting on 7 June 2002. In the light of the comments made by some Members and other necessary changes to better reflect policy intention and improve drafting, we submit at **Annex** the **revised draft** of the Rules, with the proposed amendments marked up for easy reference. The reasons for the amendments are explained in the footnotes.

Securities and Futures Commission  
Financial Services and the Treasury Bureau  
17 October 2002

[cf: Section 244(2) of the Securities and Futures Ordinance]

**SECURITIES AND FUTURES (INVESTOR COMPENSATION - CLAIMS) RULES**

~~(5 OF 2002, SECTION 244(2))~~

~~ARRANGEMENT OF SECTIONS~~

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## SECURITIES AND FUTURES (INVESTOR COMPENSATION - CLAIMS) RULES<sup>1</sup>

(Made ~~by the Securities and Futures Commission~~ under  
section 244(2) of the Securities and Futures Ordinance  
(~~5 of 2002Cap. 571~~))<sup>2</sup>

### PART ~~I~~1

#### PRELIMINARY

##### 1. <sup>3</sup>Commencement

These Rules shall come into operation on the day ~~on which~~  
~~Part XII of appointed for the commencement of the Securities and~~  
Futures Ordinance (~~5 of 2002Cap. 571~~) ~~comes into operation.~~

##### 2. Interpretation

In these ~~Rules~~, unless the context otherwise requires -  
"appointed day" (指定日期) means the date appointed under section 13;  
"associated person" (相聯者), in relation to a specified person,  
means -

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<sup>1</sup> Subsequent to the Subcommittee meeting on 7 June 2002, the SFC has consulted the Shareholders' Group at its meeting on 19 July 2002 on the draft Rules and the new investor compensation scheme. Members sought clarification on a number of issues relating to the new scheme, such as those relating to the collection of levies, the maximum limit of compensation, the set up of the independent investor compensation company, etc. The SFC explained its policy and provided clarifications on the issues at the meeting. Members did not raise further comments on the draft Rules.

<sup>2</sup> Minor drafting amendment.

<sup>3</sup> Drafting amendment to reflect the policy intention to commence concurrently these Rules and the Securities and Futures Ordinance as a whole.

- (a) a person employed or otherwise engaged by the specified person; ~~or~~<sup>4</sup>
- (b) a person who may receive or hold client assets of the specified person under section 164 of the Ordinance<sup>5</sup>; or
- (c) an employee of the person referred to in paragraph (b);

"claimant" (申索人) means a qualifying client who makes a claim under section 4;

"default" (違責) in relation to a specified person or an associated person of the specified person, means -

- (a) the insolvency, bankruptcy or winding up of the specified person or associated person of the specified person<sup>6</sup>; or

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<sup>4</sup> Minor drafting amendment.

<sup>5</sup> At the meeting of 7 June 2002, a Member asked whether clients of a licensed corporation could be compensated for the defaults by the clearing agent of the licensed corporation. The SFC has further considered the matter and come to the following views:

Clause 4 of the draft Rules allows a claim to be made where a qualifying client of a specified person sustains loss as a result of a default committed by the specified person or an associated person of the specified person. Under clause 2, "associated person" is defined to include (a) any person employed or otherwise engaged by a specified person; and (b) any person who may under section 164 of the Securities and Futures Ordinance receive or hold client assets of a specified person. While the exact compensation arrangements would have to depend on the circumstances in each case, in all likelihood, claims made by qualifying clients of a specified person against defaults by the clearing agent of the specified person are within the coverage of the draft Rules. By way of illustration,

- (a) In cases where a specified person does not handle client securities or funds and only introduces clients to its clearing agent, and the clients and the clearing agent have client agreements, then the clearing agent falls within the meaning of "specified person" and thus the clients would have a claim if the clearing agent defaults.
- (b) In cases where a specified person receives from its clients their securities or funds and places them with its clearing agent, then the clearing agent falls within the meaning of "associated person" of a "specified person" and thus, the clients would have a claim if the clearing agent defaults.

<sup>6</sup> Amendment made to reflect the policy intention to cover also the insolvency, bankruptcy or winding up of the associated person of the specified person, as is the case in respect of breach of trust, defalcation, fraud or misfeasance under paragraph (b).

- (b) any breach of trust, defalcation, fraud or misfeasance committed by the specified person or associated person of the specified person,

which occurs on or after the appointed day;

"qualifying client" (合資格客戶) in relation to a specified person,

means a person for whom the specified person provides a service but does not include -

- (a) a licensed corporation;
- (b) an authorized financial institution;
- (c) a recognized exchange company, a recognized exchange controller, or a recognized clearing house;
- (d) a person authorized to provide automated trading services under section 95-(2) of the Ordinance
- (e) an insurer authorized under section 8 of the Insurance Companies Ordinance (Cap. 41);
- (f) a manager or operator of a collective investment scheme authorized under section 104(1) of the Ordinance;
- (g) a manager or operator of an arrangement referred to in paragraph (iii) of the definition of "collective investment scheme" in Part 1 of Schedule 1 to the Ordinance;
- (h) a person who is authorized, licensed or exempt by a competent authority in a jurisdiction outside Hong Kong for any activity that in the opinion of the Commission is the same as or similar to any of the activities carried on by a person referred to in paragraphs (a) to (g);

- (i) an associate of the specified person -
  - (i) which is a corporation; or
  - (ii) who has committed ~~a default~~ any breach of trust, defalcation, fraud or misfeasance<sup>7</sup> or assisted in the commission of a default by the specified person or any other associated person<sup>8</sup> of the specified person;
- (j) the Government or a government of any place outside Hong Kong; and
- (k) a person in his capacity as a trustee or custodian of a person, scheme or arrangement referred to in paragraphs (a) to (j);

"related assets" (有連繫資產) means money and other property<sup>9</sup> -

- (a) which is entrusted to or received by a specified person or an associated person of the specified person;
- (b) to which a claimant is entitled or in which he has a beneficial interest; and
- (c) which relates to the -
  - (i) purchase;

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<sup>7</sup> The definition of "default" does not extend to the associate of a specified person and, accordingly, the elements of what constitute a "default" in the case of an "associate" must be spelt out.

<sup>8</sup> Amendment made to correct an inadvertent omission, so to reflect the policy intention.

<sup>9</sup> The LegCo Legal Adviser expressed concern at the Subcommittee meeting on 7 June 2002 that the definition of "related assets" was unclear as to whether dividends or interests entitled by a claimant would be included. The term "related assets" would cover dividends and interest which have been received by the specified person at the date of default. We believe the "property" as referred to in the provision and defined in section 1 of Part 1 of Schedule 1 to the primary Ordinance is quite broad and sufficiently reflects the policy intention.

- (ii) sale;
- (iii) holding;
- (iv) pledge;
- (v) adjustment;
- (vi) exercise; or
- (vii) expiry,

of specified securities or futures contracts;

"securities margin financing" (證券保證金融資) has the same meaning as in Part 2 of Schedule 5 to the Ordinance except that paragraph (v) of the definition of that expression does not apply;

"specified person" (指明人士) means -

- (a) an intermediary licensed or registered for dealing in securities or dealing in futures contracts;
- (b) an intermediary licensed for securities margin financing; or
- (c) an authorized financial institution which provides securities margin financing;

"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 recognized stock market or recognized futures market\_

- (a) which are entrusted to or received by a specified person or an associated person of the specified person; and

(b) to which a claimant is entitled or in which he has a beneficial interest<sup>10</sup>;

“Tribunal” (審裁處) means the Securities and Futures Appeals Tribunal established by section 216 of the Ordinance.

## **PART ~~II~~2**

### **CLAIMS FOR COMPENSATION**

#### **3. Notice inviting claims**

(1) Where the Commission has reason to believe that a specified person or any associated person of the specified person has committed a default, it may publish a notice inviting ~~any~~<sup>11</sup> qualifying client of the specified person named in the notice who believes he has sustained loss as a result of such default to claim for compensation. Such a notice shall be published in one or more English language newspapers and one or more Chinese language newspapers which are published daily and circulating generally in Hong Kong.

(2) A notice published under subsection (1) shall specify a date, not being earlier than 3 months after publication of the notice, on or before which a claim for compensation may be made under section 4.

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<sup>10</sup> Amendment made to tighten the definition, so to make more express the policy intention. The two newly added qualifications are similar to those in the definition of “related assets”.

<sup>11</sup> Minor drafting amendment.

**4. Making a claim for compensation**

(1) Where ~~any~~<sup>12</sup> qualifying client of a specified person sustains a loss -

(a) as a result of a default committed on or after the appointed day by -

(i) the specified person; or

(ii) an associated person of the specified person;

(b) in relation to -

(i) specified securities or futures contracts; or

(ii) related assets,

the qualifying client may claim compensation from the compensation fund in respect of such loss.

(2) A claim under subsection (1) may include a claim for the costs reasonably incurred in and incidental to the making and proving of the claim.

(3) A claim under subsection (1) shall be lodged with the Commission -

(a) if a notice under section 3(1) has been published, on or before the date specified in the notice; or

(b) if no such notice has been published, within 6 months after the day the claimant first became aware of the default giving rise to the claim.

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<sup>12</sup> Minor drafting amendment.

(4) A claim which is not lodged within the time limit provided in subsection (3) is barred, unless the Commission determines otherwise.

**5. Submission of claims**

(1) Subject to subsection (2), a claim under section 4(1) shall be -

- (a) lodged in the form specified by the Commission under section 402(1) of the Ordinance for the purposes of this section;
- (b) completed and signed in accordance with such directions and instructions as are included in the form; and
- (c) accompanied by such documents as are specified in the form.

(2) The Commission may accept a claim lodged otherwise than in accordance with subsection (1).

**PART ~~III~~3**

**PROCESSING OF CLAIMS**

**6. Commission may require records**

(1) The Commission may, by notice in writing served upon a person,<sup>13</sup> require the person to produce to the Commission originals or copies of such records as the Commission may reasonably require -

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<sup>13</sup> Minor drafting amendment.

- (a) in connection with a claim for compensation made under section 4(1); or
- (b) for the purpose of assisting -
  - (i) the Commission in the exercise of its rights of subrogation under section 243 of the Ordinance; or
  - (ii) a recognized investor compensation company in the exercise of its rights of subrogation under section 87 of the Ordinance.

(2) A notice under subsection (1) shall specify the records required and the date by which the person served with the notice is to furnish them to the Commission.

#### **7. Determination of loss**

- (1) The Commission shall, in relation to ~~each~~<sup>14</sup> claim for compensation, determine -
- (a) whether there has been a default by a specified person or any associated person of the specified person;
  - (b) the date of such default (if any); and
  - (c) the amount of the loss (if any) that the claimant has sustained in relation to specified securities or futures contracts or related assets, as a result of any such default, in accordance with subsection (2).

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<sup>14</sup> Minor drafting amendment.

(2) The amount of loss referred to in subsection (1)(c) shall be the loss that the Commission is satisfied the claimant has sustained having regard to -

(a) the market value<sup>15</sup>, as at the date of the default, of the specified securities or futures contracts and of any related assets less -

(i) any amount that the Commission is satisfied was due from the claimant to the specified person; and

(ii) any specified securities, futures contracts or related assets that have been returned to the claimant after the date of the<sup>16</sup> default; and

(b) any costs that the Commission is satisfied were reasonably incurred by the claimant incidental to the making and proving of his claim for compensation under section 4 .

## 8. Notice of determination

(1) ~~where Subject to subsection (2), where~~<sup>17</sup> the Commission makes a determination under section 7, it shall issue a notice of determination to the claimant as soon as practicable thereafter.

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<sup>15</sup> At the meeting on 7 June 2002, the LegCo Legal Adviser asked how "client money" held in the specified person's account should be valued under clause 7, in particular, whether interest on client money held by a specified person would be counted. The policy is that client money held by a specified person will be valued at face value. The market value of \$1,000 deposited in a term deposit will be \$1,000 plus any interest accrued as at the date of the default but not interest accrued after that date. As the loss is determined having regard to values at the date of default, no allowance will be made for loss of interest which may have been earned on money lost due to the default, after the date of default.

<sup>16</sup> Minor drafting amendment.

<sup>17</sup> Amendments made in response to the comment of some Members expressed at the meeting on 7 June 2002, to provide the claimant a reasonable opportunity of being heard if the SFC is minded to reject his claim in whole or in part.

(2) ~~<sup>17</sup>where the Commission determines to disallow a claim in whole or in part, it shall give its reasons in the notice of determination.~~ The Commission shall not disallow a claim in whole or in part unless it has given the claimant a reasonable opportunity of being heard and, where the Commission decides to disallow the claim in whole or in part, it shall give its reasons in the notice of determination.

(3) ~~<sup>18</sup>If~~ Where the Commission determines that compensation should be paid to a claimant, it shall specify the following in the notice of determination -

- (a) the name of the person found to be in default<sup>19</sup>;
- (b) the date of the default;
- (~~bc~~) the amount of the loss sustained by the claimant as determined under section 7;
- (~~ed~~) any relevant specified securities or futures contracts or related assets; and
- (~~de~~) the amount of compensation payable under these Rules.

## **9. Payment of compensation**

(1) Subject to subsection (2) and section 11, the following amounts shall be paid out of the compensation fund -

- (a) any compensation payable to a claimant as specified in the notice of determination under section 8(3)(d);

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<sup>18</sup> Minor drafting amendment.

<sup>19</sup> Amendment made to ensure that all key elements in any determination appear in the notice of determination.

(b) any compensation payable following a decision of the Tribunal or the Court of Appeal, under Part XI of the Ordinance; and

(c) any costs awarded in favour of a claimant by the Tribunal, or the Court of Appeal, following a decision referred to in paragraph (b).

(2) The total amount of compensation payable to a claimant under subsection (1)(a) and (b) shall not exceed the maximum amount prescribed by the Securities and Futures (Investor Compensation - Compensation Limits) Rules (L.N. of<sup>20</sup> 2002).

(3) In determining the total amount of compensation to be paid to a claimant under subsection (1)(a) and (b), and in applying the limits prescribed in section 3(1) and (2) of the Securities and Futures (Investor Compensation - Compensation Limits) Rules (L.N. of 2002), the Commission may aggregate separate claims for compensation by a claimant, or a number of claimants, or parts of those claims, if it is satisfied that the separate claims, or parts of those claims, represent the losses sustained by one person arising out of the same default.

(4) The Commission may pay the compensation by instalments if it determines that it is necessary or appropriate to do so.

**PART IV~~4~~**

**MISCELLANEOUS**

**10. Financial arrangements**

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<sup>20</sup> Minor drafting amendment.

The Commission may arrange for such insurance, surety, guarantee or other financial arrangements as it considers appropriate to facilitate the administration of the compensation fund.

**11. Provision where the money available to the compensation fund is insufficient to meet claims**

(1) If, at any time, the Commission determines that the amount of money available to the compensation fund is insufficient to pay the total amount of compensation then payable to the claimants, or likely to become so payable -

(a) under these Rules; and

(b) in the circumstances referred to in section 9(1)(b),

the amount available to the compensation fund is to be apportioned among the claimants in such manner as the Commission may determine.

(2) In the event that any amounts referred to in section 9(1) remain unpaid because the Commission has determined that an apportionment shall be made under subsection (1), the amount are to be paid when there is sufficient money available to the compensation fund.

**12. Discharge of claims**

Upon payment of the full amount determined to be payable to a claimant under these Rules ~~has been paid~~<sup>21</sup>, the rights of the

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<sup>21</sup> Minor drafting amendment.

claimant against the compensation fund in relation to that claim and the default<sup>22</sup> are absolutely discharged.

**13. Appointed day**

The Commission may by notice published in the Gazette appoint a date as the appointed day for the purposes of these rules.

Chairman,  
Securities and Futures Commission

2002

**Explanatory Note**

These Rules are made by the Securities and Futures Commission ("the Commission")<sup>23</sup> under section 244(2) of the Securities and Futures Ordinance (~~5 of 2002~~)Cap. 571 ("the Ordinance")<sup>24</sup>. They prescribe the persons who may make a claim for compensation from the ~~Investor~~ Investor ~~Compensation Fund~~ established under section 236 of the Ordinance. They also prescribe the manner in which such a claim is to be made and how such a claim will be assessed and paid.

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<sup>22</sup> Technical amendment made to reflect the right of the claimant in respect of the default, which is consistent with section 120(2) of the Securities Ordinance.

<sup>23</sup> Minor drafting amendment.

<sup>24</sup> Minor drafting amendment.

2. These Rules should be read in the light of the Securities and Futures (Transfer of Functions - Investor Compensation Company) Order (L.N. of 2002) which transfers certain functions of the Commission to a recognized investor compensation company.