

Bills Committee on Securities and Futures (Amendment) Bill 2005
Follow-up to seventh meeting on 22 March 2006

This paper sets out the response of the Administration and the Securities and Futures Commission (“SFC”) to the issues raised at the seventh meeting of the Bills Committee held on 22 March 2006.

(a) Whether a reserve power similar to section 11(1) of the Securities and Futures Ordinance (“SFO”) is given to the executive government under the legislation of other jurisdictions

2. Different jurisdictions have different frameworks governing the operation of market regulators. It is difficult to assess whether other jurisdictions have a reserve power similar to section 11(1) of SFO by merely surveying overseas statutes since the different structural, legal and operational model of the market operator may enable the use of other means of control or influences other than statutory controls in the securities-related legislation.

3. We have nevertheless looked into the case of the Financial Services Authority (FSA) of the United Kingdom (UK). Our initial research shows that the Financial Services and Markets Act 2000 (FSMA), i.e. the legal underpinning for the FSA to act as the UK’s sole financial regulator and supervisor, does not have a reserve power similar to section 11(1) of SFO. Under the FSMA, the Government does have the power to : -

- ✧ direct the FSA to cover particular issues in its public Annual Report, including its own performance;
- ✧ establish whether the FSA is providing value for money;
- ✧ periodically review the secondary legislation which the FSA operates under and the boundaries of regulation; and
- ✧ launch a statutory inquiry into possible serious regulatory failure of the FSA.

(b) Providing a statutory provision to require the Chairman and the Chief Executive Officer (CEO) of the SFC to attend meetings of the committees and subcommittees of the Legislative Council (LegCO) when requested

4. The Administration has carefully considered the suggestion together with the SFC and we consider that members’ concern about the

accountability of the Chairman and CEO of SFC to LegCo is already being addressed by the Legislative Council (Powers and Privileges) Ordinance. Section 9(1) of the said ordinance empowers LegCo or its standing committee to order any person to attend before the Council or before such committee and to give evidence or to produce any paper, book, record or document in the possession or under the control of such person. Section 9(2) further allows any other committee specially authorized by a resolution of the Council to exercise the powers conferred by section 9(1).

5. We would also like to point out that as an independent regulator, the SFC has always been cooperative with LegCo and its committees and subcommittees in respect of attending meetings on request and providing information on its work subject to the confidentiality requirement of the SFO. Irrespective of the suggestion in question, the SFC will continue with this cooperation spirit and respond positively to the requests of LegCo, its committees and subcommittees.

(c) What constitutes “material interest” and “material business dealing”

6. The additional administrative safeguards to be imposed on the future SFC Chairman include -

- (i) he/she should not be a director of any listed company in Hong Kong; and
- (ii) he/she should not have any material interest in any principal business activity or be involved in any material business dealing with a listed company or any person or institution engaged in activities regulated by the SFC.

An example of “*having a material interest in any principal business activity of a listed company or any person/institution engaged in activities regulated by the SFC*” would be shareholder status or directorship of the SFC Chairman in a listed company / licensed intermediary. For a listed company, the holding of about 5% shares may be regarded as material. This is the threshold that triggers the duty to disclose interest in listed companies in Part XV of SFO. As regards being “*involved in any material business dealing with a listed company / licensed intermediary*”, an example will be where the SFC Chairman or a company in which he holds shares or is a director has business dealings with the listed company or licensed intermediary. It is difficult to say what the exact value of the contract should be before it will be regarded as a “material business dealing”. It depends on the size, turnover, capital involved etc. of both the listed company and the company in which the SFC Chairman has

interest. Under section 155B of the Companies Ordinance, a director is required to disclose to the company material interest in any matter and failure to do so is an offence. There is no definition for the term “material interest” in the Companies Ordinance and we are not aware of any Hong Kong case law or judicial discussions on the meaning of the term in the Ordinance.

7. Where the proposed SFC Chairman is a partner of a law firm whose clients are listed companies regulated by the SFC, the Administration takes the view that there is a risk that a potential or real conflict of interest may arise if the proposed candidate is appointed as Chairman of the SFC. Thus, we would require, as a condition to the appointment, that the candidate resign as partner from the law firm and that he or she should not during the term of appointment have any direct or indirect interest in the law firm.

8. The above requirements will not be provided in the SFO but will be included in the terms of appointment of the future Chairman. In addition, the prospective Chairman will be required to agree to comply with these requirements before his / her appointment takes effect. We do not consider it necessary to include the additional safeguards in the law as sections 378 and 379 of the SFO already provide criminal sanctions to any person who breaches the secrecy and avoidance of conflicts requirements under these two provisions.

(d) The Quorum for a meeting of the SFC

9. Currently, section 16 of Part 1 of Schedule 2 to the SFO provides that the quorum for a meeting of the Commission is not less than one third of the executive directors of the Commission and not less than one third of the non-executive directors of the Commission. As the Chairman is neither an executive director nor non-executive director under the Bill, his attendance at meetings of the Commission will not be counted for the purpose of forming a quorum. Having carefully considered the views of this Committee that the future SFC Chairman should be counted for the purpose of forming a quorum, we would like to propose an amendment to the Bill by adding a new section 16A to Part 1 of Schedule 2 of SFO. We propose that, for the purpose of forming a quorum for a meeting of the Commission under section 16 of Part 1 of Schedule 2 to the SFO, the Chairman will be deemed to be a non-executive director. A copy of the detailed wordings of this proposed amendment to the Bill and the marked-up amendment to the SFO is attached at **Annex**.

(e) The circumstances under which the Chief Executive may exercise the reserve power and invoke section 11(1) of SFO

10. Members of this Committee have requested the Administration to advise whether the Chief Executive has exercised any reserve power comparable or similar to section 11(1) of SFO in the recent management incident of the Kowloon-Canton Railway Corporation (KCRC). The Administration wishes to confirm that neither the Chief Executive nor the Chief Executive in Council has exercised any power under the KCRC Ordinance in the course of the recent KCRC incident, which was resolved by the Managing Board of the Corporation. As such, the Administration cannot comment on whether disputes between the senior management and the SFC Chairman in future would create a condition for invoking the reserve power. Nevertheless, we would like to highlight the statutory restriction embedded in section 11(1) that the Chief Executive may only invoke the power if –

- (i) it is in the interest of the public to do so; and
- (ii) the written direction must be for the purpose of furthering any of the regulatory objectives of the SFC or the performance of any of its functions under the SFO.

Financial Services and the Treasury Bureau
Securities and Futures Commission

28 March 2006

Extract from Securities and Futures (Amendment) Bill 2005

3. Securities and Futures Commission

Part 1 of Schedule 2 is amended -

(i) by adding -

"16A. For the purpose of forming a quorum
under section 16, the chairman of the
Commission shall be counted as a non-
executive director of the Commission."

Extract from the Securities and Futures Ordinance (SFO)

[Part 1 of Schedule 2, SFO]

PART 1

CONSTITUTION AND PROCEEDINGS OF COMMISSION, ETC.

Meetings

16. The quorum for a meeting of the Commission is not less than one third of the executive directors of the Commission and not less than one third of the non-executive directors of the Commission.

16A. For the purpose of forming a quorum under section 16, the chairman of the Commission shall be counted as a non-executive director of the Commission.