

**立法會**  
**Legislative Council**

LC Paper No. CB(1)1477/06-07

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by the Administration)

Ref : CB1/PL/FA/1

**Panel on Financial Affairs**

**Minutes of meeting**  
**held on Friday, 2 March 2007 at 8:30 am**  
**in Conference Room A of the Legislative Council Building**

- Members present** : Hon CHAN Kam-lam, SBS, JP (Chairman)  
Hon James TIEN Pei-chun, GBS, JP  
Hon Albert HO Chun-yan  
Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP  
Hon James TO Kun-sun  
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 Ronny TONG Ka-wah, SC  
Hon CHIM Pui-chung  
Hon TAM Heung-man
- Members attending** : Hon Andrew CHENG Kar-foo  
Hon WONG Kwok-hing, MH
- Members absent** : Hon Bernard CHAN, GBS, JP (Deputy Chairman)  
Dr Hon David LI Kwok-po, GBS, JP

**Public officers  
attending**

: Agenda Item IV

Hong Kong Monetary Authority

Mr William RYBACK  
Deputy Chief Executive

Mr Raymond LI  
Executive Director (Banking Development)

Mr Arthur YUEN  
Executive Director (Banking Supervision)

Agenda Item V

Mr Kevin HO  
Permanent Secretary for Financial Services and the  
Treasury (Financial Services)

Agenda Item VI

Mr Frederick MA, JP  
Secretary for Financial Services and the Treasury

Mrs Dorothy MA  
Principal Assistant Secretary (Financial Services)  
Financial Services and the Treasury Bureau

**Attendance by  
Invitation**

: Agenda Item IV

Octopus Cards Limited

Ms Prudence CHAN Bik-wah  
Chief Executive Officer

Mrs Cindy CHENG  
Sales and Marketing Director

Mr HO Hau-cheong  
Finance Director

EPS Company (Hong Kong) Limited

Mr Raymond SO Wai-piu  
General Manager

Mr Cary POON Yat-shing

Product Development Manager

Agenda Items V and VI

Securities and Futures Commission

Mr Eddy FONG  
Chairman

Mr Martin WHEATLEY  
Chief Executive Officer

Agenda Item VI

Mr Brian HO  
Executive Director (Corporate Finance)  
Securities and Futures Commission

**Clerk in attendance:** Miss Polly YEUNG  
Chief Council Secretary (1)5

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

Ms Elyssa WONG  
Deputy Head (Research & Library Services)

Mr Thomas WONG  
Research Officer 4

Ms Annette LAM  
Senior Council Secretary (1)3

Ms Rosalind MA  
Senior Council Secretary (1)8

Ms Sharon CHAN  
Legislative Assistant (1)8

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Action

**I. Confirmation of minutes of meeting**

(LC Paper No. CB(1)976/06-07 — Minutes of meeting on 5 January 2007)

The minutes of the meeting held on 5 January 2007 were confirmed.

## **II. Information papers issued since the last meeting**

(LC Paper No. CB(1)989/06-07 — Securities and Futures Commission Quarterly Report (October to December 2006)

Issued — Report on "2006 Population By-census Summary Results" provided by the Census and Statistics Department)

2. Members noted that the above papers had been issued for the Panel's information.

## **III. Date of next meeting and items for discussion**

(LC Paper No. CB(1)1007/06-07(01) — List of outstanding items for discussion

LC Paper No. CB(1)1007/06-07(02) — List of follow-up actions)

### Meeting in April 2007

3. Members noted that as agreed at the last meeting held on 5 February 2007, the regular meeting scheduled for 2 April 2007 would be chaired by the Deputy Chairman in the Chairman's absence. Members agreed that the following items would be discussed at the meeting to be held on 2 April 2007 at 10:45 am:

- (a) Impact of banks' branch closure and fee-charging on the public; and
- (b) Progress update on the Companies Ordinance rewrite exercise.

### 2006 Population By-census – Summary Results

4. Members noted that the report on the "2006 Population By-census – Summary Results" was released on 22 February 2007 and issued to all Members of the Legislative Council (LegCo). The Chairman advised that the findings of the report straddled different policy areas and invited members to give views on whether and how the findings should be followed up. Ms Emily LAU considered that the Administration should be invited to give a briefing to Members on the report findings. In reply to the Chairman, the Clerk informed members that when

the "Summary Results of the 2001 Population Census" was released in 2001, the Panel on Financial Affairs (FA Panel) held a special meeting on 8 November 2001 to receive a briefing by the Commissioner for Census and Statistics. All other LegCo Members were also invited to attend the meeting. Thereafter, individual Panels could follow up issues within their purview. In the light of the arrangement in 2001, members agreed that a special meeting should be convened to receive an overall briefing by the Administration on the report. Members also agreed with Mr Abraham SHEK's suggestion that all other Members should be invited to attend the meeting and that individual Panels could follow up related issues within their respective purview afterwards. The Chairman directed the Clerk to consult members on the arrangements for the special meeting.

*(Post-meeting note: Having regard to members' availability, the Chairman directed that the special meeting be scheduled for Thursday, 12 April 2007 at 8:30 am. Members were informed of the meeting arrangement vide LC Paper No. CB(1)1137/06-07 issued on 14 March 2007.)*

#### Briefing on the work of the Hong Kong Monetary Authority

5. The Chairman recapped that members had agreed, at the special meeting held on 1 February 2007, that the regular Panel meeting on 7 May 2007 be re-scheduled to facilitate attendance of Mr Joseph YAM, Chief Executive of the Hong Kong Monetary Authority (HKMA), who would be out of town during that period due to other official commitment. Members noted HKMA's latest advice that Mr YAM would not return to Hong Kong until 14 May 2007. To facilitate preparation for the presentation and with a view to minimizing the inconvenience caused by re-scheduling of meeting, HKMA had proposed that the briefing be given at the regular Panel meeting on 4 June 2007. Members agreed to HKMA's proposal and noted that the regular meeting in May would take place on 7 May 2007 as originally scheduled. They also agreed to advance the starting time of the meeting to be held on 4 June 2007 to 8:30 am (instead of 10:45 am) in order to allow sufficient time for discussion of the following proposed agenda items :

- (i) Briefing on the work of the Hong Kong Monetary Authority ;
- (ii) Briefing by the Financial Secretary on Hong Kong's latest overall economic situation; and
- (iii) Progress of the work of the Financial Reporting Council

*(Post-meeting note: Members were informed of the meeting arrangements for the month of May and June 2007 vide LC Paper No. CB(1)1070/06-07 issued on 6 March 2007.)*

#### **IV. Operation of Octopus Cards and EPS payment system in Hong Kong**

- (LC Paper No. CB(1)1007/06-07(03) — Information paper on "Regulatory and Oversight Framework on Octopus Card and EPS" provided by the Hong Kong Monetary Authority
- LC Paper No. CB(1)1007/06-07(04) — Letter dated 23 February 2007 from Octopus Cards Limited
- LC Paper No. CB(1)1007/06-07(05) — Paper from EPS Company (Hong Kong) Limited
- LC Paper No. IN08/06-07 — Information note on "Operation of the Octopus Card in Hong Kong" prepared by the Research and Library Services Division
- LC Paper No. CB(1)1068/06-07(01) — Speaking note of Ms Prudence CHAN, Chief Executive Officer of Octopus Cards Limited
- LC Paper No. CB(1)1068/06-07(02) — "Octopus EPS Add-Value-Explanatory Diagrams" provided by the Octopus Cards Limited  
(Tabled at the meeting and issued on 5 March 2007)
- LC Paper No. CB(1)1068/06-07(03) — Speaking note of Mr Raymond SO, General Manager of EPS Company (Hong Kong) Limited)

Briefing by Octopus Cards Limited

6. At the invitation of the Chairman, Ms Prudence CHAN, Chief Executive Officer of Octopus Cards Limited (OCL) gave a brief account on the recent incidents associated with the failed Octopus EPS add-value transactions. Ms CHAN stressed that OCL attached great importance to the protection of customers' interests and highlighted the following remedial actions taken by OCL in the wake of the failed transactions:

- (a) Suspending the operation of Octopus EPS add-value system at all railway stations from 3 February 2007 and those at other premises (including car parks and shopping malls) starting from 17 February 2007. As Octopus EPS add-value transactions represented an average of 1.5% of total daily add-value transactions, customers could choose to add value to their cards through other means which were in normal operation.

- (b) Reviewing the Octopus EPS add-value transactions taken place during the period between 5 December 2006 to 3 February 2007 to identify cases where EPS accounts had been charged but without crediting the Octopus Cards. Refunds were made to all 571 affected customers by 14 February 2007.
- (c) Extending the service hours of OCL's customer hotline with effect from 3 February 2007 to facilitate customers' enquiries on transaction records.
- (d) Appointing an international consultant PricewaterhouseCoopers to conduct an independent review of the incident, including identifying the cause of the problem, recommending improvement measures on areas like the operational risk control environment of OCL and the refund process.

7. Ms Prudence CHAN said that while OCL had taken immediate steps to identify the causes of the problem, these had yet to be ascertained as the investigation involved multiple parties, including OCL, EPS Company (Hong Kong) Limited (EPSCO), Mass Transit Railway Corporation (MTRC), Kowloon-Canton Railway Corporation (KCRC), the modem and network provider and the EPS terminal suppliers. To facilitate members' understanding of the process involved in the EPS add-value transactions, Ms CHAN briefed members on three scenarios involving normal transactions, unable to connect transactions and abnormal transactions with the aid of flow-charts (LC Paper No. CB(1)1068/06-07(02) ). She assured members that OCL would take forward the review in cooperation with Prof CHAN Chi-fai, the Advisor appointed by the Monetary Authority, and its consultant next week. The Board of Directors of OCL had also established a special board committee under the chairmanship of independent director, Mr Roger LUK, to oversee the work relating to the review. She re-affirmed that OCL was fully committed to providing services to residents and visitors in Hong Kong and would spare no effort in rectifying the problem expeditiously.

#### Briefing by EPS Company (Hong Kong) Limited

8. At the invitation of the Chairman, Mr Raymond SO, General Manager of EPSCO, briefed members on the incidents relating to cases of failed Octopus EPS add-value transactions. Mr SO advised that in an Octopus Card add-value transaction, EPSCO's role was to make EPS payment through debiting money from cardholder's bank account while OCL was responsible for adding monetary value to the Octopus Card. EPSCO provided OCL with a day-end reconciliation data file which covered all transactions processed by EPSCO and a summary of all transactional activities at the EPS Host System relating to Octopus Add-Value Machines (AVMs) within an EPS fund settlement day. The data enabled OCL to reconcile with their own transaction records. Mr SO also set out in chronological order the follow-up actions taken by EPSCO since the receipt of enquiry from OCL on 1 February 2007. Mr SO pointed out that at this stage of the investigation,

there was no evidence suggesting that the problem was related to the network upgrade to the system serving the machines at the MTR and KCR stations carried out on 4 December 2006. He assured members that EPSCO would spare no effort in providing assistance to the independent investigation with a view to identifying the causes of the problem as soon as possible.

9. At the invitation of the Chairman, Mr Cary POON, Product Development Manager of EPSCO, gave a power-point presentation on the following technical issues related to the system design of the Electronic Fund Transfer (EFT) Module and the network upgrade conducted on 4 December 2006:

- (a) The pre-defined communication protocol under which the EFT Module initiated communication while the EPS Host System responded. EPSCO examined and certified each model of EFT Module to be installed in AVMs to ensure that it followed the specifications of the pre-defined communication protocol.
- (b) EFT Module must treat an EPS payment unsuccessful whenever EFT Module did not receive payment response from the EPS Host System within the preset time interval (currently 30 seconds).
- (c) Network upgrade to the system conducted on 4 December 2006 merely changed the network equipment which connected the EPS Host System to the Public Switch Data Network. There was no software or hardware upgrade on AVMs at MTR and KCR stations.

Briefing by the Hong Kong Monetary Authority

10. At the invitation of the Chairman, the Deputy Chief Executive of the Hong Kong Monetary Authority (DCE/HKMA) briefed members on the framework for regulatory oversight by HKMA on the Octopus Card and EPS. He highlighted the following points:

- (a) On regulatory framework for Octopus, HKMA authorized OCL as a deposit-taking company in 2000 and had been supervising it as such since then. The primary supervisory objective was to ensure the safety and soundness of the institution so as to protect the interests of cardholders.
- (b) HKMA supported the wider application of electronic money in Hong Kong. The electronic money market was opened to all potential operators and future competition by means of two routes, namely, by licensed banks or non-banking institutions seeking to become deposit-taking companies to issue or facilitate the issue of multi-purpose stored value cards (MPCs). OCL was an example of the latter. The imposition of the same regulatory requirements on the existing and potential card issuers helped ensure a level playing field for market players.

- (c) In addition to regulatory requirements under the Banking Ordinance (Cap.155) (BO), OCL was required to comply with the Code of Practice for Multi-Purpose Stored Value Card Operation (MPC Operation Code), which specifically required, among other things, that there should be no measures having the effect of unfairly limiting competition in the market. Where practicable, OCL should also aim to share its technical platform with other parties interested in card issuing.
- (d) HKMA had formulated an informal oversight framework to promote the general safety and efficiency of the retail payment systems in Hong Kong. Under this framework, EPSCO together with seven other credit and debit card scheme operators drew up and issued a Code of Practice for Payment Card Scheme Operators in December 2006.
- (e) HKMA had required OCL to conduct a thorough investigation into the root causes of the problem of failed add-value transactions and arrange for prompt refunds to affected cardholders. On 16 February 2007, the Monetary Authority appointed Prof CHAN Chi-fai as an Advisor to OCL and required OCL to commission an independent auditor to review the incident as well as boarder issues and to submit a report on the review to HKMA.

## Discussion

### *Investigation of the causes of the problem and refund to affected cardholders*

11. Noting that some 14.7 million Octopus Cards were in circulation with daily average transactions totaling about \$80 million in value, Mr WONG Kwok-hing considered that protection of the interest of cardholders was an issue of wide public concern. As cases of failed Octopus EPS add-value transactions had been detected since December 2006, Mr WONG was concerned about the long lead time taken by OCL to investigate the causes of the problem and announce the appointment of an independent auditor as its consultant.

12. In reply, Ms Prudence CHAN stressed that OCL attached great importance to protecting the interests of its customers. She explained that OCL had first become aware of customer complaint regarding the failed transactions in early February 2007. A review was conducted on the Octopus EPS add-value transactions that had taken place during the period 5 December 2006 to 3 February 2007 as it was initially believed that the problem was related to the system upgrade of the communication network on 4 December 2006. OCL had taken immediate follow-up and remedial actions including investigation, suspension of the operation of the Octopus EPS add-value system, refund to affected customers and extension of service hours of its customer hotline. She said that OCL had to take some time to work out with HKMA the scope of the review to be undertaken by the

consultant before an announcement could be made on the day of the meeting.

13. Regarding the timeframe for the review, Ms Prudence CHAN advised that the consultant expected to take about three to four months to complete the review and the review report would be released for public information. At the request of Ms Emily LAU, Ms CHAN undertook to provide the Panel with the report when such was available.

14. Mr James TO noted that in the review of the 500,000 Octopus EPS add-value transactions taken place during the two-month period, OCL had identified 571 cases where EPS accounts had been charged without crediting the Octopus Cards, i.e. a 0.1% failure rate. In this connection, Mr TO was concerned that among the daily EPS add-value transactions amounting to \$2.1 million, a 0.1% failure rate would mean an extra \$2,100 credited to OCL's settlement account daily, which could have accumulated to a large sum over time. He therefore enquired whether OCL would take the initiative to review the transactions which had taken place before 5 December 2006 to identify failed transactions and arrange refund to the affected customers accordingly. Mr WONG Ting-kwong and Mr Andrew LEUNG expressed similar concern. Mr WONG was also concerned about OCL's investigation of the root causes of the problem. Mr LEUNG asked OCL to inform the public of the date of the first occurrence of failed or faulty add-value transactions.

15. Ms Prudence CHAN responded that as advised earlier on at the meeting, the root causes of the problem had not been ascertained as investigation was still underway involving multiple parties and complicated technical issues in the operation of the Octopus EPS add-value system. This partly explained why an independent consultant had to be appointed to review the operation of the add-value services as well as OCL's operational risk control environment with a view to identifying the root causes of the problem and prescribing solutions, including the checking of reconciliation data with OCL's settlement account. She assured Members that where practicable and necessary, OCL would not hesitate to implement measures to improve the Octopus Card system, and would not defer action until completion of the review.

16. Mr James TO maintained his view that checking of the Octopus EPS add-value transactions before 5 December 2006 should be conducted as soon as possible and not until the completion of the independent review. Mr TO called on HKMA to take follow-up actions to ensure OCL's checking of such transaction records to protect the interests of cardholders. Mr Abraham SHEK expressed similar view and requested OCL to advise whether it had reviewed these transactions and, if yes, to provide information to the Panel on the number of failed transactions where EPS accounts had been debited without the value being added to the relevant Octopus Cards.

17. As to OCL's refund arrangements, Ms Prudence CHAN advised that OCL's refund mechanism was a reactive one in response to requests. Given the fact that about 90% of the Octopus Cards were anonymous, it was not possible for

OCL to identify the cardholders and approach them for refund. Nevertheless, OCL was committed to responding promptly and professionally to customers' requests for refund. Ms CHAN said that the consultant appointed by OCL would assist in refining the arrangements and related policy to support the refund process, examine action to be taken operationally and technically, and make recommendations to rectify the problems so as to avoid similar recurrence. She confirmed that OCL would provide full disclosure of relevant information to the public and act according to the recommendations of the independent review.

18. Responding to Mr WONG Ting-kwong's enquiry about the monetary value involved in the 571 cases of failed transactions, Ms Prudence CHAN advised that the total amount was about \$140,000. As to Mr WONG's concern about the timing for resumption of the suspended Octopus EPS add-value service, Ms CHAN said that in the interest of cardholders, the services would not be resumed until the problems that caused the failed transactions were resolved. She however reiterated that as the Octopus EPS add-value transactions represented only about 1.5% of the total daily add-value transactions, cardholders could avail themselves of other modes of add-value services which had all along been in normal operation.

OCL

19. Noting that 90% of Octopus Cards were anonymous, Mr Andrew LEUNG considered this not conducive to OCL's proactive review of add-value transactions and to remedial action such as refund in the event of failed or other faulty transactions. To inspire public confidence in the use of the Octopus Card, Mr LEUNG called on OCL to encourage the use of automatic add-value service (AAVS) and Personalized Octopus Card by the public in which the identity of the cardholder could be ascertained. In this connection, Mr LEUNG suggested that OCL should consider issuing Personalized Octopus Card without an additional charge on the cardholder.

20. In this regard, Mrs Cindy CHENG, Sales and Marketing Director of OCL, informed members that the public could choose to use AAVS through their banks free of charge. OCL currently charged \$20 to cover the administration cost for the issue of a Personalized Octopus Card. Ms Prudence CHAN pointed out that individual customers might have their own preference for anonymous or Personalized Octopus Cards. OCL would facilitate the public in making informed choices through promotional efforts on the merits and characteristics of different types of Octopus Card. Responding to Mr Andrew LEUNG's further enquiry on access to cardholders' information from the EPS system, Ms CHAN said that to safeguard personal privacy, OCL would not access to or retrieve the personal information of cardholders kept on the EPS system.

21. Mr Andrew LEUNG sought HKMA's view on encouraging the use of Personalized Octopus Cards. In response, DCE/HKMA advised that under the current Octopus Card system, the public had a choice to use anonymous cards or cards in their personal names. It would be up to individual users to decide on the type of Octopus Card they would like to use.

*Improvements to the Octopus Card system and Octopus Card add-value services*

22. Pointing out that OCL had in hand an abundant amount of deposits paid by cardholders for the 14.7 million Octopus Cards in circulation, Mr Andrew CHENG said that cardholders had a legitimate expectation for the effective and secure operation of the Octopus Card system. Mr CHENG said that on the contrary, OCL had been operating in a non-transparent manner and communication with its customers was far from adequate. To restore public confidence in the use of MPCs, Mr CHENG suggested that OCL should make immediate improvements to its operational risk control, including putting in place a proactive rather than reactive policy for investigation of and refund for abnormal/failed transactions, providing more channels (e.g. via Internet and at all automatic turnstiles at MTR and KCR stations) to enable Octopus cardholders to check their card balance conveniently and conducting more frequent checks and upgrading of the Octopus Card infrastructure.

OCL

23. Miss TAM Heung-man opined that the recent incidents of failed add-value transactions revealed the unsatisfactory internal control within OCL. Miss TAM was of the view that in taking forward the upcoming review by the independent consultant, OCL should aim at improving its internal control in areas such as system monitoring and data reconciliation to prevent recurrence of similar problems and restore public confidence in the Octopus Card system.

24. Ms Prudence CHAN noted Members' views for consideration and concurred with the importance of restoring public confidence in the use of Octopus Card. To this end, the scope of work of the independent consultant would include refining the policies to support the refund process and making recommendations to address the issues so as to avoid similar problems in the future. She said that OCL would consolidate all the views and suggestions for examination with the independent consultant in the upcoming review with a view to implementing practicable measures to address the concerns of the public expeditiously. Ms CHAN further advised that the consultant would work together with Prof CHAN Chi-fai, the Advisor to OCL appointed by the Monetary Authority and the special board committee headed by Mr Roger LUK, in the review process.

OCL  
EPSCO

25. Mr Ronny TONG pointed out that under the current work-flow of the Octopus EPS add-value service, cardholders might not be able to detect that their accounts had been debited for failed add-value transactions unless they checked details of their bank statements. To enhance protection for cardholders, Mr TONG suggested OCL/EPSCO to examine the feasibility of re-engineering the work-flow so that value could be added to the Octopus Cards first before EPS accounts were debited, subject to adequate funds being available in the EPS accounts concerned.

26. In this regard, Ms Prudence CHAN said that this was the mode of operation for AAVS. OCL and its working partners would examine the feasibility of applying similar arrangement to other add-value services such as the Octopus EPS add-value service.

27. Mr Abraham SHEK believed that quite a number of 14.7 million Octopus Cards in circulation were not in active use. He was of the view that OCL might consider utilizing the accumulated amount of unclaimed deposit money to enhance its system and provide better service to its customers. He therefore requested OCL to provide supplementary information on the number of Octopus Cards not in active use; and whether the accumulated deposit money for the inactive Octopus Cards would be utilized to the benefits of cardholders.

28. Mr Jeffrey LAM said that as the Octopus Card system had been in use for some ten years since 1997 and providing service to a large number of cardholders, it was the responsibility of OCL to take proactive steps to ensure the smooth operation of the system so as to protect the interests of its customers. In this connection, Mr LAM enquired on the measures, if any, implemented by OCL to monitor system performance in the past decade, such as regular inspections and upgrading of the system software and hardware.

29. Ms Prudence CHAN advised that system monitoring was part of OCL's ongoing work. Apart from regular maintenance and necessary system upgrades, OCL would develop new products/technologies to enhance its services. Moreover, OCL had made publicity efforts to facilitate customers' access to service information. By way of illustration, OCL published advertisements in newspapers in late February 2007 to inform the public of alternative means of Octopus Card add-value services after the suspension of the add-value service through the EPS system. OCL would also enhance the provision of information through its official website and the distribution of information leaflets etc.. On the work of the consultant in system monitoring and upgrading, Ms CHAN said that OCL would take on board the recommendations of the consultant to enhance the operation of the Octopus Card system in collaboration with the various parties concerned.

#### *Competition in Hong Kong's multi-purpose stored value card market*

30. Ms Emily LAU was concerned that despite the voluntary adoption of the MPC Operation Code by OCL in 2005, the electronic money market in Hong Kong was not competitive. In this connection, she noted with concern that a number of MPC schemes (e.g. Mondex and VisaCash) introduced some years ago had gradually faded out and as a result, the Octopus Card remained the only MPC scheme in Hong Kong. Ms LAU questioned whether there was a level-playing field for market players interested in issuing MPCs in Hong Kong and whether HKMA had conducted any study and/or received any complaint on monopolization or unfair competition in the electronic money market.

31. In reply, DCE/HKMA advised that HKMA had not received any complaint on unfair competition in the electronic money market. He assured members that HKMA endeavoured to ensure the availability of a platform for robust competition in the market for interested market players to issue MPCs. He said that reasons for the unsuccessful launching of other MPC schemes such as Mondex and VisaCash might be attributable to the lack of consumer interest in

these products. As a result, banking institutions were unable to achieve the value of transaction necessary to support the technological requirements for broader use of the MPCs. Banking institutions had found their MPCs business not lucrative, in particular when there was competition from other services such as credit cards which had become more popular.

32. Ms Emily LAU was of the view that if there were entry barriers for other market players to issue MPCs for use in public transport services, competition in the electronic money market would not be possible. The Chairman noted that there might be technical difficulties as different MPCs might require different service delivery platforms. He remarked that if different technologies could be synchronized resulting in a common platform for the use of different MPCs, the concern about market competition featuring multiple operators could be addressed.

33. Mr Abraham SHEK shared Ms Emily LAU's concern and considered that the substantial market demand for MPCs as revealed in the 14.7 million Octopus Cards in circulation should have attracted other interested MPC operators if there was a level-playing field for all potential operators. He queried whether OCL had been offered any preferential treatment by public transport operators such as MTRC and KCRC which were also the major shareholders of OCL, thereby resulting in market monopolization by OCL.

34. In response, Ms Prudence CHAN pointed out that other payment modes such as cash payment and credit cards had posed direct competition to OCL. She confirmed that public transport operators did not offer any preferential terms/treatment to OCL.

35. The Executive Director (Banking Development) of HKMA advised that in line with the Government's competition policy, HKMA encouraged fair competition in the electronic money market. Whilst there was no statutory provision under BO to require compliance of OCL with measures to promote fair competition, OCL had voluntarily adopted the MPC Operation Code, which required, among other things, that there should be no measures having the effect of unfairly limiting competition in the market. In addition, OCL should aim to share its technical platform with other parties interested in card issuing and merchants acquiring business after taking into account the security requirements and reasonable commercial considerations.

36. Mr Abraham SHEK remained concerned whether adequate safeguards were in place to ensure fair competition and a level-playing field for market players interested in issuing MPCs in Hong Kong. He requested HKMA and OCL to provide further information to address his concern. Mr SHEK also considered that issues relating to the use of Octopus Card in public transport should be discussed by the Panel on Transport.

37. In conclusion, The Chairman said that Members could follow up related issues on the use of MPCs at the relevant Panel(s) if they so wished. He also urged

the Administration and OCL to take into consideration Members' views and suggestions to facilitate the smooth operation of Octopus Card add-value transactions, in particular through encouraging the use of AAVS and Personalized Octopus Card.

*(Post-meeting note: OCL provided a written reply on 27 March setting out its interim response to concerns in paragraphs 13, 16, 19, 22 and 25 and response to concerns in paragraphs 27 and 36. The reply was circulated to members vide LC Paper No. CB(1)1248/06-07 on 28 March 2007. The written response from HKMA to concern in paragraph 36 was issued to members vide LC Paper No. CB(1)1302/06-07 on 3 April 2007.)*

## **V. Budget of the Securities and Futures Commission for the 2007-2008 financial year**

(LC Paper No. CB(1)1007/06-07(06) — Paper provided by the Administration)

38. The Chairman welcomed Mr Eddy FONG, Chairman of the Securities and Futures Commission (C/SFC), who was attending the Panel meeting for the first time after taking up the appointment.

### Briefing by the Securities and Futures Commission and the Administration

39. At the invitation of the Chairman, Mr Martin WHEATLEY, Chief Executive Officer of the Securities and Futures Commission (CEO/SFC) briefed members on the main features of the revised estimates for 2006-07 and proposed estimates for 2007-08. He highlighted the following points:

- (a) SFC's revenue in 2006-07 had grown significantly, as a result of a substantial increase in levy income due to robust market activities. The revised estimated revenue for 2006-07 was 96.4% above the approved estimates. The reserves of SFC remained at a level which was more than twice its estimated operating expenses. However, since the rate of levies on securities and future/options contracts had just been reduced with effect from 1 December 2006, no further reduction was recommended for the time being. SFC was consulting the Financial Secretary on possible new initiatives to make better use of the reserves. On the expenditure side, SFC had kept its operating expenditure for 2006-07 within the approved estimates.
- (b) SFC projected a surplus budget of \$478.52 million for 2007-08. The estimated revenue for 2007-08 was \$1,077.83 million, which was 6.6% below the revised estimates for 2006-07, taking into account the full year effect of the reduction in levy rate. The estimated operating expenditure for 2007-08 was \$599.31 million,

which was 7.9% above the 2006-07 revised estimates. The increase was mainly attributable to the increase in Personnel Expenses by \$46.33 million arising from the provision for additional manpower and for increase in staff remuneration and benefits in line with the market trend. The major initiatives included creation and upgrading of posts, as well as an average of 5% pay increase. With the proposed budget surplus and a reasonable size of reserves, SFC had for the fifteenth year in a row not requested any appropriation from LegCo.

- (c) On staff establishment, SFC exercised vigilant control over operating expenses by limiting the increase in establishment. Despite significant increase in workload, complexities of work and responsibilities, SFC had only proposed a modest increase in the number of posts in 2007-08 (i.e. creation of six new posts and upgrading of five posts) which were considered essential to redress the pressure on human resources. SFC expected that pressure on human resources would rise as a result of the uptake of new regulatory functions such as the proposed implementation of statutory backing of listing rules.

40. At the invitation of the Chairman, the Permanent Secretary for Financial Services and the Treasury (Financial Services) (PS(FS)) briefed members on the Administration's views on the SFC budget for 2007-08. He said that the Administration agreed with SFC's prudent approach in the management of finance by proposing only a modest increase in operating expenditure, including an increase in remuneration and establishment, despite the substantial increase in revenue arising from robust performance of the securities market. As the reduction in levy rate had taken effect only in December 2006, the Administration would keep in view the reserves level of SFC in the light of market performance and where appropriate, discuss with SFC on ways to better utilize its reserves..

## Discussion

### *Manpower provision and staff turnover*

41. Whilst noting SFC's undertaking to exercise prudence and vigilance in the management of finance and staff resources, Ms Emily LAU expressed concern about the difficulties faced by SFC in competing with the private sector for suitable staff, given the prevailing robust performance of the securities market. In this connection, Ms LAU enquired about the problem, if any, of high staff turnover faced by SFC and whether the provision for an average 5% pay increase could adequately address the problem of loss of staff. She stressed the need for SFC to retain experienced and high-calibre staff to perform its regulatory functions effectively and to meet the challenges of rapid changes in the securities market. As such, Ms LAU was of the view that SFC should consider utilizing its reserves to implement measures to tackle difficulties relating to staff recruitment and retention.

42. C/SFC advised that the financial sector in general was in great demand for talents, in particular those in the accounting and legal professions. As for SFC, the turnover problem was more acute at the middle management level. Whilst the provision of additional resources for an average of 5% pay increase in 2007-08 was considered appropriate to bring the pay level in line with the market pay trend, C/SFC said that SFC would monitor closely any sharp increase in staff turnover rate.

43. In this regard, CEO/SFC added that SFC did experience a loss of talent to the financial sector, partly because the training received in SFC and contacts with market participants were recognized as important edges which made SFC staff highly sought after in the employment market. He informed members that the average staff turnover rate of SFC in 2006 was 13-14%, which was lower than the average rate of 18-20% in the financial sector. SFC had also put in place a number of measures to tackle the problem of staff turnover, in particular at the middle management level. These included the implementation of a five-day week and an average of 5% pay increase. CEO/SFC nevertheless pointed out that pay level was not the only consideration for staff serving in SFC as a public regulatory body. PS(FS) added that the Administration was mindful of the need for SFC to attract and retain staff of the right calibre to cope with the workload and upcoming challenges. Regarding measures to address recruitment and retention problem, he shared CEO/SFC's view that it was also important for SFC to put in place measures to boost staff morale and sense of belongings and to improve job satisfaction, in addition to offering pay packages comparable to the market.

44. Ms Emily LAU remained concerned that a staff turnover rate of 13-14% might affect the effective performance of SFC's regulatory functions, thereby jeopardizing the position of Hong Kong as an international financial centre. In response, CEO/SFC advised that while SFC had experienced a higher staff turnover rate recently when compared with that during the years of economic downturn, the average rate was still much lower than the overall rate in the financial sector. SFC was committed to ensuring the effective performance of its functions and had therefore put in place measures to ensure sufficient staffing support. He believed that with adequate and proper staff training, the existing staff at SFC could handle its regulatory functions effectively.

45. Mr Abraham SHEK supported the budget of SFC for 2007-08. He nevertheless noted that only six new posts would be created to cope with the increase in workload arising from various initiatives and questioned whether the modest manpower increase would be adequate to cope with the rapid development of the financial market, in particular the development of REITs and new financial products. Mr SHEK was of the view that provision of adequate manpower resources for SFC was crucial to maintaining the regulatory effectiveness of SFC and the competitiveness of Hong Kong as an international financial centre.

46. In response, C/SFC assured members that SFC would keep its manpower provision under review and make necessary adjustments to cope with workload

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arising from changing demands of the financial market. He further advised that Mr Abraham SHEK's concern related to facilitation of market development, which was one of the three core tasks of SFC, the other two being regulation and education. C/SFC said that with the reserves accumulated in the past years, SFC had plans to step up efforts in facilitation and education in the 2007-08 financial year and would endeavour to do its best in this regard with support from Members. To address Mr Abraham SHEK's concern, SFC/the Administration would provide information on the measures taken to facilitate market development and the introduction of new financial products in Hong Kong; as well as how the efficacy of the existing regime compared with that of overseas jurisdictions such as Singapore.

*Investigation and enforcement actions by SFC*

47. Mr Albert HO informed the meeting that a member of the public sought assistance from his office recently on an alleged case of unlawful act of a listed company. According to this person, SFC had told him that the complaint would not be pursued by SFC for investigation due to resources constraint. Mr HO was gravely concerned about the criteria or factors adopted by SFC in assessing the merits of complaints received, including the criteria for according priority and allocating resources for investigation, as well as whether resources constraint was a factor for consideration in deciding whether a complaint would be dealt with. Given the abundant reserves of SFC, Mr HO was of the view that additional resources should be allocated to the investigation of complaints.

48. In reply, CEO/SFC advised that while he would not comment on a particular case, it was the policy of SFC that all complaints received would be considered on their own merits. The complaints received would be subject to a formal screening process and considered by a committee which met on a weekly basis for the purpose. The complaints would be assessed in terms of factors such as the severity of the alleged misconduct/offence and the jurisdiction of SFC over the complaint etc. He assured members that resources constraint was not a factor for deciding whether a complaint should be pursued. Where a complaint warranted further action, SFC would identify the necessary resources and take appropriate action. In 2006, SFC had outsourced certain jobs to the private sector where in-house resources were insufficient to cope with the investigation work. For example, tender had been awarded to accountancy firms to perform additional audits on broker firms during the investigation of broker firms failure in 2006. Responding to Mr Albert HO's further enquiry on the number of complaint cases, CEO/SFC advised that SFC received an average of 20 to 30 complaints a week. In this regard, C/SFC invited Mr Albert HO to provide more detailed information on the aforesaid complaint case so that SFC could examine whether or not the case should be pursued.

49. Ms Emily LAU recapped that during the scrutiny of the Bill to give effect to the splitting of the chairman post of SFC, members were assured that there would be a clear division of responsibilities between the SFC Chairman and CEO in that the former would not be involved in the day-to-day regulatory work of SFC

nor influence the decisions of the executive arm on individual cases being reviewed or investigated. She therefore sought clarification as to whether C/SFC's request for information on the complaint case from Mr Albert HO was consistent with such division of responsibilities. In response, C/SFC advised that it was his responsibility, as the head of SFC who led the Board as a team, to ensure that complaints from the public would be dealt with by the executive arm in a proper manner. He nevertheless assured members that he would not be involved in the details or the investigation of the complaint.

#### *Other concerns*

50. Referring to the summary of the turnover and levy rate assumptions in paragraph 27 of the Annex to the paper provided by the Administration, Mr SIN Chung-kai enquired whether transactions in derivative warrants were subject to levy. In reply, CEO/SFC advised that the levy only applied to transactions in interests defined as "securities" and the question would hinge on whether derivative warrants were securities.

*(Post-meeting note: SFC has subsequently clarified that derivative warrants listed on the Stock Exchange of Hong Kong (the Stock Exchange) are securities, and transactions in derivative warrants on the Stock Exchange are subject to the transaction levy.)*

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51. To facilitate members' assessment of the cost effectiveness of SFC in performing its various functions, Mr SIN Chung-kai requested SFC to consider devising and including key performance indicators (KPIs) in its future budgets. In response, PS(FS) pointed out that it might not be practicable to apply KPIs to SFC's performance of its regulatory and enforcement functions. Nevertheless, he said that SFC/the Administration would look into Mr SIN's request.

52. Summing up, the Chairman called on SFC to give due consideration to members' views and make necessary adjustments to its resources allocation with a view to enhancing operational efficiency and retaining experienced personnel.

## **VI. Securities and Futures (Amendment) Bill 2007**

(LC Paper No. CB(1)1007/06-07(07) — Paper provided by the Administration

LC Paper No. CB(1)1008/06-07 — Background brief on "Major Proposals of the Securities and Futures (Amendment) Bill 2007" prepared by the Secretariat )

Briefing by the Administration/Securities and Futures Commission

53. At the invitation of the Chairman, the Secretary for Financial Services and the Treasury (SFST) briefed members on the background and the rationale of the Administration's proposal to amend the Securities and Futures Ordinance (SFO) so as to give statutory backing to major listing requirements. He highlighted the following points:

- (a) To reinforce Hong Kong's status as an international financial centre, it was essential to enhance market quality and protect investor interests. Hong Kong's status as an international financial centre and the premier capital formation centre for the Mainland had been hard-earned. To further consolidate Hong Kong's position, the Administration must enhance market quality in order to strengthen international investors' confidence in the financial markets. At the same time, the Administration should be mindful of the need to preserve the competitiveness of the Hong Kong markets by maintaining an efficient market without imposing undue compliance burden.
- (b) The Administration attached great importance to enhancing the regulatory regime for the financial markets. One of the major tasks was to give statutory backing to major listing requirements.
- (c) The existing legislation did not prescribe positive disclosure obligations on listed corporations, and no statutory sanctions were imposed on non-disclosure, late disclosure or selective disclosure of price-sensitive or other relevant information. Giving statutory backing to major listing requirements would create a statutory obligation on listed corporations and relevant parties to comply with these requirements and would enable the imposition of a wide range of statutory sanctions commensurate with the seriousness of the breaches.
- (d) The Administration had consulted the public and the market. They were generally supportive of the proposal. When consulted at its meeting on 4 April 2005, the Panel had expressed support in principle for the proposal and had provided comments on the overall approach.
- (e) The Administration and the regulators had conducted in-depth discussion on the issues raised by Panel members and on the legislative approach for the listing requirements. There had also been exchange of views with market practitioners and investor representatives.
- (f) The proposal as presented in the paper had been developed in the light of the discussion among the Administration, the regulators and market players. The proposal represented an appropriate balance

between enhancing market quality and facilitating market development. It would provide a legal basis for the effective enforcement of the major listing requirements by the regulator without imposing undue compliance burden on listed corporations.

- (g) The Administration hoped that the Panel would support the proposal for introducing the Securities and Futures (Amendment) Bill 2007 within the 2006-2007 legislative session with a view to enhancing the quality and competitiveness of the equity market.

54. At the Chairman's invitation, CEO/SFC, with the aid of power point presentation, took members through the salient points as follows:

- (a) The existing Listing Rules made and administered by the Hong Kong Exchanges and Clearing Limited (HKEx) were non-statutory. Compliance with these rules by issuers was based on contractual listing agreements between them and the HKEx. The HKEx however did not have statutory investigative powers, nor was there any positive disclosure obligation under the existing SFO.
- (b) In January 2005, the Administration and SFC issued in parallel "The Consultation Paper on Proposed Amendments to the Securities and Futures Ordinance to give Statutory Backing to Major Listing Requirements" and "A Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules (SMLR)" to gauge the views of the public and the market on the proposed amendments to SFO and the proposed rules to be made under the amended SFO.
- (c) There were concerns that in future, breaches of minor detailed requirements in the rules might attract severe statutory sanctions. The possible overlapping of roles and duties between HKEx and SFC, whether there were adequate checks and balances on the disciplinary powers of SFC in listing matters, as well as potential differences between SFC's statutory listing rules and the non-statutory rules of HKEx in terms of content, interpretation and administration were some other main areas of concern.
- (d) Notwithstanding the aforesaid concerns, the market had broad support for giving statutory backing to the major requirements of the listing rules covering the following areas:
  - (i) disclosure of price-sensitive information;
  - (ii) periodic financial reporting; and
  - (iii) shareholders' approval of connected and certain notifiable transactions.

- (e) There was general market consensus that empowering SFC to impose sanctions would ensure efficiency and timeliness in dealing with breaches, especially minor and technical breaches.
- (f) Under the new legislative approach, the statutory listing requirements representing fundamental obligations of listed corporations in the three disclosure areas would be set out in the primary law in the form of general principles. They would be supported by provisions in a new schedule to the SFO setting out the relevant factors for consideration when determining whether there was a breach of the general principles. To facilitate compliance with the statutory provisions, a non-statutory listing code containing the more detailed and technical requirements would be issued by SFC to provide guidance for the market on how the statutory listing requirements were to be interpreted and complied with. A breach of the schedule and the code by itself would not constitute market misconduct but might be taken as evidence in enforcement procedures or civil/criminal proceedings.
- (g) The new legislative approach had taken into account market comments and expectations to provide for the following:
  - (i) only one regulator on statutory rules to minimize the possibility of conflicting decisions between two regulators;
  - (ii) certainty and clarity so that issuers and company directors would know whether they should deal with the SFC or the HKEx; and
  - (iii) consistency in decision making and in the interpretation of the statutory provisions and the listing code.
- (h) Depending on its seriousness, a breach of the statutory obligations might potentially be subject to SFC disciplinary action, Market Misconduct Tribunal (MMT) proceedings, or criminal prosecution with penalties including imprisonment. It was proposed that SFC be empowered to impose civil sanctions including civil fines up to \$10 million on the primary targets (directors and issuers). It was also proposed that the MMT be empowered to impose, in addition to existing sanctions, new civil sanctions including public reprimands and unlimited civil fines.
- (i) Sanctions would be proportionate and reasonable, taking into account the seriousness of the breach, whether the breach was intentional, and its impact on the investing public. The SFC's overall focus was to encourage and assist compliance. Formal enforcement action would only be the last resort.

- (j) Full-time decision-makers, who would be experienced senior staff e.g. retired judges, lawyers, tribunal members etc would be appointed to a panel to be set up by SFC, to make enforcement decisions in relation to breaches of statutory listing requirements. In adopting this approach, the SFC had referred to overseas models, including the Regulatory Decisions Committee set up by the United Kingdom's Financial Services Authority. To allay market concern about the expanded role of SFC as the investigator, the prosecutor, and the judge in dealing with breaches of statutory listing rules, the panel would be functionally separated from SFC's Enforcement Division and would report directly to the Chief Executive Officer of the SFC. SFC's disciplinary decisions were also subject to appeal to the Securities and Futures Appeals Tribunal (SFAT).

55. Summing up, CEO/SFC advised that the Administration, SFC and HKEx would work closely to develop an appropriate operational mechanism to avoid dual regulation and conflicting decisions. SFC would consult the market and the Panel on major changes in future policy and development.

56. At this juncture, The Chairman informed members that he would need to leave at around 11:00 am for the airport. As the Deputy Chairman was not present at the meeting, members elected Mr Andrew LEUNG to take over the chair.

## Discussion

### *Compliance burden on small and medium listed companies*

57. Mr James TIEN declared that he was a non-executive director of two listed companies. He said that Members of the Liberal Party supported in principle the proposed amendments to give statutory backing to major listing requirements. Noting that the proposed statutory listing requirements, when enacted, would be applicable to companies seeking a listing, as well as existing listed companies, Mr TIEN considered that the proposal would not pose a burden on large and well-established listed companies but might impose a heavy compliance burden on small and medium companies as the latter might lack the necessary resources to fully meet the compliance requirements. He also raised concern on whether SFC would, when enforcing the listing rules, only target enforcement action at small companies.

58. Mr Abraham SHEK and Mr CHIM Pui-chung shared Mr TIEN's views. Mr CHIM Pui-chung pointed out that unlike large listed corporations, small listed companies might have resources constraint in engaging the service of legal and accounting professionals. Referring to his observation that SFC tended to target only small companies, Mr CHIM highlighted the need for a mechanism to safeguard against giving preferential treatment to big corporations when SFC performed its regulatory role. Dr Raymond HO was also concerned about certain perception that SFC tended to target enforcement action at small listed companies.

59. In response, SFST explained that the main objectives of giving statutory backing to the listing requirements were to enhance investors' confidence and market quality by bringing the regulatory regime on par with international standards. It was expected that corporate governance would be enhanced in the process to encourage compliance. He assured members that in formulating the proposal, full consideration had been given to striking an appropriate balance between strengthening the regulatory regime and catering for the market's need and market development. Regarding the impact on small listed companies, SFST pointed out that the new regime, when implemented, would in fact be beneficial to these companies as their compliance with the statutory requirements would demonstrate to investors, institutional investors in particular, the quality of these companies.

60. In this connection, CEO/SFC stressed that all listed companies, irrespective of size, would be subject to the same statutory listing requirements when such were in place. There was no question of SFC targeting its enforcement action at small companies only. He reiterated that SFC's overall focus was to encourage and assist compliance. Formal enforcement action would be taken as the last resort when circumstances so warranted.

61. As regards the concern about limited resources of small companies, CEO/SFC pointed out that it was the responsibility of listed companies and those seeking to list in Hong Kong to comply and familiarize with the listing requirements and related legislation. It was also incumbent upon these companies to be equipped with the necessary legal, accounting and other professional resources to discharge their obligations and comply with relevant requirements.

*Justifications for giving statutory backing to listing rules*

62. Mr Abraham SHEK questioned why statutory backing for listing requirements had not been considered when the SFO was passed in 2003, but was raised now when Hong Kong prided itself as an international financial centre. He sought explanation on whether there were any flaws in the existing listing regime which fell short of international requirements and required rectification.

63. In reply, CEO/SFC explained that the lack of regulatory teeth over listing requirements had all along been a concern to the market and the regulators. He said that in general, Hong Kong's listing requirements were on a par with international standards and that Hong Kong had bypassed New York and London in terms of the funds raised by initial public offerings. Notwithstanding the success attained, there was no room for complacency. While the vast majority of the companies listed in Hong Kong were law-abiding, the legislative proposal would enhance the existing regulatory regime and safeguard against abuse by a

very small number of companies (perhaps about 0.1%) whose action, if not properly sanctioned, might undermine the integrity of the market.

64. Mr James TO noted that under the current proposal, statutory listing requirements such as full and prompt disclosure of price-sensitive information would be set out in SFO in the form of general principles. Mr TO was concerned whether such general provisions had sufficient legal certainty, especially for enforcement purposes and in criminal prosecution. In response, CEO/SFC advised that Mr TO's concern was mainly a drafting issue and would be taken on board when the Administration/SFC proceeded to draft the relevant legislative amendments.

#### *Checks and balances on the powers of SFC*

65. Regarding concerns about the expanded role of SFC as the investigator, prosecutor and judge after taking up new regulatory responsibilities in listing, Mr Abraham SHEK enquired about the mechanism of imposing adequate checks and balances on SFC's regulatory powers.

66. In response, CEO/SFC stressed that under the current proposal, SFC would not be empowered to make rules by way of subsidiary legislation. On top of the existing checks and balances, SFC had proposed to ringfence the decision-making powers from the enforcement team by setting up a panel of full-time decision makers functionally separate from the SFC Enforcement Division. Moreover, SFC's decisions were subject to an appeal/review mechanism under which any person aggrieved by SFC's regulatory decisions could lodge an appeal to SFAT.

#### *International practice*

67. Ms Emily LAU supported in principle the Administration's proposal to give statutory backing to major listing requirements and concurred with the need for early implementation of the proposal. Noting that under the current proposed legislative approach, a new schedule would be added to SFO to set out the factors for consideration when determining whether there was a breach of the general principles and a non-statutory listing code would be issued by SFC to provide guidance on compliance, Ms LAU enquired whether this new approach was in line with the best international practice and whether the new regulatory regime would give SFC sufficient regulatory teeth to deal with breaches. She also sought clarification on whether a breach of the provisions of the new schedule and the listing code would not necessarily amount to misconduct.

68. In reply, CEO/SFC advised that there was no single global blueprint that could be followed by all jurisdictions. While the European Union had set out broad principles on insider dealings and market manipulation for its member states to follow, the Financial Services Authority of the United Kingdom on which Hong Kong modeled its principle-based approach was delegated the power to make statutory rules. CEO/SFC also clarified that a breach of the schedule or the listing

code would not in itself amount to a breach of the principles prescribed in SFO but would be a factor or evidence in determining whether there was a breach of the principles and might be taken as evidence in enforcement procedures or civil/criminal proceedings. He nevertheless stressed that each case would have to be considered on its own merits and the onus would be on SFC to prove beyond reasonable doubt that a breach of the principles had taken place that warranted sanctions.

69. In response to Ms Emily LAU's concern whether the current proposal was a compromise resulting from the pressure from certain sectors of the community, SFST reiterated that the current proposal aimed to improve the effectiveness of the regulatory regime in order to strengthen Hong Kong's position as an international financial centre. There was no question of compromise but full consideration had been given to balancing the need for enhanced regulation and the flexibility necessary for market development.

*Concern about possible duplication of function with the Financial Reporting Council*

70. Mr Ronny TONG said that he was in support of giving statutory backing to major listing requirements from the outset. Regarding the proposal to confer investigative and regulatory powers on SFC, he was concerned about any possible duplication of regulatory functions with the recently set up Financial Reporting Council (FRC) and, if yes, how the Administration would propose to rationalize the functions of the two bodies, such as by delineating their respective role and functions clearly in legislation.

71. In response, SFST advised that the regulatory function of FRC was to investigate irregularities associated with auditing and financial reporting of listed companies. Its function was different from that of SFC. When investigating alleged serious misconduct which might involve breaches of different nature, a certain degree of overlapping in the operation of different regulatory and enforcement bodies might be inevitable, though a high degree of duplication was not expected. He also pointed out that it might not always be practicable to specify exhaustively the demarcation of roles and responsibilities of different regulatory bodies in legislation. He nevertheless advised that the Administration would work closely with SFC, HKEx and FRC to achieve the common goal of enhancing market quality.

*Concern about pre-vetting requirement*

72. As listed companies were held responsible for the accuracy of the information they released, Mr CHIM Pui-chung considered the current practice of HKEx pre-vetting listed companies' circulars, announcements, and disclosure materials unnecessary and should be abolished.

73. In response, CEO/SFC agreed that it was the responsibility of listed companies to ensure compliance with disclosure requirements. Under the revised

regime, instead of dealing with the pre-vetting of announcements and notices, the focus of SFC would be on post-vetting with a view to ascertaining whether the companies had made any misrepresentation or provided misleading information.

*Flexibility and transparency of regulatory action*

74. While supporting in principle the spirit of the proposed amendment, Mr CHIM Pui-chung cautioned against draconian provisions and urged SFC to exercise greater flexibility in enforcement, particularly when dealing with breaches of statutory listing requirements relating to information disclosure. He pointed out that as commercial dealings were subject to changes, it was possible that certain development in the course of negotiation could render earlier disclosure inaccurate, making the listed company liable for giving false or misleading information. Mr CHIM considered that the Administration/SFC should issue clear guidelines on the listing rules to facilitate compliance by listed companies, especially small or overseas ones.

75. Mr Jeffrey LAM indicated his support for the proposal as a timely measure to enhance market quality and further reinforce Hong Kong's position as an international financial centre. He nevertheless highlighted the need for some degree of flexibility to enable prompt response to changes in market needs. Noting that market-sensitive information, particularly price-sensitive information, warranted special treatment, he supported Mr CHIM Pui-chung's view that SFC should issue clear guidelines to facilitate better understanding and compliance.

76. In response, CEO/SFC advised that the new legislative approach sought to enhance regulatory effectiveness while allowing SFC sufficient flexibility in the modification and interpretation of the provisions in the new schedule to SFO by issuing the non-statutory listing code having regard to market changes. SFC would provide guidelines on the listing rules and the criteria for assessing the seriousness of breaches to facilitate understanding and compliance by listed companies.

77. To allay the anxiety and ease the pressure on companies under investigation by SFC, Mr CHIM Pui-chung urged that in cases where no offences were found to have been committed, SFC should notify the companies concerned that the case was concluded and that no further action would be taken against them.

78. Mr Ronny TONG also expressed concern over the lack of transparency in the disciplinary decisions made by SFC and enquired on the measures, if any, to be taken to enhance transparency during the investigation and hearing process, as well as in the imposition of sanctions. Mr James TO also expressed dissatisfaction with SFC's lack of transparency in regulatory and enforcement matters.

79. Noting members' concern, CEO/SFC concurred that the company under investigation should be duly informed of the outcome as soon as investigation was concluded. On transparency, he pointed out that at times, it might be difficult to

strike a balance between the need to safeguard the necessary privacy during the course of investigation and the need for public disclosure. As regulatory action by SFC was not a public judicial process, SFC would not normally make any public statement in respect of cases under investigation as premature disclosure might result in pre-judging the cases. At the conclusion of investigation where misconduct was established and where no appeal was lodged, it was the usual practice for SFC to issue a press release setting out clearly the offences in question, the reasoning for reaching the disciplinary decision, as well as the sanctions imposed. In the event of an appeal to the SFAT, the findings of the SFAT would be published at the conclusion of the tribunal hearing.

80. CEO/SFC pointed out that the implementation of the new legislative proposal would serve to enhance transparency of the listing requirements. Apart from prescribing the general principles in the principal ordinance, SFC would set out the factors to be considered in making disciplinary decisions and imposing sanctions in the new schedule to SFO, as well as issue a non-statutory listing code to provide guidance for the market on how the statutory listing requirements were to be interpreted and complied with. The building up of precedent cases over time would enable listed corporations to have a better understanding on the operation of the listing requirements and on how breaches would be handled.

81. As regards the time required for investigation of breaches, SFST pointed out that this would depend on the circumstances of individual cases. While every effort would be made to avoid undue delay in the investigation and hearing process, it was equally important to follow the due process with a view to ensuring procedural fairness and reaching a fair and appropriate decision.

82. While supporting the proposal, Dr Raymond HO shared members' concern about the need for greater transparency and flexibility. Noting that the market practice in Hong Kong was not the same as that of other major overseas markets such as New York, London and Tokyo, he was concerned whether the Hong Kong market had the flexibility to cope with the needs for future development.

83. Miss TAM Heung-man said that she supported the proposed legislative amendments which sought to improve the regulatory regime and market quality. She also urged the Administration to come up with measures to address the concerns raised during previous Focus Group consultations so as to draw more support from the stakeholders. Sharing members' concern over transparency, she called on the Administration to consider further initiatives to enhance transparency.

84. Noting members' concern, SFST agreed that flexibility and transparency were essential elements for the securities market. He assured members that the Administration would endeavour to preserve flexibility in the administration of the statutory listing rules to ensure the efficient operation of the market, while allowing more transparency where practicable.

*Other concerns on listing*

85. Noting that many companies recently listed in Hong Kong were state or private enterprises from the Mainland, Mr James TIEN was concerned whether the number of local and foreign companies seeking to list in Hong Kong was on the decrease. While confirming that most of the companies recently listed in Hong Kong, particularly in 2006, were from the Mainland, SFST advised that one of HKEx's major initiatives was to open up the market to encourage listings of more overseas issuers. Referring to the recommendations of the Focus Group on Financial Services in the recent Economic Summit on "China's 11<sup>th</sup> Five-Year Plan and the Development of Hong Kong", SFST recapped that measures would be taken to facilitate the listing of foreign companies and to attract well-established and eligible foreign enterprises to list in Hong Kong, thereby consolidating Hong Kong's role as an international listing platform for quality companies. It was also hoped that more local companies would make use of Hong Kong's listing platform.

**VII. Any other business**

86. There being no other business, the meeting ended at 11:35 am.

Council Business Division 1  
Legislative Council Secretariat  
4 May 2007