

立法會
Legislative Council

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Panel on Financial Affairs

Minutes of meeting
held on Thursday, 5 January 2006 at 10:00 am
in the Chamber of the Legislative Council Building

- Members present** : Hon Bernard CHAN, JP (Chairman)
Hon James TIEN Pei-chun, GBS, JP
Ir Dr Hon Raymond HO Chung-tai, S.B.St.J., JP
Hon LEE Cheuk-yan
Hon James TO Kun-sun
Hon CHAN Kam-lam, SBS, JP
Hon SIN Chung-kai, JP
Hon Emily LAU Wai-hing, JP
Hon Abraham SHEK Lai-him, JP
Hon Jeffrey LAM Kin-fung, SBS, JP
Hon Andrew LEUNG Kwan-yuen, SBS, JP
Hon WONG Ting-kwong, BBS
Hon Albert Jinghan CHENG
Hon TAM Heung-man
- Members attending** : Hon CHEUNG Man-kwong
Dr Hon YEUNG Sum
Hon Audrey EU Yuet-mee, SC, JP
Dr Hon Fernando CHEUNG Chiu-hung
Hon KWONG Chi-kin
- Members absent** : Hon Ronny TONG Ka-wah, SC (Deputy Chairman)
Dr Hon David LI Kwok-po, GBS, JP
Hon CHIM Pui-chung

**Public officers
attending**

: Agenda Item IV

Mrs Sarah KWOK
Deputy Secretary for Financial Services and the Treasury
(Financial Services)

Miss Alice CHEUNG
Principal Assistant Secretary for Financial Services and the
Treasury (Financial Services)

Ms Lorna WONG
Principal Executive Officer
Broadcasting Authority

Mr P L PO
Secretary
Broadcasting Authority

Agenda Item V

Mr David LAU
Deputy Secretary for Financial Services and the Treasury
(Treasury) (Acting)

Mr LI Wing
Controller
Student Financial Assistance Agency

**Attendance by
invitation**

: Agenda Item IV

Mr Peter AU-YANG
Acting Chairman
Securities and Futures Commission

Mr Keith LUI
Senior Director (Supervision of Markets)
Securities and Futures Commission

Mr Gerald D GREINER
Deputy Chief Operating Officer and Head of Exchange Division
Hong Kong Exchanges and Clearing Limited

Mr Mark BEWLEY
Assistant Vice President (Listing Division)
Hong Kong Exchanges and Clearing Limited

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

Staff in attendance : Ms Connie SZETO
Senior Council Secretary (1)4

Ms Rosalind MA
Senior Council Secretary (1)8

Mr Justin TAM
Council Secretary (1)3

Ms May LEUNG
Legislative Assistant (1)8

Agenda Item IV

Mr KAU Kin-wah
Assistant Legal Adviser 6

Action

- I. Confirmation of minutes of meeting**
(LC Paper No. CB(1)614/05-06 — Minutes of meeting on 7 November 2005)

The minutes of the meeting held on 7 November 2005 were confirmed.

II. Information paper issued since the last meeting

2. Members noted that no information paper had been issued since the last regular meeting held on 5 December 2005.

III. Date of next meeting and items for discussion

(LC Paper No. CB(1)615/05-06(01) — List of outstanding items for discussion

LC Paper No. CB(1)615/05-06(02) — List of follow-up actions)

3. The Chairman informed members that there were three proposed discussion items for the next regular meeting of the Panel to be held on Monday, 6 February 2006:

- (a) Briefing on the work of the Hong Kong Monetary Authority;
- (b) Progress report on proposed measures to address risks arising from securities margin financing; and
- (c) Briefing on the draft Mandatory Provident Fund Schemes (General) (Amendment) Regulation 2006.

4. On paragraph 3(a) above, the Chairman said that the Chief Executive of the Hong Kong Monetary Authority (CE/HKMA) would brief the Panel on the work of HKMA and two subjects requested by members: impact of branch closure by banks on the public; and policy and arrangement governing post-termination employment of HKMA's senior executives.

5. Mr SIN Chung-kai suggested that CE/HKMA be invited to cover HKMA's annual budget for 2006-07 in his briefing on 6 February. Ms Emily LAU supported the suggestion. Responding to members' enquiries, Clerk to Panel advised that in response to the Panel's previous requests for HKMA to brief the Panel on its annual budget, CE/HKMA had responded in writing on 19 April 2005 and then at the Panel meeting on 6 May 2005 that the Financial Secretary, on the advice of the Exchange Fund Advisory Committee and its Governance Subcommittee, had approved the disclosure of information on the HKMA's administrative budget for a financial year in HKMA's Annual Report starting from the 2004 Annual Report. Mr SIN and Ms LAU considered this arrangement far from satisfactory. Referring to the existing practice under which the Securities and Futures Commission (SFC) would present its annual budget to the Panel for Members' information before the commencement of each financial year, they reiterated that HKMA's annual budget should be subject to the same arrangement so as to enhance the transparency of HKMA's expenditure and public confidence in its accountability. The Chairman agreed to invite CE/HKMA to consider the suggestion.

6. On paragraph 3(b), the Chairman said that when the Panel was briefed on 17 December 2004 on the progress of the public consultation on the proposed measures to address the risk arising from securities margin financing, members had requested the Administration and the SFC to report further progress to the Panel in a

year's time. The SFC had subsequently provided a progress report on 2 December 2005 (LC Paper No. CB(1)454/05-06(01)). At the request of members, the Administration and the SFC would brief the Panel on the progress report on 6 February 2006.

7. As regards paragraph 3(c), the Chairman said that the Administration proposed to brief the Panel on the draft Mandatory Provident Fund Schemes (General) (Amendment) Regulation 2006, which aimed at improving the existing investment regulations. The Administration planned to move a resolution at the Legislative Council (LegCo) in the 2005-06 session for effecting the amendments.

8. Members agreed that the three items mentioned in paragraph 3(a) to (c) above be placed on the agenda for the meeting on 6 February 2006. They further agreed that the meeting be held from 9:00 am to 12:45 pm.

IV. Briefing on the review of derivative warrants market

(LC Paper No. CB(1)615/05-06(03) — Paper provided by the Administration

LC Paper No. CB(1)615/05-06(04) — Background brief prepared by the Legislative Council Secretariat

LC Paper No. LS19/05-06 — Paper on “Regulation of Securities related Programme broadcast through the Mass Media” prepared by the Legal Service Division of the Legislative Council Secretariat

LC Paper No. CB(1)630/05-06(01) — Report on “A Healthy Market for Informed Investors – A Report on the Derivative Warrants Market in Hong Kong (November 2005)” issued by the Securities and Futures Commission)

9. The Chairman advised that in view of recent public concerns about the risks associated with warrants trading in Hong Kong, the Administration, the SFC and Hong Kong Exchanges and Clearing Limited (HKEx) were invited to discuss the subject with the Panel, in particular on the need for strengthening the measures for regulation of warrants trading (including regulation of media programmes on warrants trading), and measures for guarding against market manipulation and addressing potential conflict of interest. The Chairman also drew members' attention to Hong Kong Securities and Futures Industry Staff Union (HKSFISU)'s submission tabled at the meeting.

(*Post-meeting note: HKSFISU's submission was issued to members of the Panel and non-Panel Members vide LC Paper No. CB(1)661/05-06(01) on 6 January 2006.*)

Briefing by the SFC

10. At the Chairman's invitation, Mr Peter AU-YANG, Acting Chairman of the SFC briefed members on the key findings and proposals set out in the report "A Healthy Market for Informed Investors – A Report on the Derivative Warrants Market in Hong Kong" (the Report) issued on 25 November 2005. He highlighted the following points:

- (a) The report was triggered by concerns both within the SFC and the market about the increased activity in the derivative warrants (DWs) market. These concerns related to a range of matters including the possible impact on the overall stability of the stock market, possible market manipulation, appropriateness of the existing regulatory framework, and the level of investor knowledge and understanding.
- (b) Findings in the Report revealed that DWs, if used properly, could play a useful role in the portfolio of investors. Many international markets had a DW market and many markets in Asia were trying to develop their DWs markets. Although trading activities in the DWs market in Hong Kong were voluminous accounting for about 19% of the total market turnover, they did not currently threaten the overall stability of the stock market given its current market value of about \$4.5 billion and dynamics of the stock market as a whole.
- (c) The SFC had the following observations on the features and practices in DWs market in Hong Kong-
 - (i) DWs were complex products and many investors, particularly retail investors, did not fully understand how they worked;
 - (ii) There were currently a number of undesirable or inappropriate practices in the market. On the enforcement side, the SFC had commenced a number of formal investigations relating to activities in DWs market including possible false trading, fixing of the settlement price during the expiry process, non-compliance with the liquidity providing obligations and illegal short-selling of DWs. The SFC would continue investigations in this area;
 - (iii) Issuers were adopting high penetration marketing techniques to promote their DWs. As a result, DWs were now regarded as a mainstream financial product rather than being recognized as the complex products that they were; and

- (iv) There was a tendency for unsophisticated investors to rely heavily on turnover when deciding whether or not to invest in a particular DW, rather than understanding its particular features and value.
- (d) The two main areas that the SFC needed to focus on were improving the regulatory regime for DWs in Hong Kong and enhancing investor understanding about DWs and their operation. In this connection, the Report contained a Six-Point Plan, as follows:
 - (i) Tightening the requirements on liquidity providers generally and making their operations more transparent;
 - (ii) Facilitating issuers to issue additional units in popular warrants, and allowing other issuers to issue identical warrants to enhance market competition;
 - (iii) Banning commission rebates and other incentive schemes;
 - (iv) Publishing new guidelines on marketing of DWs and working with the Broadcasting Authority (BA) in relation to commentators who were not regulated by the SFC;
 - (v) Requiring issuers to use “plain language” in listing documents and to publish a two-page summary of key product features, risks and benefits of each warrant; and
 - (vi) Launching new investor education initiatives to further improve investor understanding on DWs.

11. Mr Peter AU-YANG added that the SFC had invited market participants and the public to give views on the proposals in the Report before the end of January 2006. The SFC had so far received four submissions, including the one from HKSFISU. The SFC would consider the comments received and discuss them with the HKEx. Where appropriate, specific proposals for amendments to the SFC’s Codes and Guidelines, and/or the Listing Rules would thereafter be developed and consulted on in due course.

(Post-meeting note: Mr Peter AU-YANG’s speaking notes were issued to members of the Panel and non-Panel Members vide LC Paper No. CB(1)661/05-06(02) on 6 January 2006.)

Discussion

Impact of the growth of DWs market

12. Mr CHAN Kam-lam and Ms Emily LAU noted from the paper provided by the SFC that trading in the DWs market in Hong Kong from January to October 2005 was the most active in the world, and its growth had outpaced the development of DWs markets in other major international financial centres. Specifically, the average daily turnover in the DWs market in Hong Kong had arisen from HK\$0.6 billion (or 5% of the total stock market turnover) in 2000 to HK\$2.1 billion (or 13% of the total) in 2004 and further to HK\$3.3 billion (or 18% of the total) for the first ten months of 2005. Mr CHAN and Ms LAU were concerned about the reasons for such a significant growth of the DWs market in Hong Kong but not in other major international financial centres.

13. Mr Peter AU-YANG advised that it was essential for a financial market to provide both cash and derivative products so as to diversify its product range and meet the different needs of investors. However, some derivative products might be more popular in a financial market than other markets. For instance, warrants were more popular in Hong Kong and European markets, and stock options in American markets. Mr Gerald GREINER, Deputy Chief Operating Officer and Head of Exchange Division of the HKEx supplemented that “contract for difference” was a popular derivative product in Singapore, the United Kingdom (UK) and Australia. As regards the situation in Hong Kong, Mr Keith LUI, Senior Director (Supervision of Markets) of the SFC advised that when the first DW was listed in 1989, there were no specific rules for listing DWs at the time and the listing was achieved by adapting the rules for listing equity securities. Recognizing the differences in the nature of DWs and equity securities, separate rules were eventually developed and incorporated in the Listing Rules to provide for the listing of DWs. The rules were then revamped in 2001-02 for regulatory reforms which brought about the significant growth of the DWs market in Hong Kong. In recent years, other markets in Asia, including South Korea, the Mainland and Malaysia, were actively promoting their DW markets making reference to the successful experience of Hong Kong.

14. Mr CHAN Kam-lam and Ms Emily LAU considered that the Administration and the SFC should analyze the reasons for the significant growth of the DWs market in Hong Kong and the impact of such growth. Ir Dr Raymond HO, Mr KWONG Chi-kin and Mr James TO shared their view. Noting that many small investors had been using DWs as a short-term speculative instrument and had suffered losses, they expressed grave concern whether the small investors were aware of the risks involved in the trading of DWs.

15. Mr Keith LUI explained that the risks involved in the trading of DWs in respect of financial standing of issuers were similar to those of bonds. Given that a DW only conferred a right but not an obligation to buy or sell the underlying asset, the loss to an investor was thus capped at the amount paid for the DW. This explained why DWs had become increasingly attractive to investors in recent years. Nonetheless, DWs were complex products and might not be suitable for unsophisticated investors. It was important to enhance investor education on DWs so

that investors understood their complexities and risks and could use the product appropriately to suit their investment needs.

16. Mr CHAN Kam-lam, Ms Emily LAU, Ir Dr Raymond HO, Mr KWONG Chi-kin and Mr James TO were concerned about the impact of the growth of DWs market on the overall stability of the stock market, the negative social impact of DWs trading activities, and the protection for the small investors concerned. In this connection, they requested the Administration, the SFC and the HKEx to take the following actions:

- (a) To provide a comparison with other major financial centres, such as the United States (US), the UK, Italy, Germany and Singapore, in the following aspects:
 - (i) To compare the regulatory regime for DWs in Hong Kong with those for similar products in other major financial centres. The comparison should cover the role and market functions of DWs in respective markets; and
 - (ii) To assess and explain why there was a significant growth of the DWs market in Hong Kong but not in other major financial centres.
- (b) To provide information on investors' participation in DWs market in Hong Kong in recent years, including the following items:
 - (i) A breakdown of the number and percentage of investors by different categories;
 - (ii) A breakdown of the transaction volume and value traded by different categories of investors (with percentages to the total transaction volume and value), and the investors' gain or loss positions; and
 - (iii) Information about small investors in DWs market, including the number and percentage of small investors who were aware of the nature and risks involved in DWs and their level of understanding; the number and percentage of small investors who were using DWs as a short-term speculative instrument; and whether any problems related to the small investors' trading behaviour, such as those related to gambling behaviour, had been identified.
- (c) To provide information on issuers' participation in DWs market in Hong Kong in recent years, including the number of issuers involved and their gain or loss from issuing DWs in Hong Kong; and

- (d) With the information mentioned in items (a) to (c) above, to assess the impact of the significant growth of DWs market in Hong Kong, in particular the impact on the stability of the stock market, small investors and the community as a whole, and assess the need to introduce further measures to strengthen regulation of issuers of DWs and to curb improper trading practices in the market.

17. In response, the Deputy Secretary for Financial Services and the Treasury (Financial Services) (DS(FS)1) said that the Administration recognized the need to maintain market stability, enhance investor protection and confidence, and promote market development. To this end, the Administration was aware of the efforts of the SFC and the HKEx in monitoring market practices and risks involved in the trading of DWs, and their impact on the overall market stability, as well as strengthening enforcement actions against malpractices and improper trading activities. The Administration was mindful of the importance of enhancing investor education to help them understand the risks associated with DWs, assess their ability to undertake such risks and manage the risks. The SFC, with joint effort from the HKEx, was committed to further strengthening the regulatory regime of DWs and enhancing investor education.

18. On the impact on the overall stability of the stock market, Mr Peter AU-YANG advised that as at the end of December 2005, although the average daily turnover in the DWs market accounted for about 19% of the average daily total stock market turnover, the total market value of DWs was about \$4.5 billion, representing 0.06% of the total market capitalization of the stock market (8,000 billion). These figures had indicated that given the size of the DWs market and current dynamics of the stock market, the trading activities in DWs market, though voluminous, did not currently pose a threat to the overall stability of the stock market. Moreover, the SFC had developed a market risk monitoring system to assist in monitoring the various markets. The system served to enhance the understanding of market dynamics and identify risks that might pose a threat to market stability.

19. Mr Peter AU-YANG further pointed out that the SFC was aware of the improper practices in the market, such as those mentioned in paragraph 10(c) above. Moreover, it was observed that a number of small and medium sized brokerages had been very active in the DWs market. The majority of their clients only conducted day-trading. Clients appeared to take advantage of a number of current market practices which encouraged high volume day-trading, such as the tight spread quoted by liquidity providers which effectively reduced the transaction costs for the clients; the commission rebates offered by issuers to brokers; and the readiness of some brokers to charge low commission rates or allow clients to trade unlimited quantities of DWs for a fixed nominal commission payment. The Enforcement Division of the SFC had commenced a number of investigations relating to such practices and would continue its work in this area. To address the problems identified, the SFC had put forward the Six-Point Plan as mentioned earlier at the meeting. Mr Gerald GREINER also pointed out that the HKEx had been taking measures to

enhance the transparency of the DWs market. It would also cooperate with the SFC in taking enforcement actions to curb improper market practices.

20. Noting the SFC's reply that trading activities in DWs market, though voluminous, did not currently pose a threat to the overall stability of the stock market, Hon Emily LAU requested the SFC to elaborate in writing on the level at which the growth of DWs market would be considered as posing a threat to the overall stability of the stock market.

21. Ms Emily LAU enquired whether the fall in the stock market in mid August 2005 was connected with improper trading activities of DWs. Mr Keith LUI explained that the turnover in the stock market had been increasing since early 2005 and the Hang Seng Index (HSI) reached the historic height of about 15 500 points in early August 2005. The fall in HSI in mid August 2005 had reflected the general market expectation of an adjustment and the play of other factors, such as surge in oil prices and concern about rising interest rates.

Need for strengthening the existing regulatory framework

22. Referring to HKSFISU's submission, Mr KWONG Chi-kin pointed out that while HKSFISU welcomed SFC's initiative to conduct the review and enhance investor education on DWs, it criticized the Report for failing to address the fundamental problems in the DW markets in Hong Kong. HKSFISU had also expressed grave concern on a number of issues, including the concern that the proposal of facilitating further issues of DWs by issuers might increase the risk of the warrants concerned and jeopardize the interest of small investors, and the need for strengthening the regulation of issuers, in particular their capital requirements and issuers which were foreign investment banks. Mr KWONG requested the Administration and the SFC to address these concerns.

23. Mr CHAN Kam-lam shared HKSFISU's concern. He considered that it was not justified to introduce the proposal of facilitating further issues and identical issues of DWs under the Six-Point Plan as this would greatly increase investment risk of the DWs concerned. In his view, the Six-Point Plan could not address the problems in the DWs market. Mr CHAN urged that the Administration and the SFC should consider measures including restricting unsophisticated investors from investing in DWs market and tightening the regulation of media programmes on DWs.

24. In response, Mr Peter AU-YANG said that the SFC welcomed HKSFISU's comments on the Report and would study them carefully. He also advised that the Six-Point Plan was made to address the problems and improper market practices identified in the trading of DWs. For instance, the proposal of banning commission rebates and other incentive schemes was aimed at addressing issues of day-trading and improper practices to increase the turnover of a particular DW. As regards the proposal of facilitating further and identical issues of DWs by issuers, the proposal

aimed at addressing the concern about supply and demand imbalances, alleviating price anomalies, and enhancing market competition of DWs. The proposal would not result in unlimited issuance of a DW as the issuance of DWs would still be subject to other rules of the regulatory regime. Mr Gerald GREINER supplemented that overseas DW markets had also adopted similar measures to facilitate issuers in issuing DWs or other derivative products with a view to addressing the concern about supply and demand imbalances of the products.

25. Mr Keith LUI also pointed out that the SFC had issued guidelines to issuers regarding marketing materials on DWs. Issuers were required to comply with the relevant rules, including making adequate disclosure in the marketing materials on risks of the DW concerned, providing well based analyses on the DW and ensuring that there was no misleading information in the materials. There were also guidelines in the Code of Conduct for Persons Licensed by or Registered with the SFC. The SFC's licensed or registered analysts making commentaries or recommendations on a DW through the mass media were required to declare interests relating to the DW and the issuers.

26. Ms Lorna WONG, Principal Executive Officer of the BA advised that under the Radio Code of Practice on Programme Standards and the Generic Code of Practice on Television Programme Standards, the licensees were required to make every reasonable effort to ensure that the factual content of programmes was accurate, and to devise and institutionalize a mechanism whereby its presenters of news programmes and factual programmes would declare the relevant interests. She added that an average of over 200 hours of media programmes relating to financial products were broadcast every week currently. Despite the surge in the number of such programmes in recent years, the number of complaints received by the BA relating to such programmes had remained small. A majority of the complaints received were related to minor factual content of the programmes and no serious cases of inaccurate information had been reported.

27. Mr CHAN Kam-lam was concerned whether the Administration and the SFC would consider tightening the regulation of media programmes on the trading of DWs so as to ensure that advice given in the media programmes did not involve false or misleading information. Ir Dr Raymond HO held the same concern. He urged that consideration be given to tighten the disclosure system for media commentators to declare their interests related to the products in respect of which they would give advice. In response, Mr Peter AU-YANG pointed out that one of the measures proposed under the Six-Point Plan was for the SFC to publish new guidelines on marketing of DWs and to work with the BA in relation to commentators who were not regulated by the SFC.

28. Ms Emily LAU and Mr James TO enquired about the regulation of issuers of DWs. Mr Gerald GREINER advised that stringent requirements were set out in the Listing Rules, including the following requirements:

- (a) An issuer had to be a non-private company with a net asset value of more than \$2 billion;
- (b) An issuer was required either to have a credit rating within the top three investment grades or be an entity that was regulated by either the SFC, the HKMA or other recognized overseas regulators; or had a guarantor who met this criterion; and
- (c) An issuer had to possess relevant experience in issuing and managing the issue of similar products.

29. Mr Keith LUI supplemented that issuers of DWs were usually large investment banks and overseas financial institutions which had sound financial status and established risks control systems for managing their risks. The credit rating of issuers was regularly reviewed by credit rating agencies. As issuers were market participants, their performance was subject to on-going monitoring by the HKEx.

Measures to protect investors

30. Mr CHAN Kam-lam expressed support for the SFC to step up investor education on DWs. Ir Dr Raymond HO stressed the need to strengthen investor education to enhance small investors' understanding of the features and risks of DWs. In response, DS(FS)1 stressed that the Administration recognized the importance of enhancing investor education on DWs to promote investors' awareness and understanding of the features and complexities of DWs, and strengthening the regulatory regime for DWs to protect the interests of investors. She noted that the Report had included a number of proposals in these areas and that the SFC and the HKEx would continue to collaborate in taking forward the proposals.

31. Mr James TIEN pointed out that while a number of small investors were aware of the risks involved in the trading of DWs, they had been using DW as a short-term speculative instrument for making quick profits. On the measure of enhancing investor education, Mr TIEN suggested that consideration be given to highlight the risks involved in the trading of DWs and that the instrument was not a suitable investment tool for unsophisticated investors.

32. Mr SIN Chung-kai noted that certain sophisticated investment products traded in the two exchanges in Hong Kong were restricted to professional investors. He also noted that the Financial Services Authority (FSA) in the UK had implemented suitability checks on investors, allowing only those who had passed certain threshold, such as knowledge and investment experience, to invest in complex investment products. Mr SIN suggested that in order to enhance investor protection, the SFC should consider implementing suitability checks on investors in Hong Kong, making reference to the system adopted by the FSA.

33. In response, Mr Keith LUI advised that the Code of Conduct for Persons

Licensed by or Registered with the SFC required licensees and registrants to assess the suitability of investors, including the level of risks investors could take, before marketing the financial instruments to investors. As part of investor education efforts, the SFC had prepared information on different investment products and had been encouraging the brokerage industry to disseminate such information to clients. The SFC would work with the industry to enhance provision of information on DWs to the investing public. Mr Peter AU-YANG pointed out that as retail investors had all along been allowed to invest in DWs, there might be difficulty in implementing Mr SIN Chung-kai's suggestion mentioned in paragraph 32 above. Nevertheless, he undertook to consider the suggestion. Mr SIN Chung-kai requested the SFC to study his suggestion and provide a written response in due course.

34. Noting that it was the practice in the US prohibiting financial analysts from trading the securities which they recommended, Mr James TIEN suggested that consideration be given to adopt similar practice in Hong Kong so as to address the concern about financial analysts' potential conflict of interest when giving investment advice.

35. In response, Mr Keith LUI advised that paragraph 16.4 of the Code of Conduct for Persons Licensed by or Registered with the SFC set limitations on dealing of securities by financial analysts that they reviewed, including prohibiting analysts from dealing in or trading any securities in respect of a listed corporation that they reviewed within 30 days prior to and three business days after the issue of investment research on the listed corporation, and requiring analysts to disclose relevant relationships with the listed corporation concerned.

36. Mr James TIEN considered that it was not sufficient to require a financial analyst, at the time he provided an analysis or comments on securities in respect of a listed corporation in the mass media, to disclose his financial interest in the listed corporation. He suggested that the SFC should make reference to the US practice referred to in paragraph 34 above to improve the regulatory regime on financial analysts.

37. While recognizing the need to address the problem of potential conflict of interest of financial analysts, Mr Peter AU-YANG stressed the importance of striking a proper balance between such need and the interests of the analysts. He added that the SFC had given due consideration to this issue when revising the Code of Conduct for Persons Licensed by or Registered with the SFC in 2004.

38. Mr CHAN Kam-lam pointed out that the HKEx's website had not provided up-to-date information on the trading volume and activities of DWs to enable small investors to better understand the performance and volatility of warrants. He considered that the HKEx should strengthen its services in this area. In response, Mr Gerald GREINER said that the HKEx had been making efforts in various fronts to educate market participants and the investing public about DWs, including distribution of education materials and flyers through different channels, publication

of articles relating to DWs on newspapers, organizing professional training courses for market participants and investor education seminars for the public. Mr GREINER added that the HKEx was revamping its website with a view to providing investors with useful information relating to DWs in a more efficient and user-friendly manner. The HKEx would also cooperate with the SFC in taking forward other proposals in enhancing investor education on DWs.

(Post-meeting note: The SFC's written response to members' views and requests expressed at the meeting was issued to members and non-Panel Members vide LC Paper No. CB(1)1091/05-06(01) on 16 March 2006.)

V. Briefing on the sale and outsourcing of the funding and administration of loans made to students

(LC Paper No. CB(1)615/05-06(05) — Paper provided by the Administration)

Briefing by the Administration

39. At the invitation of the Chairman, the Deputy Secretary for Financial Services and the Treasury (Treasury) (Acting) (DSFST) briefed members on the Administration's proposal to dispose of the Government's non-means tested student loan portfolio and outsource the funding and administration of these loan schemes to the private sector. DSFST pointed out that the proposal formed part of the Administration's asset disposal programme. While it was the Government's original intention to dispose of the whole student loan portfolio (i.e. all the four loan schemes including the two means tested and two non-means tested schemes) amounting to some \$5 billion, after due consideration of market sentiments and administrative considerations, it had decided to exclude the means tested schemes from the current exercise. The two non-means tested loan schemes operated on a full-cost recovery basis. Interest was payable on the outstanding balance of the loan at the "no-gain-no-loss" rate, which was 5.275% as at 1 December 2005, plus a 1.5% risk-adjusted factor which sought to cover the Government's risk in disbursing unsecured loans.

40. DSFST explained that in line with the "Small Government, Big Market" principle, the Government considered that the existing student loan portfolio should be sold and the funding and administration of any future loans under the two schemes outsourced to the private sector. The disposal/outsourcing would bring in long-established management skills in the private sector in respect of loan processing and administration, which would help improve service standards to borrowers. In this connection, the Administration had earlier invited expressions of interest on a non-committal basis from the financial institutions in Hong Kong. A number of financial institutions had indicated interests in acquiring the existing loan portfolio and/or taking over the funding and/or administration of future loans subject to the terms and conditions to be determined in due course. DSFST assured members that it

was the Government's policy to ensure that no student was deprived of education due to lack of means. To safeguard the interests of the students in taking forward the proposal, the overriding requirement of preserving the terms and conditions of the schemes as approved by the Finance Committee and the administrative standards of the loans would be clearly set out in the tendering document, which would form part of a legally binding agreement with the successful tenderer.

Discussion

Consultation with Education Panel

41. Dr YEUNG Sum, Chairman of the Panel on Education (Education Panel), considered that the Administration's proposal represented a significant change in the policy on the funding and administration of student loans. He expressed his strong dissatisfaction that the Administration had failed to consult the Education Panel on the proposal, and called upon members of the Panel on Financial Affairs (FA Panel) to support his request for the Administration to withdraw the paper and consult the Education Panel on the proposal. Dr YEUNG also pointed out that LegCo Members of the Democratic Party objected to the proposal. While it was estimated that the proposal would bring about \$7 million annual savings, the Democratic Party was of the view that education was an important investment for the better future of Hong Kong, and cost savings should not be a major factor of consideration.

42. In response, DSFST explained that the proposal formed part of the Administration's asset disposal programme and was under the purview of the Financial Services and the Treasury Bureau. The Administration therefore put forward the proposal to the FA Panel. While indicating no objection to Dr YEUNG Sum's request for consulting the Education Panel on the proposal, DSFST welcomed the FA Panel's views on the proposal at this meeting. Ms Emily LAU requested the Administration to make better consultation arrangements with relevant LegCo Panels in future where the proposals involved more than one policy bureau.

43. Mr James TIEN, Mr LEE Cheuk-yan, Ms Emily LAU, Mr CHEUNG Man-kwong, Ms Audrey EU and Mr Albert CHENG supported Dr YEUNG Sum's request and considered it more appropriate for the Administration to consult the Education Panel on the proposal first. While not objecting to the proposed consultation with the Education Panel, Mr CHAN Kam-lam was of the view that as the proposal was put forward to the FA Panel, with all other non-Panel Members invited to join the discussion of the item, Members present might take this opportunity to give their preliminary views on the proposal.

Impact of the proposal on loan borrowers

44. Mr LEE Cheuk-yan pointed out that the paper provided by the Administration failed to set out the information on the impact of the proposal on loan borrowers, such as whether financial institutions would be allowed to change the administrative fee

for each loan application and the differences in the methods employed by the Administration and financial institutions for collecting outstanding loans. Mr LEE considered that the Administration should consult student bodies on the proposal before putting forward the proposal to the Education Panel. Referring to a written submission from the Hong Kong Federation of Students (HKFS) tabled at the meeting, Mr CHEUNG Man-kwong said that he had received a number of submissions from student bodies and therefore considered it necessary for Members to hear the views of relevant parties on the proposal when it was discussed at a meeting of the Education Panel. Ms Emily LAU also urged the Administration to consult the relevant parties on the proposal.

(Post-meeting note: The written submission from HKFS was circulated to members vide LC Paper No. CB(1)661/05-06(03) on 6 January 2006.)

45. In response, the Controller, Student Financial Assistance Agency advised that as a matter of fact, the Administration had briefed the student bodies on the proposal on a number of occasions, such as at regular meetings of the Joint Committee on Student Finance. The Administration had assured the student bodies that the interests of the students would be safeguarded in the implementation of the proposal.

46. Ms Emily LAU commented that the Administration should have included in its paper for this meeting relevant information pertaining to the previous discussions/consultations with student bodies. Ms LAU then requested that the outcome of consultation with student bodies and other relevant parties, including their views and concerns, and the Administration's responses, be included in the papers to be submitted to the Education Panel and FA Panel in due course.

47. Ms Audrey EU expressed concern about the impact of the proposal on loan borrowers. Given that the two loan schemes currently operated on a full-cost recovery basis, Ms EU doubted whether the financial institutions concerned would seek to make profit by changing the terms and conditions of the loans. Moreover, Ms EU requested the Administration to provide details about the financial implications of the proposal, such as how the estimated \$7 million annual savings had been worked out.

48. Mr CHAN Kam-lam also expressed concern on the possible impact of the proposal on loan borrowers. He considered that the Administration should set out in its papers to be submitted to the Education Panel and the FA Panel the measures to be put in place to safeguard the interest of the students concerned and to ensure that the proposal would not adversely affect the interest payable by them and their other rights and obligations.

49. Mr Albert CHENG also expressed concern on whether measures would be put in place to safeguard the interest of the students concerned, in particular measures to ensure that financial institutions would not adopt illegal or improper means to collect the outstanding loans from students.

50. Pointing out that the existing credit services provided by banks/financial institutions to university students had generated a number of complaints, Mr SIN Chung-kai asked the Administration to provide information on the number and nature of the complaints received by the Administration (including the Hong Kong Monetary Authority) in recent years about credit services provided to students, and the Administration's assessment on whether the implementation of the proposal would give rise to more complaints of similar nature and/or result in a situation where financial institutions provided excessive credit services to students.

Admin

51. DSFST took note of Members' views and undertook to take follow-up actions as requested before reverting to the FA Panel on the proposal. As to Members' concern about the impact of the proposal on loan borrowers, DSFST assured members that the terms and conditions of the loan schemes and the administrative standards of the loans would be preserved after the implementation of the proposal. While the financial institutions which took over the administration of the loan schemes would not be allowed to increase the interest payable or administrative charges, there might be room to improve the terms offered to students through reduction in administration cost by bringing in long-established management skills in the private sector.

Conclusion

Admin

52. In concluding the discussion, the Chairman urged the Administration to consult the Education Panel and relevant student bodies on the proposal before reverting to the FA Panel. He also requested the Administration to incorporate the relevant information requested by Members into the papers to be submitted to the Education Panel and the FA Panel in due course, and to include in the paper for the FA Panel the views of the Education Panel.

(Post-meeting note: The Administration consulted the Education Panel on the proposal on 26 January 2006, and representatives of student bodies were invited to present their views at the meeting.)

VI. Any other business

Proposal for the Panel to further discuss the issue of conflict of interest between Mr Paul CHENG's advisory role with the Deutsche Bank and his role as the Chairman of the Board of Directors, The Link Management Limited

(LC Paper No. CB(1)600/05-06(01) — Letter dated 16 December 2005 from Hon James TO to the Chairman of the Panel)

53. The Chairman advised that pursuant to the decision of the House Committee on 9 December 2005, a special meeting of the Panel was held on 14 December 2005 for Members to discuss the financial issues related to the listing of The Link Real Estate Investment Trust (The Link REIT). In response to the Panel's invitation, Mr Paul CHENG, Chairman of the Board of Directors, The Link Management Limited (The Link), had indicated in his reply dated 12 December 2005 that due to short notice and his prior commitment in China, he was unable to attend the meeting. The Chairman pointed out that in concluding the discussion at the special meeting, he had invited members to consider whether it was necessary for the Panel to follow up the issues relating to the listing of The Link REIT, such as the issue of conflict of interest between Mr CHENG's advisory role with the Deutsche Bank and his role as the Chairman of the Board of Directors, The Link. Some members had then responded that it was not necessary for the FA Panel to discuss the subject further or to invite Mr CHENG to attend a meeting of the Panel for discussion of the conflict of interest issue, while other members present did not express other views at that time. In the circumstance, the Chairman had concluded that it was not necessary for the Panel to follow up the issue.

54. The Chairman advised that Mr James TO had subsequently written to him, requesting the Panel to follow up the conflict of interest issue and invite Mr Paul CHENG to attend a Panel meeting to discuss the issue with members. Having regard to House Rule 24(n) which provided that the decisions of a committee should not be reopened for discussion unless with the permission of the committee, the Chairman considered that it should be for the Panel to decide whether Mr TO's request should be accepted.

55. Mr James TO pointed out that as Mr Paul CHENG had not attended the special meeting on 14 December 2005, a number of the queries raised by Members at the meeting had been left unanswered. To enable Members and the public to fully comprehend the issue and Mr CHENG and the relevant parties to clarify the points in doubt, Mr TO considered it necessary for the Panel to follow up the conflict of interest issue. He opined that while the Chairman had sought members' views on whether the Panel should follow up the subject at the end of the special meeting, some of the members present at that time had not indicated their stance explicitly on the subject. In Mr TO's view, the Panel had not made an explicit decision not to follow up the subject.

56. Mr Abraham SHEK considered that a decision of the Panel had been taken at the special meeting on 14 December 2005. He opined that Mr James TO's request to reopen the discussion at a Panel meeting could be put to vote. Nevertheless, Mr SHEK raised concern on whether it was appropriate for the Panel to invite The Link, which was a listed company, to attend its meeting.

57. Ms Emily LAU shared Mr James TO's view that the conflict of interest issue and other financial issues involved in and after the listing of The Link REIT had not been fully addressed at the special meeting on 14 December 2005, and supported

Mr TO's request for further discussion of the subject. She however did not consider it necessary for the Panel to make its decision on the matter through the casting of vote.

58. Mr Albert CHENG recalled that while members had deliberated at the special meeting on 14 December 2005 on the suitable forum for further discussion of the conflict of interest issue or other financial issues relating to the listing of The Link REIT, i.e. whether it should be followed up at meetings of the FA Panel or the Panel on Housing, no explicit decision had been made at the special meeting that the FA Panel should not follow up the subject.

59. Mr James TIEN, Mr CHAN Kam-lam and Mr Jeffrey LAM considered that the Panel had decided at the special meeting that follow up discussion of the subject was not necessary. The subject should be reopened for discussion only if there were new points or information for the consideration of the Panel.

60. Mr James TO stressed that his suggestion for the Panel to follow up the subject was to enable Members to examine the conflict of interest issue in detail. Mr LEE Cheuk-yan pointed out that it would be in the interest of the public for the Panel to invite Mr Paul CHENG to clarify in person, at a meeting of the Panel, all the queries on the conflict of interest issue and other financial issues involved in and after the listing of The Link REIT. After discussion, members agreed that the subject be scheduled for further discussion at the Panel meeting to be held on 3 April 2006. Members also agreed that Mr Paul CHENG and other representatives of The Link, the Financial Services and the Treasury Bureau, the Housing, Planning and Lands Bureau, and the Securities and Futures Commission be invited to the meeting.

61. There being no other business, the meeting ended at 12:45 pm.

Council Business Division 1
Legislative Council Secretariat
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