

**立法會**  
**Legislative Council**

LC Paper No. CB(1)704/07-08  
(These minutes have been seen  
by the Administration)

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**Panel on Financial Affairs**

**Minutes of meeting**  
**held on Monday, 7 January 2008 at 10:45 am**  
**in the Chamber 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  
Dr Hon David LI Kwok-po, GBM, GBS, JP  
Hon James TO Kun-sun  
Hon Bernard CHAN, GBS, JP  
Hon SIN Chung-kai, SBS, JP  
Hon Emily LAU Wai-hing, JP  
Hon Abraham SHEK Lai-him, SBS, JP  
Hon Jeffrey LAM Kin-fung, SBS, JP  
Hon Andrew LEUNG Kwan-yuen, SBS, JP  
Hon WONG Ting-kwong, BBS  
Hon CHIM Pui-chung
- Members absent** : Hon Ronny TONG Ka-wah, SC (Deputy Chairman)  
Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP  
Hon TAM Heung-man
- Public officers attending** : Agenda Items IV and V

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

Agenda Item IV  
Hong Kong Monetary Authority

Mr Arthur YUEN, JP  
Executive Director (Banking Supervision)

Mr LI Shu-pui  
Head (Banking Supervision)<sup>5</sup>

**Attendance by invitation** : Agenda Items IV and V

Securities and Futures Commission

Mrs Alexa LAM  
Executive Director  
Intermediaries & Investment Products

Mr Keith LUI  
Executive Director  
Supervision of Markets

Mr Stephen PO  
Senior Director  
Intermediaries & Investment Products

Mr Rico LEUNG  
Director  
Supervision of Markets

Hong Kong Exchanges and Clearing Limited

Mr Gerald GREINER  
Chief Operating Officer

Mr Stewart SHING  
Executive Vice President and  
Head, Clearing Division

Mr Alfred WONG  
Chief Technology Officer and  
Head, Information Technology Division

Mr Eric YIP  
Head, Cash Market Department

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

**Staff in attendance:** 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 and matters arising**

(LC Paper No. CB(1)423/07-08 — Minutes of meeting on  
5 November 2007

LC Paper No. CB(1)512/07-08 — Minutes of special meeting on  
8 November 2007)

The minutes of the meeting held on 5 November 2007 and the special meeting held on 8 November were confirmed.

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

(LC Paper No. CB(1)406/07-08 — Mandatory Provident Fund  
Schemes Statistical Digest —  
September 2007

LC Paper No. CB(1)449/07-08 — Securities and Futures  
Commission Quarterly Report  
(July – September 2007))

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)510/07-08(01) — List of outstanding items for  
discussion

LC Paper No. CB(1)510/07-08(02) — List of follow-up actions)

3. The Chairman recapped that pursuant to members' agreement at the last meeting held on 3 December 2007, the regular meeting for February 2008 would be re-scheduled to be held on Tuesday, 29 January 2008 to facilitate the attendance of Mr Joseph YAM, the Chief Executive of the Hong Kong Monetary Authority (HKMA). Members agreed that the following items be scheduled for discussion at the meeting to be held on Tuesday, 29 January 2008, starting at 10:00 am:

- (a) Briefing on the work of HKMA; and
- (b) The 70% mortgage cap on residential property.

4. On item (b), Ms Emily LAU informed members that she had requested the Secretariat to prepare a background brief on the subject to facilitate members' discussion. The Chairman confirmed that the Secretariat was preparing the background brief and would issue it shortly for members' perusal.

*(Post-meeting note: The background brief on item 3(b) above was issued to members vide LC Paper No. CB(1) 559/07-08 on 10 January 2008.)*

#### **IV. Congestion in securities trading networks**

(LC Paper No. CB(1)362/07-08(01) — Administration's paper on congestion in securities trading networks )

5. The Chairman declared that he was a Non-Executive Director of the Securities and Futures Commission (SFC). He then invited the representatives of the Administration, HKMA, SFC and the Hong Kong Exchanges and Clearing Limited (HKEx) to brief members on the subject.

#### Briefing by the Administration and the financial regulators

6. The Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) (PAS/FS) said that the Administration had invited HKEx, SFC and HKMA to provide information about the incident of network congestion experienced by investors in executing buying and selling orders for a newly listed stock (i.e. Alibaba.com) on 6 November 2007. In brief, the network congestion experienced by investors at market opening at 10:00 am on 6 November 2007 was mainly caused by an unprecedented volume of order submissions within a very short period of time. The situation only lasted for a short period of time and had improved significantly when the order submission rate for the stock started to subside at around 10:15 am. PAS/FS pointed out that for the maintenance of Hong Kong's position as an international financial centre, the Administration had all along attached great importance to the stability and reliability of the financial infrastructure. The financial regulators fully recognized the importance of ensuring effective on-line trading and were of the view that the securities trading system of HKEx and most

financial intermediaries had demonstrated their abilities to cope with the recent surge in market activities and to handle some of the world's largest Initial Public Offerings (IPOs). HKEx would further increase the trading capacity of its Automatic Order Matching and Execution System/Third Generation (AMS/3) from 1.5 million to 5 million trades per day in January 2008. Meanwhile, HKMA was also monitoring the system utilization of on-line securities trading systems of major authorized institutions (AIs) on an ongoing basis.

7. The Executive Director (Banking Supervision), Hong Kong Monetary Authority (ED/HKMA) advised that according to the confirmation obtained by HKMA from major AIs, their on-line trading systems had been under normal operation on the day when the trading of Alibaba.com (Alibaba) was debuted i.e. 6 November 2007. He also informed members that as at end 2007, the number of retail Internet banking accounts had increased by around 24% and the transaction volume of on-line securities trading had increased by 133% when compared with the corresponding figures of 2006. In the light of the growing use of on-line securities trading services by bank customers and ongoing investor confidence in this channel of service delivery, HKMA was keenly aware of the importance of ensuring effective and reliable services to customers. To this end, HKMA had stepped up efforts in technology risk supervision focusing on risk management of AIs, including the requirements on AIs to formulate effective and practical business continuity plans to enable timely recovery of services in case of system disruption and to provide effective alternative service delivery channels (such as phone banking and manned customer service hotlines) to ensure continuous service to customers. As shown by HKMA's ongoing monitoring of system utilization of on-line securities trading systems of major AIs, their systems had achieved high reliability and smooth operation with a rate of normal operation in the range of 99.8% to 99.9%. ED/HKMA stressed that HKMA had been monitoring the technology risk management of AIs in a comprehensive manner and considered the performance of the trading systems of AIs reasonable so far.

8. Mr Keith LUI, Executive Director, Supervision of Market of the Securities and Futures Commission (ED(SM)/SFC) stressed that SFC had all along attached great importance to ensuring the reliability and stability of securities trading facilities in Hong Kong. In this connection, SFC was kept informed by HKEx on the processing capacity of its system and enhancement efforts. Pointing out that the network congestion experienced by investors on the first trading day of Alibaba was mainly attributable to an unprecedented volume of order submissions in the first 20 minutes after market opening, ED(SM)/SFC said that HKEx had taken prompt action to ensure the smooth execution of orders received by AMS/3. SFC had been monitoring HKEx's ongoing initiatives in system planning and upgrading for coping with the increase in market activities.

9. Mr Gerald GREINER, Chief Operating Officer of the Hong Kong Exchanges and Clearing Limited (COO/HKEx) advised that HKEx kept its system capacity under continuous and careful monitoring to ensure that the capacity could cope not only with historical peaks, but also the projected growth of market activities. He

informed members that in 2007, the processing capacity of AMS/3 had already been increased from 1.2 million to 1.5 million trades per day when the peak historic rate was about 0.5 million trades per day. Further major system upgrading would be carried out in 2008 and the capacity could be increased further to 7.5 million trades per day if necessary. COO/HKEx pointed out that by the end of 2008, the processing capacity of AMS/3 could cope with about six times of the daily peak trading records, which was above the normal requirement of a spare system capacity to handle about two to three times of the peak. Moreover, HKEx could upgrade the AMS/3 within a relatively short lead time of about three months.

## Discussion

### *Congestion experienced during the debut trading of Alibaba.com*

10. Mr Andrew LEUNG cautioned that the credibility of Hong Kong's status as an international financial centre and a preferred listing venue for enterprises might be undermined should serious network congestions occur during future trading peaks. He therefore enquired about the remedial actions taken by the Administration and the financial regulators after the network congestion on the first trading day of Alibaba.

11. In response, PAS/FS advised that following the peak period of order submissions on the first trading day of Alibaba, the Administration had invited HKMA, SFC and HKEx to review the system capacity of on-line trading facilities. She reiterated that in general, the financial regulators were of the view that the securities trading system of HKEx and most financial intermediaries had demonstrated the abilities to cope with the recent surge in market activities. HKEx had planned to upgrade the capacity of its AMS/3 in 2008 with a view to increasing its processing capability.

12. Mr James TIEN was concerned whether the interest of small investors had been jeopardized on the first trading day of Alibaba, given its volatile price movements on that day. In this connection, Mr TIEN enquired whether large buying or selling orders placed by institutional investors had been given priority over small orders placed by retail investors in the trading systems operated by broker firms and HKEx.

13. In this regard, COO/HKEx and ED(SM)/SFC confirmed that HKEx's trading system would process order submissions strictly according to the time and price priority. COO/HKEx said that a new order received by AMS/3 would be placed in a store and forward queue pending order matching with a priority number according to the time of receipt regardless of whether the order had come from an institutional or retail investor and the number of shares being transacted. ED(SM)/SFC further explained that there was a pre-market opening process for brokers to submit trading orders involving large transactions through an auction process before market opening. This auction process had accounted for the surge in the price of Alibaba from the initial \$13 to about \$30 before market opening on 6 November 2007. Given the sharp rise in the price of the stock after market opening, there was a large number

of orders during the first 20 minutes of market opening to cancel or modify the earlier instructions.

14. Mr SIN Chung-kai highlighted that the crux of the problem was the capability of the on-line securities trading system to process an unprecedented volume of order submissions within a short period of time, not its overall capacity spread over a longer span of time. As such, Mr SIN was of the view that HKEx's AMS/3 should be equipped with sufficient capability to cope with the extreme situation where a tremendous volume of orders were submitted into the system within just a few minutes on the busiest day. He enquired whether HKEx had experience in dealing with order submissions in bunches similar to that on the first trading day of Alibaba and the arrangements, if any, that had been made to cope with such a historical peak in the past.

15. In response, COO/HKEx said that the response time for orders submitted to AMS/3 could vary at different times of the day. The large number of Alibaba orders on 6 November 2007 was unique and unprecedented. In the light of the experience of the debut trading of Alibaba, HKEx had suitably modified the arrangements for processing the transactions of IPO stocks. These arrangements had been tested in the debut trading of another newly listed stock, i.e. China Railway. With comparable, if not more, order submissions for this stock, the maximum time for a second response for orders was less than 10 seconds, which was a significant improvement over the maximum response time of 5.5 minutes for Alibaba orders. COO/HKEx believed that with further upgrading of the AMS/3 system in January and later in 2008, the system would be able to cope with heavy trading on active days and peak periods as a whole and on debut trading days of popular stocks. ED/HKMA further informed members that HKMA had been monitoring the peak utilization rate in its supervision of AIs' technology risk management under which AIs would be required to upgrade their system capacity when the peak utilization rate of their systems reached a high level.

*Requirements on AIs and broker firms to cope with contingencies*

16. The Chairman observed that in addition to the capacity of AMS/3 of HKEx to cope with heavy trading through continuous system upgrade, it was also important to ensure the capacity and reliability of the on-line trading systems operated by AIs and broker firms. In this connection, he enquired whether regulatory requirements were in place for AIs and broker firms to report system disruptions to their respective regulators, namely HKMA and SFC. The Chairman was of the view that constant reviews by HKMA and SFC of the provision of on-line trading services by AIs and broker firms would be crucial to safeguarding investors' interest.

17. In response, ED/HKMA confirmed that AIs were required to make immediate reports to HKMA on system disruptions. He said that the performance of Internet banking and on-line securities trading systems operated by AIs in 2007 were satisfactory, with major AIs attaining a rate of normal operation of 99.8% to 99.9%. AIs were also required to formulate effective and practical business continuity plans

in case system disruption occurred and to take steps to recover the system within reasonable time. On average, AIs had managed to recover system disruptions within one to two hours. In addition to providing alternative service delivery channels during system disruptions, AIs were required to inform their customers of these channels and deploy additional resources for service delivery when necessary.

18. Mrs Alexa LAM, the Executive Director (Intermediaries & Investment Products), the Securities and Futures Commission (ED(IIP)/SFC) also confirmed that intermediaries were required to report system disruptions to SFC. She advised that as of November 2007 there were about 200 securities firms under the supervision of SFC which provided on-line securities trading services, with on-line transactions clients constituting about 10% to 20% of the total number of clients of major brokers. ED(IIP)/SFC further advised that as reported by some broker firms, their trading systems were operating with abundant spare capacity as their current trading activities had only taken up about 40% of their system capacity. As part of their licensing requirements, brokers should have in place on-line securities trading systems with sufficient operational integrity and address issues of security, reliability, capacity and contingency. Broker firms were required to conduct regular system testing and formulate appropriate contingency plans such as informing clients of alternative service delivery channels and deploying sufficient manpower to process customer orders manually. ED(IIP)/SFC pointed out that where a broker firm had records of frequent system disruptions, SFC would critically review its suitability for continued provision of on-line securities trading services. SFC would also make enquiries with broker firms in the event of unusual market turnover to check out the operation of their on-line trading systems.

19. Responding to the Chairman's further concern about the lead time for system recovery and the possible losses suffered by investors, ED/HKMA explained that the lead time for system recovery varied between cases depending on the causes of disruption. While the average time required was one to two hours, some AIs had managed to recover their systems within a shorter time of say, about 30 minutes. He pointed out that it was HKMA's supervisory objective to achieve 100% smooth system operation. Nevertheless, HKMA had not prescribed any specific requirement on the lead time for system recovery by AIs as HKMA considered it more appropriate for AIs to achieve system recovery as soon as practicable having regard to the circumstances of the disruption and with a view to minimizing inconvenience caused to customers.

20. Given the increasing use of on-line trading services by investors, the Chairman cautioned that broker firms and AIs might have concentrated their resources to alternative service delivery channels in providing on-line trading services and thus might not be able to deploy sufficient resources for manual processing of customers orders promptly when system disruption occurred.

*Enhancing on-line trading systems to keep pace with market developments*

21. Mr James TIEN was concerned about measures to enhance the on-line trading systems operated by broker firms to prevent recurrence of network congestion in future. In response, ED(SM)/SFC advised that through participation in the regular market rehearsals conducted by HKEx, broker firms could test out the compatibility of their on-line securities trading systems with HKEx's system. Broker firms were responsible for keeping up their system performance to provide an acceptable level of service to their customers.

22. Mr Andrew LEUNG was of the view that in addition to involving broker firms in regular market rehearsals and relying on their initiatives to enhance the capacity of their on-line securities trading systems, the Administration should, in conjunction with SFC and HKEx, set out system requirements for reference and compliance by broker firms. In view of the increasing demand for on-line securities trading, Mr LEUNG considered that the Administration and the financial regulators should work closely and proactively to ensure that the systems operated by HKEx and broker firms would have the necessary capability to cope with rapid market changes.

23. PAS/FS advised that it might not be practicable to specify a hard and fast system capacity requirement for compliance by all broker firms or for AMS/3 as any target capacity set at one point of time might later become inadequate due to the continuous increase in market activities. As such, the Administration considered it more effective for HKEx to monitor closely the operation of its trading system and its compatibility with the systems operated by brokers, and to arrange for timely system upgrade to meet market developments and customer demands. Broker firms would have to review the need for upgrading their on-line securities trading systems on account of their service needs.

24. Mr Andrew LEUNG remained concerned that if broker firms failed to take timely action to upgrade their trading system, the interest of small investors would be jeopardized as network congestion might still occur with the bottleneck at the broker's front-end trading facilities, despite the efficient processing capability of AMS/3. He was therefore of the view that brokers and other intermediaries should at least be subject to a regulatory requirement to keep their system capacity and operation under constant review. The Chairman shared Mr LEUNG's view and called on the Administration to consider formulating a policy on the regulation of on-line securities trading services having regard to anticipated market developments, such as the further liberalization measures under the Qualified Domestic Institutional Investors (QDII) Scheme and the launch of the "through train" scheme for individual Mainland investors to invest in Hong Kong equities.

25. Noting members' concerns about the need for trading systems to meet market demands, PAS/FS said that HKEx would keep under review the need or otherwise for further upgrading of its system capacity. As regards the concern about the capability of on-line securities trading systems to cope with future increase in market activities, PAS/FS advised that the Administration had asked the financial regulators to closely monitor the effectiveness of these systems, so as to ensure smooth

handling of anticipated increase in market activities arising from future expansion of the initiatives such as the QDII scheme and the possible launch of the "through train" scheme. As for requirements on brokers to upgrade their systems, PAS/FS recapped that financial intermediaries under the supervision of SFC were required to observe the guidelines issued by SFC, including the requirement on financial intermediaries to be "fit and proper" persons in providing service to customers. If the on-line trading system operated by a certain broker failed to provide a reasonable level of service to its customers to the extent that the broker's ability to meet the "fit and proper" criteria was called into question, SFC could consider taking regulatory action against the broker.

26. Mr James TO opined that clear and objective system requirements were important for the purpose of monitoring compliance, as individual broker firms might only carry out necessary upgrades out of business considerations. In this connection, Mr TO enquired whether and what objective service standards and system requirements had been set by financial regulators for compliance by financial intermediaries, such as the frequency for review of system capacity by intermediaries and the thresholds which would trigger a review. PAS/FS advised that the Administration was fully aware of the need for constant review of the system capacity of stakeholders to cope with the surge in market activities, and noted that the financial regulators would take this into account in performing their regulatory duties.

27. ED/HKMA said that under the technology risk supervisory framework of HKMA, AIs were required to keep their on-line service systems under ongoing review and the peak utilization rate versus the designed system capacity was used as one of the supervisory benchmarks. Depending on the design and capacity of individual AIs' trading systems, the threshold which would trigger regulatory concerns was when the peak utilization rate had reached around 50% to 70% of the designed system capacity. In addition to monitoring the peak utilization rate of AIs' on-line trading systems, HKMA had liaised with individual AIs and the Hong Kong Association of Banks to look into the service requirements arising from possible new initiatives such as the QDII Scheme and the "through train" scheme.

28. ED(SM)/SFC highlighted that SFC supervised the financial intermediaries through issuing guidelines on internal controls. Instead of prescribing quantitative service standards or requirements on system capacity, SFC required intermediaries to review and upgrade their systems to meet customer demands and to achieve their intended level of service. Moreover, the regular market rehearsals conducted by HKEx would enable broker firms to examine the compatibility of their trading systems with AMS/3 and consider the need or otherwise for upgrading. The complaints received by SFC were also indicators of the performance of individual broker firms. He advised that only a small number of the complaints received by SFC related to the provision of on-line securities trading services by broker firms. Upon receipt of a complaint, SFC would make enquiry with the broker concerned. Where the complaint had arisen from misunderstanding of the operation of the

on-line system, the broker would be required to explain to the complainant accordingly.

29. Noting the different approaches adopted by HKMA and SFC, Mr James TO was of the view that to achieve more effective monitoring of the provision of on-line securities trading services, the Administration/SFC/HKEx should consider prescribing objective service standards and setting trading system requirements for the reference and compliance by brokers. In doing so, due regard should be given to the peak volume for on-line market activities in addition to the historical peak. Mr SIN Chung-kai was concerned that under the existing regulatory framework, small-sized broker firms would not have the incentive to invest in system upgrading to meet the requirement of peak volume on-line market activities on a special occasion such as the debut trading day of an over-subscribed IPO. In this regard, Mr SIN opined that an alert mechanism for a sudden surge in market activities giving rise to an exceptionally high market turnover should be devised. In this connection, he also asked the Administration to consider the feasibility of taking the lead in forming a task force to coordinate emergency response efforts among various stakeholders when network congestion in securities trading occurred.

Admin/  
SFC/  
HKEx

Admin

## V. Investor Participant Accounts administered by the Hong Kong Securities Clearing Company Limited

(LC Paper No. CB(1)510/07-08(03) — Administration's paper on investor participant accounts administered by the Hong Kong Securities and Clearing Company Limited)

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

30. At the invitation of the Chairman, PAS/FS and ED(IIP)/SFC outlined the measures taken by SFC and HKEx to promote the use of the Stock Segregated Accounts (SSAs) and the Investor Participant Accounts (IPAs), which were introduced in 1994 and 1998 respectively. These measures included system improvements to streamline the operations and enhance the user-friendliness of such accounts, as well as investor education programmes and publicity campaigns aimed at raising investors' awareness of the services. Notwithstanding these efforts, the take-up rate of SSAs and IPAs remained low. As at November 2007, there were only about 18 000 IPAs and about 2 100 SSAs.

31. PAS/FS stressed that the Administration attached great importance to investor protection and education, both of which were crucial to the stability and healthy development of the financial market. The Administration, in collaboration with SFC and HKEx, would continue to introduce initiatives to raise investors' awareness of their rights and promote better understanding of investment risks. Further promotional measures for SSAs and IPAs targeting at retail investors would be introduced. Regular seminars would be organized in collaboration with

investment brokers on investor protection featuring SSAs and IPAs. Publicity programmes would be launched to encourage brokers and financial institutions to send information leaflets/applications forms etc to their clients. Other initiatives would include taking stock of measures by brokers to promote IPAs and SSAs, conducting surveys to gauge investors' attitude to and understanding of IPAs and SSAs, soliciting feedback from existing SSA and IPA users to identify any operational difficulties, and conducting a corporate fee review including the charges of SSAs and IPAs. On longer-term measures, SFC and HKEx would conduct a review to identify ways and means to address the inherent problems with the current asset custodian arrangements to minimize the risks of possible misappropriation by brokers.

32. ED(IIP)/SFC assured members that SFC, as the market regulator, closely monitored the activities of securities firms and financial intermediaries with a view to safeguarding investors' interests and minimizing the risks of misappropriation, and would continue to work with the Administration and HKEx on the promotion of SSAs and IPAs. She also urged investors to stay vigilant and give due consideration to balancing the needs for retaining greater control over their securities, and for the convenience of depositing their shares in brokers' omnibus accounts with the Central Clearing and Settlement System (CCASS).

### Discussion

#### *Safeguards against risks of misappropriation by brokers*

33. While appreciating the various investor education and publicity efforts made by SFC and HKEx as set out in the Administration's paper (LC Paper No. CB(1)510/07-08(03)), Mr Abraham SHEK enquired about the protection measures available to retail investors who had not subscribed for IPA and SSA services. In response, ED(IIP)/SFC explained that at present, most investors' securities were deposited with the CCASS in brokers' omnibus accounts. This arrangement, while giving brokers the convenience of full control of the securities and money movements in their omnibus accounts and investors the convenience of trading without being directly involved in processing securities and money movements, carried the risks of possible misappropriation by brokers. She pointed out that to safeguard his assets, the safest option was for a retail investor to open an IPA under his own name, so that only the investor himself could authorize the transfer of stocks in and out of the account. ED(IIP)/SFC nevertheless said that investors had to make a choice to suit their own needs, balancing investment convenience against investment protection. Some of the measures which retail investors could take to safeguard their interests included the following :

- (a) Cheques should not be made payable to individual account executives (AE) of the broker firm, nor should money be deposited into an AE's personal bank accounts.

- (b) Monthly statements and account activity statements were important documents. Investors should not authorize the sending of such statements to their AEs.
- (c) Investors should monitor closely the activities of their stocks accounts, and carefully check transaction statements and other documents issued by auditors requesting verification.
- (d) In the event of any discrepancy or doubt, investors should make enquiry with the broker firm in question or call the SFC hotline for assistance.

34. Regarding the availability of educational materials on how to be a smart investor, the Chairman noted that information pamphlets and educational programmes through various channels were currently available to enhance the investing public's awareness of their rights and the risks they faced. He shared Mr SHEK's view that educational and promotional efforts should be stepped up to raise investors' awareness and to encourage the use of IPAs and SSAs for better protection.

*Safeguarding stock brokers' interests under the existing settlement arrangement*

35. While acknowledging the need for investor protection and expressing support for promoting the use of SSAs and IPAs, Mr CHIM Pui-chung drew the meeting's attention to the potential risks faced by stock brokers under the existing settlement arrangement if IPAs were widely adopted. As the IPA holder was the legal owner of the stocks deposited in the CCASS, the broker in question had no control over the stocks transacted. Hence, upon the expiry of the 2-day settlement period under the existing T+2 settlement mechanism, if the IPA holder failed to complete the transaction, the broker would not be able to take any action but would become liable. If IPAs were to be widely used, Mr CHIM enquired whether the Administration and HKEx would consider replacing the existing T+2 settlement requirements with a same-day settlement regime in order to minimize the risks to which brokers were exposed. Nevertheless, he understood that this might not be technically feasible for overseas banks and this issue had to be properly addressed. He called on HKEx to consider upgrading the CCASS to a level comparable to that of the premier accounts operated by some banks whereby investors and/or stock brokers could phone-in with a Personal Identity Number to place instructions to authorize the settlement and/or the transfer of shares in and out of the IPAs and SSAs on the trading day in question, or as soon as practicable after the transaction. While acknowledging that the volume of transactions would be huge, Mr CHIM said that he could not see why such a practice that had been proven feasible in Shanghai, Shenzhen and Taiwan could not be applied to Hong Kong. He suggested the Administration to conduct a study to assess the feasibility with reference to the experience of other territories.

36. Noting Mr CHIM Pui-chung's concern about brokers' interests under the current security settlement and custodian arrangements, COO/HKEx advised that

IPAs and SSAs were not meant to solve all the potential problems faced by investors and brokers, neither could IPAs and SSAs be expected to eliminate the risks associated with margin accounts, short selling, and the credit positions of the clients. ED(SM)/SFC restated that IPAs and SSAs were introduced mainly for the better protection of investors who could have greater control over their securities.

37. In this connection, Mr Stewart SHING, Executive Vice President and Head, Clearing Division of HKEx (EVP/HKEx) recapped that SSA was introduced in 1994 as a sub-account segregating an investor's stocks from the broker's and other investors' stock holdings. In view of public concerns in the wake of the collapse of the C.A. Pacific Group, IPA was introduced in 1998 as a direct custodian account of stocks in CCASS for investors. An IPA opened in the name of the investor gave the investor direct and full control over his stocks kept in the account and only the IPA holder was recognized as the legal owner by Hong Kong Securities Clearing Company Limited (HKSCC) for authorizing the withdrawal or deposit of stocks. Trading would still need to be done through the brokers of the buyers and sellers, but the HKSCC would transfer the stocks to the broker's account only upon the investor's instruction and confirmation.

38. On whether the widespread use of IPAs and SSAs would adversely affect the business of broker firms, Mr Albert HO opined that the spate of broker firm closures in the past few years had sparked off a confidence crisis among retail investors and prompted many of them to turn to banks for buying or selling of listed stocks. Hence, the use of IPAs and SSAs, if proven to be effective, could in fact help restore investors' confidence in broker firms. Mr HO also asked whether and in what ways an investor could have the protection of an IPA and SSA while retaining the convenience of personalized investment service by his broker.

39. In response, ED(SM)/SFC and EVP/HKEx recapped that it was up to the individual investor to make his own choice in accordance with his needs, balancing the convenience of investment against greater control over his stocks. For example, an investor could open an IPA for safekeeping those stocks purchased for longer-term investment. For stocks to be traded on a short-term basis, they could be deposited with the broker's omnibus account under CCASS, or could be transferred to an SSA. As an SSA holder, he would be informed of any stock movements in the SSA via SMS/email alerts as well as daily and monthly statements.

#### *Review of the fee structure*

40. On the fee regime, Mr CHIM Pui-chung said that the HKSCC, being the sole authorized institution for the clearing and settlement of securities trading in Hong Kong and for operating IPAs and SSAs, should maintain a reasonable fee structure. Noting that HKEx would conduct a fee review including the charges of IPA and SSA, Ms Emily LAU sought elaboration and enquired about the existing fee levels, the room for reduction, and the timetable for the fee review.

41. In response, COO/HKEx advised that there were different charges for different types of services, such as the custody of securities and collection of dividends. The charges for some services had in fact been reduced over the years to promote the use of IPAs. IPAs and SSAs were operated on a not-for-profit basis for the purpose of safeguarding investor interest and preserving market integrity. He said that 16 service enhancements had been introduced and more would be introduced to improve user-friendliness. To attract more investors to use IPAs and SSAs, HKEx would review the fee levels, explore room for fee reduction, and examine the possibility of further streamlining and consolidating the existing fee regime. In this connection, the Chairman remarked that the small amount of fee charged for IPAs would unlikely deter investors from using the service.

*The slow take-up of Investor Participant Accounts*

42. Ms Emily LAU noted that despite various system enhancements and promotional measures to promote the use of IPAs since its introduction in 1998, the take-up rate remained low. She sought explanation for the low take-up rate. In response, EVP/HKEx advised that the 18 000 or so IPA holders represented about 1% of the total number of investors. The major reasons for the low take-up were retail investors' lack of awareness of the benefits of these accounts and investors' preference for trading convenience. In this regard, PAS/FS clarified that about 50% to 60% of investors currently traded their stocks through the brokerage service of banks. Mr Albert HO and the Chairman considered that the fear of losing their clients might have discouraged small broker firms from promoting the use of IPAs and SSAs among their clients.

43. Ms Emily LAU expressed concern about the relatively unsatisfactory response from investors to the use of IPAs. She sought the Administration's elaboration on the proposed promotional measures as set out in paragraph 10 of the Administration's paper (LC Paper No. CB(1)510/07-08(03)), and questioned whether the efforts to promote IPAs were worth-pursuing.

44. In reply, PAS/FS advised that in addition to the system enhancements to streamline the operations of IPA and SSA, educational and promotional efforts had all along been undertaken by SFC and HKEx on an ongoing basis. To encourage the wider use of these accounts and services, the views of investors and existing users on both the benefits and operational difficulties in using the services would be sought in a more organized and systematic manner with a view to identifying possible improvement measures. Regarding the time-table for review and implementation of improvement measures, ED(SM)/SFC said that investor education and protection was a long-term and ongoing exercise. The review in question would be conducted in due course.

45. The Chairman shared Ms Emily LAU's concern about the slow take-up of IPAs over the last 10 years since its introduction in 1998. He said that although the current regulatory regime was by and large effective, the isolated incidents of fraud and misappropriation by brokers had inevitably undermined investors' confidence

and tarnish Hong Kong's reputation as a leading international financial centre. Moreover, the switch to using banks' securities trading services in recent years might have put much pressure on small broker firms, which was not conducive to fair competition and to the healthy development of the securities industry.

*Restrictions on short selling*

46. Mr CHIM Pui-chung noted that under the existing regulatory regime, short selling, except under exempt circumstances, constituted a criminal offence. Considering that short selling might be caused inadvertently, Mr CHIM urged the Administration and SFC to consider relaxing the existing restrictions so that inadvertent short selling would not be penalized while repeated short selling would be treated as an offence. As regards the costs incurred in the course of investigation and legal proceedings for alleged broker misconduct, Mr CHIM considered it unreasonable that the brokers and ultimately their clients had to bear the huge investigation and litigation costs incurred.

Concluding remarks

47. Summing up, the Chairman considered that to ensure effective protection for investors, IPAs should be made part and parcel of the stock transaction regime, instead of just an optional service. He believed that the current inconvenience of using IPAs would gradually be removed through service improvements and operational enhancements. He requested the Administration, in collaboration with SFC and HKEx, to consider and explore the feasibility of institutionalizing IPA into the existing regime. To facilitate members' reference, the Administration/SFC/HKEx were also requested to provide information in the form of a flow chart setting out the steps/procedures required to be taken by an IPA holder and his broker in placing and executing buying and selling orders of listed stocks.

Admin

Admin

**VI. Any other business**

48. There being no other business, the meeting ended at 12:40 pm.

Council Business Division 1  
Legislative Council Secretariat  
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