

立法會
Legislative Council

LC Paper No. CB(1)1076/04-05
(These minutes have been seen
by the Administration)

Ref : CB1/BC/3/04

Bills Committee on Companies (Amendment) Bill 2004

**Minutes of the fifth meeting held on
Thursday, 24 February 2005, at 8:30 am
in the Chamber of the Legislative Council Building**

- Members present** : Hon Audrey EU Yuet-mee, SC, JP (Chairman)
Hon Albert HO Chun-yan
Hon CHAN Kam-lam, JP
Hon Miriam LAU Kin-ye, GBS, JP
Hon Abraham SHEK Lai-him, JP
Hon WONG Ting-kwong, BBS
Hon Ronny TONG Ka-wah, SC
Hon TAM Heung-man
- Members absent** : Dr Hon LUI Ming-wah, JP
Hon SIN Chung-kai, JP
Hon CHIM Pui-chung
- Public officers attending** : Miss Emma LAU
Deputy Secretary for Financial Services and the Treasury
(Financial Services)
- Mr Alan LO
Principal Assistant Secretary for Financial Services and
the Treasury (Financial Services)
- Mr Jackie LIU
Assistant Secretary for Financial Services and the Treasury
(Financial Services)

Mr K F CHENG
Senior Assistant Law Draftsman
Department of Justice

Attendance by invitation : The Hong Kong Mortgage Corporation Limited

Mr James LAU
Chief Executive Officer

Mr Philip LI
Senior Vice President (Finance)

Ms Susie CHEUNG
General Counsel and Company Secretary

Ms Kathleen YEUNG
Vice President (Financial Control)

Hong Kong Capital Markets Association

Mr Brian YIU
Chairman

Mr Nicholas WONG
Executive Committee Member

Hong Kong Institute of Certified Public Accountants

Mr Roger BEST
Immediate Past President

Hong Kong University of Science and Technology

Professor Kalok CHAN
Head and Professor of Department of Finance

The Chinese University of Hong Kong

Professor Raymond SO
Associate Professor of Finance

Clerk in attendance : Miss Salumi CHAN
Chief Council Secretary (1)5

Staff in attendance : Miss Mona LAI
Assistant Legal Adviser 7

Ms Connie SZETO
Senior Council Secretary (1)4

I. Confirmation of minutes of meeting

(LC Paper No. CB(1)939/04-05 — Minutes of fourth meeting held on 3 February 2005)

The minutes of the meeting held on 3 February 2005 were confirmed.

II. Meeting with deputations, academics and the Administration

(LC Paper No. CB(1)668/04-05(01) — Submission dated 22 December 2004 from The Hong Kong Mortgage Corporation Limited

LC Paper No. CB(1)668/04-05(03) — Paper provided by the Administration (including Annex A — Administration's response to the submission dated 22 December 2004 from The Hong Kong Mortgage Corporation Limited)

LC Paper No. CB(1)692/04-05(01) — Submission dated 10 January 2005 from The Hong Kong Mortgage Corporation Limited

LC Paper No. CB(1)692/04-05(03) — Hong Kong Mortgage Corporation Limited's letter dated 11 January 2005 commenting on the paper provided by the Administration (LC Paper No. CB(1)668/04-05(03))

- LC Paper No. CB(1)647/04-05(01) — Submission dated 31 December 2004 from the Hong Kong Capital Markets Association
- LC Paper No. CB(1)681/04-05(01) — Administration's response to the submission from the Hong Kong Capital Markets Association
- LC Paper No. CB(1)709/04-05(01) — Submission dated 12 January 2005 from the Hong Kong Institute of Certified Public Accountants
- LC Paper No. CB(1)938/04-05(01) — Submission dated 14 February 2005 from Professor Kalok CHAN, Head and Professor of Department of Finance, Hong Kong University of Science and Technology
- LC Paper No. CB(1)938/04-05(02) — Submission dated 14 February 2005 from Professor Raymond SO, Associate Professor, Director, M. Sc. Programme in Finance, The Chinese University of Hong Kong
- LC Paper No. CB(1)938/04-05(03) — Letter dated 1 February 2005 from The Asian Securitization Network
- LC Paper No. CB(1)938/04-05(04) — Submission dated 2 February 2005 from Dr Bao Ben-Hsien & Mr Yuen Kam-Por for and on behalf of Professor Ferdinand Akthar Gul, Head and Chair Professor of Accounting and Corporate Governance, School of Accounting and Finance, The Hong Kong Polytechnic University

- LC Paper No. CB(1)938/04-05(05) — Submission dated 15 February 2005 from ACI – The Financial Markets Association of Hong Kong
- LC Paper No. CB(1)938/04-05(06) — Joint submission dated 17 February 2005 from Dr Maurice K S TSE, Associate Dean, School of Economics & Finance, and Dr Frederik Pretorius, Associate Professor, Department of Real Estate and Construction, The University of Hong Kong
- LC Paper No. CB(1)938/04-05(07) — Submission dated 16 February 2005 from Heller Ehrman White & McAuliffe LLP
- LC Paper No. CB(1)938/04-05(08) — Submission dated 18 February 2005 from Ms Ann Rutledge, a partner of R & R Consulting
- LC Paper No. CB(1)938/04-05(09) — Paper provided by the Administration on “Impact of the Bill on the asset-securitization market in Hong Kong”)

2. The Bills Committee deliberated (Index of proceedings attached at **Appendix**).

(Post-meeting note: The power-point presentation material on group accounts provided by the Administration was issued to members vide LC Paper No. CB(1)988/04-05(01) on 24 February 2005.)

Follow-up actions

3. Members noted the concern of the asset-securitization industry and some academics that the proposed “control-based” definition of “subsidiary” for the purpose of group accounts would have an adverse impact on the development of the asset-securitization market in Hong Kong, and the industry’s suggestion that a carve-out from the Bill be provided for securitization special purpose entities (SPEs). Members also noted that the Administration and the Hong Kong Institute of Certified Public Accountants considered it inappropriate to provide the proposed carve-out as it

would lead to inconsistent approach in the preparation of group accounts thereby derogating from the purpose of the Bill.

4. To facilitate the Bills Committee's consideration of the issue, members invited the Hong Kong Mortgage Corporation Limited (HKMCL), Hong Kong Capital Markets Association (HKCMA), Professor Kalok CHAN and Professor Raymond SO to elaborate their views further in writing, particularly on the following points:

- (a) the type(s) of "control" that a transferor (or originator) needed to exercise over its securitization SPE, including a situation where the SPE was set up under the "auto-pilot" mechanism; and
- (b) other possible alternatives to address the issue, e.g. whether a mechanism could be devised in such a way that securitization SPEs would not fall within the proposed definition of "subsidiary" and hence would not be subject to consolidation in companies' group accounts.

Admin

5. Members also invited the Administration to consider the views and concerns about the impact of the Bill on the development of the asset-securitization market in Hong Kong raised by the industry and academics at the meeting, and to respond to further submissions from them on the subject.

III. Any other business

6. There being no other business, the meeting ended at 10:35 am.

Council Business Division 1
Legislative Council Secretariat
11 March 2005

**Proceedings of the fifth meeting of the
Bills Committee on Companies (Amendment) Bill 2004
on Thursday, 24 February 2005, at 8:30 am
in the Chamber of the Legislative Council Building**

Time marker	Speaker	Subject(s)	Action Required
000000-000339	Chairman	(a) Confirmation of minutes of meeting on 3 February 2005 (b) Welcoming and introductory remarks	
000340-001113	The Hong Kong Mortgage Corporation Limited (HKMCL)	<u>Presentation of views</u> (LC Paper Nos. CB(1)668/04-05(01), CB(1)692/04-05(01) and (03)) (a) Concern about the negative impact of the Bill on the development of the asset-securitization market in Hong Kong (b) Consolidation of the assets and liabilities of special purpose entities (SPEs) would distort the key financial ratios of the consolidating entities, such as affecting the capital adequacy ratio and other ratios of the company (c) Support for providing a carve-out for securitization SPEs from the Bill, similar to the treatment of Qualified SPEs under the United States (US) accounting rules	

Time marker	Speaker	Subject(s)	Action Required
		<p>(d) While there had been much discussion of the trend to converge with the International Accounting Standards (IAS), nothing was imminent in the US in this area</p>	
001114-001530	Hong Kong Capital Markets Association (HKCMA)	<p><u>Presentation of views</u> (LC Paper No. CB(1)647/04-05(01))</p> <p>(a) Concern about the negative impact of the Bill on the development of the asset-securitization market in Hong Kong</p> <p>(b) Support for providing a carve-out for securitization SPEs as suggested by HKMCL</p>	
001531-002431	Hong Kong Institute of Certified Public Accountants (HKICPA)	<p><u>Presentation of views</u> (LC Paper No. CB(1)709/04-05(01))</p> <p>(a) It was appropriate to use the “control-based” definition of subsidiary to determine the true relationship between entities</p> <p>(b) The primary objective of the Bill was to require companies incorporated under the Companies Ordinance (CO) (Cap. 32) to use the “control-based” definition of subsidiary when preparing their consolidated financial statements with the purpose of enhancing the quality of financial reporting in Hong Kong</p>	

Time marker	Speaker	Subject(s)	Action Required
		<p>(c) The Bill would not have an effect on securitization where the originator of the receivables had made a “clean sale” of its receivables to a party over which it had no control</p> <p>(d) The concern about consolidation of SPEs affecting the capital adequacy ratio and other ratios of a company was a matter relating to financial regulation rather than financial reporting of companies</p> <p>(e) It was inappropriate to provide a carve-out for the securitization SPEs from the Bill as this would fail to give a true and fair view of the financial statements of companies and would hinder the comparability of financial statements</p> <p>(f) Notwithstanding that the IAS Board (IASB) was undertaking a review on the concept of control concerning accounting standard on consolidation, it had no intention to change the definition of control</p>	
002432-003048	Professor Kalok CHAN	<p><u>Presentation of views</u> (LC Paper No. CB(1)938/04-05(01))</p> <p>(a) Under a “true sale” situation, the assets of a securitization SPE were beyond the reach of the originator/transferor even</p>	

Time marker	Speaker	Subject(s)	Action Required
		<p>though the originator/transferor retained servicing and residual interests in the assets (Appendix I to the submission)</p> <p>(b) It was a fundamental weakness of the IASB's approach if assets and liabilities of the securitization SPE were recognized fully on the balance sheet of the originator, as this failed to recognize that substantial risks and rewards had already been transferred from the originator to the SPE with limited resource</p> <p>(c) The Bill was likely to have an adverse impact on the development of the asset-securitization market in Hong Kong</p> <p>(d) It was important for Hong Kong to converge with IAS in order to maintain the position as an international financial centre</p> <p>(e) Any proposed legislative amendments concerning accounting standards should take into consideration possible changes in the concept of control for securitization structure made by IASB in future</p>	
003049-003453	Professor Raymond SO	<p><u>Presentation of views</u> (LC Paper No. CB(1)938/04-05(02))</p> <p>(a) Any changes in the definition of</p>	

Time marker	Speaker	Subject(s)	Action Required
		<p>subsidiary should not impair Hong Kong's status as an international financial centre</p> <p>(b) There were variations in adopting IAS on SPE consolidation in various markets. Hong Kong should consider these variations and should not adopt IAS instantly</p> <p>(c) If off-balance sheet activities of SPEs had to be consolidated, then the revised definition of subsidiary should lay down clearly which kinds of off-balance sheet activities were to be consolidated</p>	
003454-010213	Chairman Administration	<p><u>Administration's responses to submissions</u> (LC Paper Nos. CB(1)668/04-05(03), CB(1)681/04-05(01), CB(1)938/04-05(09), CB(1)988/04-05(01))</p> <p>Administration's responses to various submissions, as follows -</p> <p>(a) The Bill would require consolidation of assets and liabilities of a SPE under a controlled-SPE situation. No such consolidation would be required under a "clean sale" situation (i.e. a genuine sale situation where the parent company did not retain any control over the SPE)</p>	

Time marker	Speaker	Subject(s)	Action Required
		<p>(b) The Bill was to introduce a “dominant influence test” to catch controlled-SPEs belonging to the group</p> <p>(c) The Bill would not have negative impact on the development of the asset-securitization market in Hong Kong</p> <p>(d) A carve-out from the Bill for the asset-securitization industry would lead to inconsistent approach in the preparation of group accounts thereby derogating from the purpose of the Bill</p> <p>(e) The Bill in the present form had received favourable support from various sectors/bodies including HKICPA, the Securities and Futures Commission, the Stock Exchange of Hong Kong Limited, the Standing Committee on Company Law Reform, the Association of International Accountants, and the Hong Kong Institute of Company Secretaries</p> <p><u>Information on international comparison on provisions and accounting standards in relation to group accounts</u> (Annex to LC Paper No CB(1)938/04-05(09))</p> <p>Administration’s briefing on the</p>	

Time marker	Speaker	Subject(s)	Action Required
010214-011012	Chairman Mr Albert HO	<p>information</p> <p>(a) Whether it was appropriate to provide a carve-out from the Bill for the asset-securitization industry</p> <p>(b) Possible measures to address the concern of the asset-securitization industry about the negative impact of the Bill on the development of the asset-securitization market in Hong Kong</p> <p>(c) Impacts of the Bill on small investors</p>	
011013-011608	HKMCL	<p>(a) The Bill would prevent off-balance sheet treatment for securitization SPEs which was an important incentive for securitization business</p> <p>(b) Securitization bonds had offered an alternative investment channel for small investors</p>	
011609-011740	Professor Kalok CHAN	<p>(a) It might not be appropriate to provide a carve-out from the Bill for the asset-securitization industry</p> <p>(b) A carve-out for securitization SPEs from the Bill, if provided, should only be an interim measure. The IASB should consider relaxing the control definition for the securitization structure in the long run</p>	

Time marker	Speaker	Subject(s)	Action Required
011741-012025	Professor Raymond SO	<p>(a) Financial reporting by financial institutions was different from that by companies</p> <p>(b) The Bill would have important impact on the development of the asset-securitization market in Hong Kong</p> <p>(c) Small investors would pay attention to key balance sheet items of companies, such as capital adequacy ratio</p>	
012026-012336	HKICPA	<p>(a) It was a policy matter as to whether a carve-out should be provided for securitization SPEs</p> <p>(b) Such a carve-out would give rise to inconsistency in the preparation of group accounts</p>	
012337-013510	Administration	<p>(a) The Bill would enhance the quality of financial reporting of companies and thus produce genuine benefits for investors</p> <p>(b) It was inappropriate to provide a carve-out for securitization SPEs from the Bill</p>	
013511-014003	Mr Albert HO HKMCL HKCMA	Whether it was appropriate to withhold the Bill in view of IASB's review of IAS 27	
014004-014420	Mr Ronny TONG HKICPA	Impact of the Bill on a "true sale" situation of receivables to a SPE	

Time marker	Speaker	Subject(s)	Action Required
014421-020529	<p>Mr Ronny TONG HKICPA HKMCL Chairman Assistant Legal Adviser 7 (ALA7)</p>	<p>(a) ALA7's view that:</p> <p>(i) the definition of "control" proposed under the Bill was different from that under the Hong Kong Accounting Standard (Annex to LC Paper No. CB(1)938/04-05(09));</p> <p>(ii) the definition of "dominant influence" under the UK Companies Act 1985 was wider than that under the Bill. In addition to the provision of the right to exercise a dominant influence over a subsidiary undertaking under section 2(1)(c) of the 23rd schedule to the Bill, section 258(4) of the UK Companies Act 1985 provided that an undertaking was also a parent undertaking in relation to a subsidiary undertaking if it had a participating interest in the subsidiary undertaking and it actually exercised a dominant influence over it; or it and the subsidiary undertaking were managed on a unified basis (Annex to LC Paper No. CB(1)938/04-05(09)); and</p> <p>(iii) as pointed out in the</p>	

Time marker	Speaker	Subject(s)	Action Required
		<p>Administration's response to the submission of Linklaters, "control contracts" might not appear to be very common in Hong Kong (LC Paper No. CB(1)681/04-05(02))</p> <p>(b) Invitation of HKMCL, HKCMA, Professor CHAN and Professor SO to elaborate their views further in writing, particularly on the following points:</p> <p>(i) the type(s) of "control" that a transferor (or originator) needed to exercise over its securitization SPE, including a situation where the SPE was set up under the "auto-pilot" mechanism; and</p> <p>(ii) other possible alternatives to address the issue, e.g. whether a mechanism could be devised in such a way that securitization SPEs would not fall within the proposed definition of "subsidiary" and hence would not be subject to consolidation in companies' group accounts</p> <p>(c) Request for the Administration:</p> <p>(i) to consider the views and concerns expressed at the meeting; and</p>	<p>Administration to take action under paragraph 5 of the minutes</p>

Time marker	Speaker	Subject(s)	Action Required
		(ii) to respond to further submissions from deputations/academics on the subject in (b) above	

Council Business Division 1
Legislative Council Secretariat
11 March 2005