立法會
Legislative Council

LC Paper No. CB(1)2740/08-09
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Panel on Financial Affairs

Minutes of special meeting
held on Thursday, 11 June 2009 at 2:30 pm
in Conference Room A of the Legislative Council Building

Members present :	Hon CHAN Kam-lam, SBS, JP (Chairman) Hon Ronny TONG Ka-wah, SC (Deputy Chairman) Hon Albert HO Chun-yan Dr Hon David LI Kwok-po, GBM, GBS, JP Hon James TO Kun-sun Dr Hon Philip WONG Yu-hong, GBS Hon Emily LAU Wai-hing, JP Hon Abraham SHEK Lai-him, SBS, JP Hon Vincent FANG kang, 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 Hon KAM Nai-wai, MH Hon Starry LEE Wai-king Hon Paul CHAN Mo-po, MH, JP Hon CHAN Kin-por, JP Hon Tanya CHAN Hon Mrs Regina IP LAU Suk-yee, GBS, JP
Member attending :	Hon WONG Kwok-hing, MH

Public officers attending : Agenda item I

Mr John LEUNG, JP
Deputy Secretary for Financial Services and the Treasury (Financial Services)3

Ms Ada CHUNG
Registrar of Companies

Miss Grace KWOK
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)6

Mr Kenneth CHENG
Principal Assistant Secretary for Financial Services and the Treasury (Treasury)

Mrs Brenda LEE
Assistant Commissioner of Inland Revenue

Agenda item II

Mr Patrick HO, JP
Deputy Secretary for Financial Services and the Treasury (Financial Services)2

Ms Angelina KWAN
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)7

Mr Raymond CHAN
Head (Banking Policy)
Hong Kong Monetary Authority

Ms Carol HUI
Acting Assistant Commissioner of Insurance (Policy and Development)
Office of the Commissioner of Insurance

Mr CHAN Chi-keung
Head of the Special Project Planning Team, Trade Controls Branch
Customs and Excise Department

Agenda item III

Ms Julia LEUNG
Acting Secretary for Financial Services and the Treasury

Ms Mandy WONG
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) 1

Mr Joseph YAM
Chief Executive
Hong Kong Monetary Authority

Mr CHOI Yiu-kwan
Deputy Chief Executive
Hong Kong Monetary Authority

Attendance by invitation : Agenda item II

Ms Yvonne MOK
Director, Intermediaries Supervision
Securities and Futures Commission

Agenda item III

Mr Martin WHEATLEY
Chief Executive Officer
Securities and Futures Commission

Mr Brian HO
Executive Director, Corporate Finance
Securities and Futures Commission

Clerk in attendance: Ms Rosalind MA
Chief Council Secretary (1)5

Staff in attendance : Mr Kelvin LEE
Assistant Legal Adviser 1

Mr KAU Kin-wah
Assistant Legal Adviser 6

Mr Noel SUNG
Senior Council Secretary (1)4

Ms Haley CHEUNG
Legislative Assistant (1)8

Action

I Companies (Amendment) Bill 2009 and Business Registration (Amendment) Bill 2009

(LC Paper No. CB(1)1829/08-09(01) — Administration's paper on the Legislative Proposals in the Companies (Amendment) Bill 2009 and Business Registration (Amendment) Bill 2009

LC Paper No. CB(1)1827/08-09 — Background Brief on Companies (Amendment) Bill 2009 prepared by the Legislative Council Secretariat)

Briefing by the Administration

At the invitation of the Chairman, Deputy Secretary for Financial Services and the Treasury (Financial Services)3 (DS(FS)3) briefed members on the legislative proposals to be included in the Companies (Amendment) Bill 2009, to provide for electronic incorporation and filing of documents and other technical amendments, ahead of the Companies Ordinance (Cap. 32) (CO) rewrite exercise. This was mainly to tie in with the implementation of Phase II of the Integrated Companies Registry Information System, which was expected to come on stream in late 2010/early 2011. Assistant Commissioner of Inland Revenue (AC/IR) also briefed members on the legislative proposals under the Business Registration (Amendment) Bill 2009 to be introduced together with the Companies (Amendment) Bill 2009, to facilitate the simultaneous application and other business registration applications through electronic means. The Administration was drafting the legislative amendments in respect of the proposals with a view to introducing the above two bills in the last quarter of 2009.

Discussion

Multiple statutory derivative actions

2. The Deputy Chairman expressed concern about details of the proposal to amend CO to expand the scope of statutory derivative actions (SDA) to cover "multiple" derivative actions. He enquired whether the proposal would fully address the issue about shareholders' rights to commence SDA on behalf of the company, i.e. whether shareholders of a subsidiary and/or associate company could commence SDA on behalf of the company.

3. DS(FS)3 advised that in a recent case *Waddington Ltd. v Chan Chun Hoo* CACV No. 220 of 2005, both the Court of Appeal and the Court of Final Appeal ruled that a "multiple" derivative action was maintainable in Hong Kong under the common law and said that it was appropriate for CO to be amended to cover "multiple" SDA as there was no justification for excluding them from the statutory regime. The proposal to expand the scope of SDA to cover "multiple" derivative actions in light of the above ruling had been discussed in detailed by the Standing Committee on Company Law Reform.

4. Registrar of Companies (R of C) added that the proposed amendment of CO would give standing to members of related companies and provide a simple and effective mechanism for shareholders of a related company to commence SDA on behalf of the company. R of C drew members' attention to the definition of related company under footnote 9 of the Administration's paper, which, in relation to a specified corporation meant any company that was the specified corporation's subsidiary or holding company, or a subsidiary of that specified corporation's holding company.

5. The Deputy Chairman expressed further concern that the proposal might give rise to an increase in the number of SDA and intervention in proceedings, thereby subjecting the operation of listed companies to higher risks of legal challenges. He called on the Administration to provide more information on the proposed amendments upon the introduction of the Companies (Amendment) Bill 2009. In reply, R of C advised that this involved the question of striking a proper balance between the rights of shareholders in commencing SDA and the effective operation of listed companies. R of C believed that the proposal would further enhance the protection of interests of minority shareholders in general. She pointed out that the operation of listed companies should not be unduly affected as shareholders had to seek leave from the court to commence SDA.

Company names

6. Mr CHAN Kin-por questioned the merits of implementing the proposal to bring forth the approval of company names prior to the company incorporation process, given that the revised procedures would only shorten the company incorporation processing time from four to one working day and that R of C could direct a company to change its name after the approval if the name was found to be objectionable upon further checking.

7. DS(FS)3 pointed out that at present, most of the processing time for incorporation of companies was spent on scrutinizing proposed company names to ensure that they were not objectionable for various reasons. To expedite the company name registration system, the Administration proposed to bring forth the approval of company names prior to the company incorporation process, whereby a company name would be accepted for registration almost instantaneously if it satisfied certain preliminary requirements, namely, it was not identical to another name on the register and did not contain words or expressions on a specified list. This preliminary scrutiny would be completed through a quick search by the computer. Further checking would be conducted manually within three months of the approval to ensure that the company name was not objectionable for various reasons, e.g. being offensive, likely to give the impression of a government connection or contrary to the public interest. Given the few cases of objectionable company names found during the scrutiny of proposed names in the past, DS(FS)3 said that cases of R of C directing a company to change its name after the approval would be few and hence the revised procedures should not cause undue disturbance to company operations.

8. Responding to Mr CHAN Kin-por's further enquiry about complaints on similar company names, DS(FS)3 advised that R of C would conduct investigation into such complaints and take necessary enforcement actions, such as directing the company concerned to change its name. DS(DS)3 further advised that to address concern about companies adopting names which closely resembled those of trademarks/brand names for conducting counterfeiting activities mainly in the Mainland, the Administration also proposed to enhance enforcement against these companies by empowering R of C to act pursuant to court orders to direct the companies concerned to change their names and to substitute the names with the company registration numbers if they failed to comply with the directions.

9. Noting that a company name might be considered objectionable for various reasons, Mr Albert HO was concerned whether words like "trust" and "fund" in a company name would render it objectionable. He further pointed out that he had come across cases where a company had obtained approval of a name comprising the word "fund" in the company incorporation process but

not in the business registration application. Mr HO questioned whether inconsistency existed in the scrutiny of company names by the Companies Registry (CR) in company incorporation and the Inland Revenue Department (IRD) in business registration.

10. R of C advised that under the existing CO, use of the word "trust" in company name required special approval from R of C. Nevertheless, such approval was not required for use of the word "fund". AC/IR supplemented that IRD would not disapprove the use of a company name with the word "fund" in the business registration if CR had granted approval of the company name in the company incorporation process. AC/IR however pointed out that in examining business registration applications, the use of words by the companies which would likely give the impression of a government connection would be objectionable.

Rewrite of Companies Ordinance

11. Mr Albert HO expressed concern about the scope and progress of the CO rewrite exercise. Noting that the Administration planned to prepare a draft Companies Bill for public consultation before it was introduced into the Legislative Council in 2010, Mr HO opined that the proposals in the Bill should be released for public discussion as early as possible, notably provisions relating to the protection of minority shareholders' interests e.g. enhancing corporate governance through codifying directors' general duties.

12. DS(FS)3 said that the Administration had conducted three topical public consultations to gauge views on certain complex issues under the rewrite exercise. The Administration would take into account public feedback from the consultations in preparation of a draft Companies Bill for public consultation in late 2009, and would arrange to consult the Panel on the draft Bill. Responding to Mr Albert HO's further enquiry on whether a white bill would be prepared for public consultation, DS(FS)3 advised that while the proposals to be included in the draft Bill would aim to be comprehensive, including proposals for protection of minority shareholders' interests, it would not be drafted in the form of a white bill as some consequential amendments involving other ordinances might not be ready by then.

13. Mrs Regina IP also expressed concern about the scope of the rewrite exercise. Referring to recent concerns about regulation of private placements by banks and share splitting in the privatization of a listed company, Mrs IP enquired whether provisions related to these issues would be covered under the rewrite exercise.

14. In response, DS(FS)3 advised that while CO contained provisions governing the publication of initial offering documents, authority to enforce

and amend such provisions vested with the Securities and Futures Commission. Consideration would be given to amending CO by transferring the relevant provisions to the Securities and Futures Ordinance (Cap. 571). DS(FS)3 said that the Administration noted public concerns about privatization conducted through a scheme of arrangement in accordance with section 166 of CO, and would put forward preliminary options for public discussion in late 2009.

II Broad framework of legislative proposal to enhance the anti-money laundering regulatory regime in respect of the financial sectors

(LC Paper No. CB(1)1829/08-09(02) — Administration's paper on broad framework of legislative proposal to enhance the anti-money laundering regulatory regime in respect of the financial sectors

LC Paper No. CB(1)1828/08-09 — Background brief on the broad framework of legislative proposal to enhance the anti-money laundering regulatory regime in respect of the financial sectors prepared by the Legislative Council Secretariat)

Briefing by the Administration

15. Deputy Secretary for Financial Services and the Treasury (Financial Services)2 (DS(FS)2) briefed the meeting on the upcoming consultation on the broad framework of a legislative proposal to enhance the anti-money laundering (AML, which for the purpose of the current proposal, included the meaning of both anti-money laundering and counter financing of terrorism) regulatory regime in respect of the financial sectors, which would commence in July and last for three months. The Administration planned to work out detailed legislative proposals in late 2009/early 2010 taking into account the comments received in the consultation exercise and brief the Panel on Financial Affair again when the second-round consultation was launched. The current proposal sought to provide statutory backing and appropriate sanctions for customer due diligence (CDD) and record-keeping requirements for financial institutions and put in place an AML regulatory framework for the remittance agents and money changers (RAMCs). This proposal aimed to address

deficiencies identified in the Mutual Evaluation (ME) conducted by the Financial Action Task Force (FATF) on Hong Kong which was completed in July 2008. DS(FS)2 advised that CDD and record-keeping requirements were currently provided for in guidelines issued by regulators. Though these guidelines were largely compliant with FATF's requirements in terms of coverage and comprehensiveness, these guidelines could not meet FATF's requirements that CDD and record-keeping obligations had to be set out in legislation which should also provide for corresponding enforcement powers and sanctions against non-compliance. Such requirements had already been implemented by other members of FATF, including Italy. DS(FS)2 added that the proposed legislation would also put in place a licensing regime for RAMCs, which would be administered by the Customs and Excise Department (C&ED). A three-month industry consultation would be conducted to gauge the views of the industries on the broad framework of the legislative proposal.

Discussion

16. Mr Jeffrey LAM appreciated the merits of enhancing the AML regulatory regime in Hong Kong in line with the international standard. Noting that FATF had highlighted the lack of statutory backing and appropriate sanctions for CDD and record-keeping requirements for financial institutions in Hong Kong, Mr LAM asked whether the standards were the only set of internationally recognized standards in this regard and why such standards had not been implemented until now.

17. DS(FS)2 responded that FATF was the inter-governmental body which set international AML standards. FATF reviewed and updated the requirements and standards from time to time and the latest requirements for providing statutory backing for CDD and record-keeping were drawn up in 2003. The regulators had started formulation of guidelines to implement the FATF requirements as soon as they were promulgated. The guidelines were put in place soon thereafter. It was only when Hong Kong's compliance was assessed by FATF in 2008 and deficiencies were identified in the current regime. The Administration had started to formulate the broad framework of legislative proposal to address the deficiencies identified by FATF immediately after the ME was completed.

18. On the proposal of introducing a licensing system for RAMCs for AML regulatory purpose, Mr Jeffrey LAM called on the Administration to take heed of the unique mode of operation of RAMCs in designing the system. Given the relatively small scale of business operation of RAMCs, Mr LAM was concerned that the new licensing requirements might create excessive burden on RAMCs and reduce the room for their survival.

19. DS(FS)2 appreciated the differences in the mode of operation of RAMCs and other financial institutions such as banks. He pointed out that whilst enhanced AML regulation would have impacts on the RAMC sector, particularly those establishments of smaller scale, the Administration would take into account the need to comply with international standards on AML and the views of the relevant sectors, and endeavour to strike a proper balance between the two by drawing up a proposal in line with the international standards taking into account local circumstances. DS(FS)2 added that the initial feedback gathered from informal engagement made with the RAMC sector indicated that they generally agreed that there was a need to put in place a AML regulatory framework for RAMCs.

20. Mr CHAN Kin-por commented that a balance had to be struck between enhancing the AML regulatory regime and enabling the continued operation of RAMCs. He enquired whether a transitional period would be allowed for RAMCs to implement the various new regulatory measures. In response, DS(FS)2 advised that the Administration would welcome views from the RAMC sector on the need for a transitional period during the upcoming industry consultation on the proposal.

21. Referring to recent press reports about the purchase of luxury flats in Hong Kong by the head of a foreign country, the Deputy Chairman pointed out that there had been wide concern about the effectiveness of the AML regulatory regime in Hong Kong. He therefore considered enhancement of the regime necessary. Noting that the legislative proposal sought to enhance the AML regulatory regime in respect of the financial sectors, the Deputy Chairman enquired whether the proposed legislation would cover the legal profession, which might be involved in conducting transactions under instructions from foreign nationals, who might be prominent officials in overseas jurisdictions. He was also concerned whether there would be any obligations for legal practitioners to conduct CDD on their clients and make reports to the relevant authorities on suspected money laundering/financing of terrorism cases.

22. DS(FS)2 responded that the current proposal would cover the financial sectors only. The Security Bureau, which oversaw AML matters concerning the designated non-financial businesses and professions, would follow up the implementation of FATF standards on AML regulatory regime for those businesses and professions, including the legal profession. Under the proposed legislative framework, the CDD requirements to be proposed were only the basic requirements for preventive purpose and they would apply to financial institutions only. Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)7 (PAS(FS)7) added that it was already a requirement under the Organized and Serious Crimes Ordinance (Cap. 455) that all persons, including legal practitioners, should report

suspected cases of money laundering/financing of terrorism to the Police for investigation. This requirement of suspicious transactions reporting was a separate legal obligation distinct from that concerned CDD, which was a preventive measure to facilitate financial institutions to identify AML risks in their business relationships.

23. Mr James TO noted with concern that criminal sanctions would be imposed on financial institutions for non-compliance with the various CDD and record-keeping requirements under the AML regulatory regime. Referring to paragraph 8(B) of the Administration's paper on the obligation of the financial institutions to implement CDD measures to identify the beneficial owner, Mr TO questioned how the regulatory authorities would determine whether a financial institution was in breach of the requirement and had committed an offence under the legislation. He called on the Administration to define clearly in drafting of the proposed legislation the mental elements under which non-compliances would constitute criminal liability on the part of the financial institutions concerned, otherwise the proposed imposition of sanctions would create great anxiety among the financial sectors.

24. PAS(FS)7 responded that the CDD and record-keeping requirements set out under paragraph 8(B) of the Administration's paper were already covered in the current supervisory guidelines issued by the regulators. In view of the good compliance records so far, it was not envisaged that financial institutions would have difficulties in complying with the proposed statutory obligations. DS(FS)2 added that the legislation would be carefully drafted to ensure that no one would be criminally liable solely because of his inadvertence in the breaches of the statutory obligations. Likewise, the relevant provisions should catch financial institutions for breaches only if they were committed without reasonable excuse. Reference would be drawn from the similar provisions in other existing legislation in drafting the relevant provisions in the proposed legislation. The Administration would welcome views from the relevant sectors on various aspects of the proposed legislation, including the proposed criminal liability and sanctions.

25. Mr Albert HO opined that instead of imposing criminal sanctions, the Administration should consider other regulatory sanctions such as fines or suspension of license for non-compliance of financial institutions. Reference should be made to the international best practices in this regard. Mr James TO expressed similar view and called on the Administration to impose on the financial institutions the minimum necessary AML regulatory requirements to achieve a proper balance between regulatory oversight and compliance burden on the institutions concerned.

26. DS(FS)2 said that according to the international standards, the AML regime should provide for a range of sanctions, including civil and criminal,

against non-compliances of different severity. He assured members that it was the Administration's intention to apply appropriate and not excessive AML regulation on financial institutions in compliance with international standards.

III Issues relating to the regulation of credit-linked products sold to retail investors

(LC Paper No. CB(1)1829/08-09(03) — Administration's paper on issues relating to the regulation of credit-linked products sold to retail investors

LC Paper No. CB(1)1829/08-09(04) — Paper on information relating to credit-linked products sold to retail investors prepared by the Legislative Council Secretariat)

Briefing by the Administration

27. At the invitation of the Chairman, Acting Secretary for Financial Services and the Treasury (Atg SFST) briefed members on issues relating to the sale of Octave Notes, which were credit-linked notes (CLNs) arranged by Morgan Stanley & Co. International Limited (MS), the number of Octave Notes-related complaints and actions taken to follow up concerns about the implications of credit events of the reference companies on the relevant series of Octave Notes.

Discussion

28. Mr KAM Nai-wai was concerned that while noteholders were likely to suffer severe loss on the principal amounts of the Octave Notes when credit events occurred, the distributing banks had not been giving them accurate and timely information on the latest market developments affecting the credit ratings of the reference companies of the Octave Notes. Mr KAM asked whether the Hong Kong Monetary Authority (HKMA) had imposed adequate disclosure and regulatory requirements on the distributing banks in this regard. He also urged HKMA to take precautionary actions before the occurrence of credit events which would result in a surge in the number of Octave Notes-related complaints from desperate investors.

29. Chief Executive, Hong Kong Monetary Authority (CE/HKMA) advised that since the collapse of the Lehman Brothers in September 2008, triggering

the early redemption of some structured financial products such as CLNs, HKMA had taken a number of steps, including the issuance of circulars and reminders, with a view to ensuring that banks would implement adequate measures to manage the risks associated with retail investment products sold to customers. These measures included alerting affected customers if there was a change to higher risk ratings assigned to investment products, putting in place adequate procedures to ensure that their customers were made aware of all relevant information issued or made available by the issuers of these products in a timely manner and keeping their relationship managers well briefed on the information so that they could competently handle enquiries from their customers. As to Mr KAM Nai-wai's concern about the handling of complaints, CE/HKMA stressed that HKMA would process all complaints of alleged mis-selling by banks seriously according to established procedures and due diligence.

30. Ms Starry LEE noted that HKMA had issued circulars to banks requiring them to improve operational procedures relating to the sale of investment products and ensure adequate and timely disclosure of information to customers. She was concerned whether HKMA had followed up to ensure compliance of banks with the requirements, say, by checking the marketing materials of retail derivative products.

31. Deputy Chief Executive, Hong Kong Monetary Authority (DCE/HKMA) advised that HKMA had rigorously monitored compliance of banks with the requirements. Banks were required to provide documentations to prove the compliance with the disclosure requirements. Banks had established procedures to notify their customers of new information provided by issuers of the investment products within a few days.

32. Mrs Regina IP and Ms Starry LEE enquired about the size of CLNs sold to retail investors in Hong Kong. Pointing out that a number of retail investors holding Octave Notes and Constellation Notes were concerned about possible decline in the value of these notes as a result of credit events triggered by insolvency of reference companies and default of the underlying collateral debt obligations (CDOs), Mrs IP asked how they could obtain the relevant market information to safeguard their interests. Ms LEE was also concerned that noteholders might have difficulties in obtaining latest information on CDOs and enquired about measures to assist them in this respect.

33. Atg SFST advised that based on information provided to the Securities and Futures Commission (SFC) by the various issuers of CLNs, the total issue size of CLNs issued from June 2003 was approximately $24.9 billion, including $12.6 billion of Lehman Brothers Minibonds, $2.5 billion of Octave Notes and $8.5 billion of Constellation Notes. DCE/HKMA added that other than the Lehman-related notes, the outstanding amount of CLNs sold through

banks were about $4.5 billion. On the disclosure of information, Atg SFST advised that investors could refer to the website of the note issuer for the latest information regarding the value of CLNs. Mr Martin WHEATLEY, Chief Executive Officer, the Securities and Futures Commission (CEO/SFC) supplemented that the issuers would make available information on CLNs on their websites and the distributing banks would be responsible for alerting their customers of the relevant information in a timely manner.

34. The Deputy Chairman questioned the propriety of the existing regulatory regime under which the issuance and distribution of CLNs to retail investors was governed by provisions under the Companies Ordinance (CO) (Cap. 32), instead of the Securities and Futures Ordinance (SFO) (Cap. 571). Given the complexity and the high-risk nature of CLNs, the Deputy Chairman was concerned that these products had not been subject to prior-vetting or authorization by the regulators. He asked whether the existing regulatory regime should be reviewed and improvements be made to enhance regulation of CLNs, such as by subjecting the products to more stringent regulatory requirements under SFO or disallowing sale to retail investors.

35. CEO/SFC advised that the relevant prospectuses of CLNs had to comply with the registration and applicable disclosure requirements in CO. Under the CO prospectus regime, SFC would authorize the prospectuses and the marketing materials of CLNs. The suitability of the products for investors would be assessed by the intermediaries, i.e. the distributing banks or brokerages, at the point of sale. The regulatory requirements on the sale of investment products (including CLNs) to retail investors through the banking network were primarily set out in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the Code). The Code required the intermediaries to ensure, inter alia, the suitability of their recommendations for their clients, that the clients understood the nature and risks of the products and had sufficient net worth to be able to assume the risks and bear the potential losses of trading in the products. While SFC had recommended to the Financial Secretary in its report on the Lehman Brothers Minibonds incident the review of the current public offering regimes, CEO/SFC pointed out that the current regulatory system of Hong Kong was similar to those adopted in other jurisdictions such as the United Kingdom, the United States and Australia.

36. CE/HKMA advised that the Deputy Chairman's concern about product authorization involved the question of whether the disclosure-based regulatory regime for investment products should be changed. He considered the current disclosure-based regime appropriate, although certain enhancements could be made in terms of the content and extent of information disclosed by issuers and distributors, of which HKMA had made some recommendations in its report on the Lehman Brothers Minibonds incident. Responding to the Deputy

Chairman's further enquiry about measures to ensure compliance with the disclosure requirements, CE/HKMA advised and CEO/SFC confirmed that SFC performed gate-keeping function under the disclosure-based regime in the authorization of offer documentation of investments products offered under the CO prospectus regime.

37. Mr James TO pointed out that as far as he understood from the complainants, the majority of them had not got a full explanation by the intermediaries at the point of sale of the early-redemption risk of Octave Notes triggered by collateral default. To find out facts of the selling process before the occurrence of credit events, Mr TO requested that HKMA and SFC immediately conduct on-site thematic examinations of the 16 banks and three brokerages which had distributed the 15 series of Octave Notes arranged by MS.

38. CE/HKMA advised that HKMA had asked the distributing banks to proactively re-examine the selling process of the Octave Notes. In light of the tight manpower position, HKMA would have to review whether staff deployment could be made to conduct on-site examinations as requested by Mr TO. DCE/HKMA supplemented that where resources permitted, HKMA would endeavour to conduct on-site examinations of the 16 distributing banks. CEO/SFC responded that arrangements could be made to conduct on-site examinations of the three brokerages concerned.

39. Mr KAM Nai-wai was disappointed with the efforts of HKMA in ensuring compliance of banks with the risk and information disclosure requirements in the sale of investment products. Mr KAM opined that it was HKMA's responsibility to carry out on-site examinations of banks to ensure compliance, and it should try to understand the selling process in full by interviewing the investors as well. Mr James TO echoed Mr KAM's view and said that HKMA should proactively contact the holders of Octave Notes as part of the examinations.

40. DCE/HKMA advised that HKMA had required banks to arrange adequate and trained staff to handle enquiries from their customers on retail derivative products. He noted the view of Mr KAM and Mr TO and said that HKMA would take this into account when planning the on-site thematic examinations of banks.

41. Pointing out that the prospectus for Octave Notes was too voluminous and complicated for ordinary investors to comprehend, Mr Albert HO was concerned that the marketing materials which investors normally relied upon for making investment decisions did not contain adequate information on the detailed product features and risks. As the guidelines which SFC referred to in reviewing the marketing materials only required that, among other things,

the marketing materials should not contain anything that was inconsistent with the information contained in the prospectus, and that the contents should not be false, biased, misleading or deceptive, Mr HO was concerned about the protection of investors' interest in the sale of Octave Notes over the counter at the banks. Mr HO pointed out that the marketing materials for Octave Notes did not include detailed information on the risks associated with the underlying collaterals, which was in his view, a material omission.

42. CEO/SFC said that it was indeed not possible to include all the information contained in the prospectus in the marketing materials. To protect the interests of investors, the guidelines for SFC to review the marketing materials had required the provision of key information, such as CLNs were not principal-protected investments, the major credit risks involved and that the products were not intended for inexperienced investors etc. The current regulatory regime required intermediaries to conduct the business with due skill, care and diligence and in the best interests of their clients. It was also the responsibility of the intermediaries to ensure that the clients understood the nature and risk of the products.

43. Responding to Mr Albert HO's comment, Mr Brian HO, Executive Director (Corporate Finance), Securities and Futures Commission confirmed that the marketing materials for Octave Notes had disclosed the risks associated with default of underlying collaterals. He undertook to provide copies of the marketing materials to Mr HO. CE/HKMA added that the issuers of CLNs would not be able to provide details of the second-level underlying collaterals at the time of issuance, as these collaterals were acquired after the issuance. CE/HKMA said that since the marketing materials for Octave Notes had indicated that the principal of the product was not protected and it involved high risks, selling the product to customers with low risk appetite might create a possibility of mis-selling.

> (*Post-meeting note*: Marketing leaflets for Octave Notes series 19 to 22 provided by SFC were circulated to members vide LC Paper No. CB(1)2117/08-09 on 30 June 2009.)

44. Mr Albert HO enquired whether, apart from explaining the product features and risks to the customers at the point of sale, banks were required to keep their customers informed, on a continuous basis, of changes in risk ratings or market developments affecting the value of CLNs. DCE/HKMA confirmed that HKMA had monitored compliance of banks with the continued disclosure requirements through reminding them to implement adequate measures to manage the risks associated with sale of retail investment products to customers.

45. The Deputy Chairman opined that as the Octave Notes were high-risk products not intended for sale to inexperienced investors, disciplinary actions should be taken against banks which had sold the product to retail investors over the counter. In this connection, the Deputy Chairman asked SFC to provide a timeframe for completion of investigations of Octave Notes-related complaints. In reply, CEO/SFC said that the investigation of complaints was in progress and time would be required for fact finding and consideration of circumstances of each case. He was therefore unable to give a definite timeframe for completion of the investigations.

IV Any other business

46. There being no other business, the meeting ended at 4:30 pm.

Council Business Division 1
Legislative Council Secretariat
12 October 2009