

立法會
Legislative Council

LC Paper No. CB(1)1262/10-11
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by the Administration)

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**Bills Committee on Securities and Futures and Companies Legislation
(Structured Products Amendment) Bill 2010**

**Fourth meeting on
Thursday, 16 December 2010, at 10:45 am
in Conference Room A of the Legislative Council Building**

- Members present** : Hon Starry LEE Wai-king, JP (Chairman)
Hon Albert HO Chun-yan
Hon James TO Kun-sun
Hon CHAN Kam-lam, SBS, JP
Hon Audrey EU Yuet-mee, SC, JP
Hon Ronny TONG Ka-wah, SC
Hon Mrs Regina IP LAU Suk-ye, GBS, JP
- Members absent** : Hon Miriam LAU Kin-ye, GBS, JP
Hon WONG Ting-kwong, BBS, JP
Hon CHIM Pui-chung
- Public officers attending** : Financial Services and the Treasury Bureau

Mr Anthony LI
Principal Assistant Secretary (Financial Services)

Hong Kong Monetary Authority

Ms Meena DATWANI
Executive Director
Banking Conduct

Ms Alice LEE
Senior Manager
Banking Conduct

Department of Justice

Mr Paul O'BRIEN
Senior Assistant Law Draftsman

Ms Karmen KWOK
Government Counsel

Attendance by invitation : Securities and Futures Commission

Mr Brian HO
Executive Director, Corporate Finance

Ms Alexandra YEONG
Director, Corporate Finance

Mrs Yvonne MOK
Director
Intermediaries Supervision

Mr Paul YEUNG
Senior Manager
Policy, China and Investment Products

Clerk in attendance : Ms Anita SIT
Chief Council Secretary (1)5

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

Mr Noel SUNG
Senior Council Secretary (1)4

I Meeting with the Administration

(LC Paper No. CB(1)788/10-11(01) — List of follow-up actions arising from the meeting on 25 November 2010 prepared by the Legislative Council Secretariat

- LC Paper No. CB(1)788/10-11(02) — Administration's paper on "Definition of Professional Investors and Update on the Progress on Reviewing/Amending the Definition"
- LC Paper No. CB(1)788/10-11(03) — Administration's paper on "Existing Regulatory Arrangements for Currency-Linked, Interest Rate-Linked and Currency and Interest Rate-Linked Instruments Issued by Authorized Institutions"
- LC Paper No. CB(1)788/10-11(04) — Administration's paper on "Meaning of 'Advertisement, Invitation or Document' in the Relevant Provisions, and the Scope of Application of the Regulatory Regime in Real Life Situations"
- LC Paper No. CB(1)813/10-11(01) — Administration's paper on "Meaning of 'Persons Outside Hong Kong' and Regulatory Arrangements for the Disposal of Unlisted Structured Products to Persons Outside Hong Kong")

The Committee deliberated (Index of proceedings attached at the **Appendix**).

Admin Follow-up actions to be taken by the Administration and related parties

2. The Administration was requested to coordinate with the Securities and Futures Commission (SFC) and the Hong Kong Monetary Authority (HKMA) to take the following actions:

- (a) To consider the suggestion of including a standard statement to explain the risks of being treated as a "professional investor" in the relevant declaration form to be signed by investors, and provide the Bills Committee with a sample of the statement;

- (b) To provide a quantitative analysis of each of the currency-linked, interest rate-linked and currency and interest rate-linked instruments (ILCL instruments) issued and/or sold by Authorized Institutions (AIs), including but not limited to the respective market shares of the aggregate of AIs incorporated in Hong Kong and that of those incorporated outside Hong Kong in terms of monetary value and percentage;
- (c) To provide a comparison between the regulatory actions taken by the HKMA on the sale of unlisted investment products by AIs before and after the Lehman Brothers Minibonds Incident, including details of the number and frequency of on-site examinations, off-site reviews and mystery shopper checking, and the number and rank of officers deployed in the work;
- (d) To provide information on the practices of other comparable jurisdictions regarding the requirement on intermediaries to make audio recordings of the sales process and ancillary arrangements; and
- (e) To provide details of the existing regulatory arrangements to deal with situations where an intermediary (including an AI) has a potential or actual conflict of interest in providing services, and an update on the progress of the review of the arrangements.

II Any other business

Date of next meeting

3. The Chairman reminded members that the next meeting would be held on 6 January 2011.
4. There being no other business, the meeting ended at 12:40 pm.

**Proceedings of the
Bills Committee on Securities and Futures and Companies Legislation
(Structured Products Amendment) Bill 2010
Fourth meeting on Thursday, 16 December 2010, at 10:45 am
in Conference Room A of the Legislative Council Building**

Time Marker	Speaker	Subject(s)	Action Required
000124 – 000323	Chairman	Opening remark	
000324 – 000622	Administration Securities and Futures Commission (SFC)	Briefing by the Administration on the definition of "professional investor" and the progress on reviewing the definition (LC Paper No. CB(1)788/10-11(02))	
000623 – 001806	Mr James TO SFC	<p>(a) Mr James TO enquired whether an investor's written consent had to be obtained if the intermediary treated the investor as a "professional investor" and whether an investor could withdraw his consent afterwards. Mr TO pointed out that a person who was highly educated, wealthy and had traded securities previously might not mean that he knew investment products well. Mr TO supplemented that his enquiry was in relation to high net worth individuals but not institutional investors. Mr TO further asked whether there was any standard form prescribed by the SFC in respect of the explanation about the risks of being treated as a professional investor.</p> <p>(b) SFC responded that the definition of "professional investor" was set out in the law and a high net worth individual who had a portfolio of HK\$ 8 million was a "professional investor" under the definition. Separately, the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct) had "know your client" requirements and suitability requirements. Some of these requirements might be waived in respect of a client who was classified as a "professional investor" under the Code. If the intermediary would like to treat a high net worth individual who had a portfolio of HK\$8 million as a professional investor under the Code of Conduct, among other things, an intermediary should provide a written explanation to the</p>	

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		<p>investor concerned explaining the risks and consequences of being treated as a "professional investor" and the information that would not be provided to him. The intermediary should also obtain a written and signed declaration from the person that the consequences of consenting to being treated as professional investor and the right to withdraw from being treated as such had been explained to him and that he wished to be treated as a professional investor. Intermediaries should also have in place procedures to enable it to carry out a confirmation exercise annually. Intermediaries should also explain to the professional investor the rights that he had waived under the Code of Conduct which included the need to ensure the suitability of a recommendation or solicitation and the need to enter into a written client agreement etc. SFC also stressed that other requirements under the Code, in particular, paragraph 5.3 of the Code, still continued to apply to intermediaries when they served professional investors.</p>	
001807 – 002220	Mrs Regina IP SFC	<p>(a) Mrs Regina IP asked who was responsible for monitoring compliance of intermediaries with relevant regulatory requirements in classifying and dealing with "professional investors" under the Code of Conduct.</p> <p>(b) SFC responded that intermediaries were expected to take a holistic approach in assessing whether an investor should be treated as a "professional investor" under the Code of Conduct. SFC was the frontline regulator of licensed corporations while HKMA was the frontline regulator of Authorized Institutions (AIs).</p>	
002221 – 002645	Mr James TO SFC	<p>Mr James TO asked whether the SFC would stipulate minimum content requirements that should be included in a statement explaining the risks of agreeing to be treated as a “professional investor”. The Chairman requested the Administration to consider including a standard statement to explain the risks of agreeing to be treated as a "professional investor" in the relevant declaration form to be signed by investors, and provide the Bills Committee with a sample of the statement.</p>	<p>The Administration to take action as required in paragraph 2(a) of the minutes.</p>

Time Marker	Speaker	Subject(s)	Action Required
002646 – 002807	Chairman SFC	In reply to the Chairman's enquiry, SFC responded that the existing minimum portfolio requirement of HK\$8 million was comparable to other jurisdictions. The guidance given under the Code of Conduct in assessing the investment experience of a professional investor was formulated having taken into account similar requirements in the UK, Australia and Singapore.	
002808 – 003135	Mrs Regina IP HKMA	In response to Mrs Regina IP's enquiry, HKMA briefed members on the actions taken by HKMA to regulate AIs on the sale of currency-linked, interest rate-linked and currency and interest rate-linked instruments (ILCL instruments), by highlighting the salient points in LC Paper No. CB(1)788/10-11(03).	
003136 – 003858	HKMA	Briefing by HKMA on the existing regulatory arrangements for ILCL instruments issued by AIs (LC Paper No. CB(1)788/10-11(03))	
003859 – 004657	Mr James TO HKMA	<p>(a) Mr James TO enquired about the regulatory arrangements for sale of currency-linked accumulators.</p> <p>(b) HKMA responded that apart from on-site examination of the sale process of currency-linked accumulators in AIs, HKMA also conducted surveys to understand the sales volume and product features, and discussed with some AIs regarding the sales arrangements. HKMA planned to issue a circular in order to ensure that AIs adopted adequate controls in the sale of currency-linked accumulators and protect the interests of investors.</p>	
004658 – 005041	Mrs Regina IP HKMA SFC	<p>(a) Mrs Regina IP enquired whether any financial institutions, other than AIs, had applied for the sale of ILCL instruments.</p> <p>(b) SFC responded that it had not received any applications for public offers of ILCL instruments by a non-AI. In response to Chairman's question as to whether non-AIs could submit applications for authorization, SFC said that as explained in an earlier paper, it was hard to foresee that any non-AI would have the basis or business case to publicly offer such products, and subject to Members'</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>views, the Administration and SFC were prepared to consider prohibiting public offers of ILCL instruments by non-AIs altogether through this Bill, for public interest considerations.</p> <p>(c) At the request of Mrs Regina IP, HKMA agreed to provide a quantitative analysis of each of the ILCL instruments issued and/or sold by AIs, including but not limited to the respective market shares of the aggregate of AIs incorporated in Hong Kong and that of those AIs incorporated outside Hong Kong in terms of monetary value and percentage.</p> <p>(d) In response to Mrs Regina IP's request, HKMA agreed to provide a comparison between the regulatory actions taken by HKMA in relation to the sale of unlisted investment products by AIs before and after the Lehman Brothers Minibonds Incident, including details of the number and frequency of on-site examinations, off-site reviews and mystery shopper checking, and the number and rank of officers deployed in the work.</p>	<p>The Administration to take action as per paragraph 2(b) of the minutes</p> <p>The Administration to take action as per paragraph 2(c) of the minutes</p>
005042 – 010418	Mr Albert HO Mr James TO SFC Chairman	<p>(a) Mr Albert HO enquired whether the regulatory requirements set by SFC for the sale of financial products by intermediaries under its supervision were similar to those imposed by HKMA on AIs. Mr HO opined that the requirement for audio-recording of the sale process was essential in preventing and/or resolving any dispute regarding mis-selling of financial products.</p> <p>(b) Mr James TO echoed Mr HO's view. Mr James TO pointed out that some intermediaries might even refuse to sell their products to investors who requested to make audio recording of the sale process by themselves.</p> <p>(c) SFC responded that SFC's code and guidelines for intermediaries in respect of the sale of financial products were similar to those for AIs laid down by HKMA, although, unlike the arrangement for AIs, the corporations licensed by SFC were not required to make audio recording of the sale process. Based on the</p>	

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		<p>findings of a public consultation, the public did not support imposing a mandatory audio recording requirement on intermediaries. SFC added that there was a debate among the executive directors of SFC and it was considered that audio recording of the sales process would provide more protection for intermediaries than investors, and the regulatory arrangements taken as a whole provided adequate protection for investors. SFC supplemented that intermediaries in many major financial markets were also not required to make any audio recording of the sale process.</p> <p>(d) SFC was requested to provide information on the practices of other comparable jurisdictions regarding the requirement on intermediaries to make audio recordings of the sales process and ancillary arrangements.</p>	<p>The Administration to take action as per paragraph 2(d) of the minutes</p>
<p>010419 – 013431</p>	<p>Mr Albert HO HKMA Mr James TO SFC</p>	<p>(a) Mr Albert HO was concerned about the regulatory arrangements to deal with situations where intermediaries (including AIs) had a potential or actual conflict of interest in providing services to investors, e.g. when an intermediary was selling an investment product issued by his employer or under a back-to-back trading situation when the risk situation of an investment product would change over time. Mr HO opined that under such circumstances an intermediary would unlikely be able to act in an impartial manner.</p> <p>(b) Mr HO also enquired whether an intermediary was required to disclose to an investor the amount of commission received from the issuer in a transaction.</p> <p>(c) Mr James TO shared Mr HO's concern and said that although intermediaries in other developed financial markets might be allowed to sell financial products issued by their principals, there might be separate legislation in these jurisdictions to govern the conduct and liabilities of intermediaries involved in selling such financial products.</p>	

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		<p>(d) HKMA and SFC responded that SFC had included a pre-sale disclosure requirement in the Code of Conduct, and with effect from June 2011, intermediaries would be required to disclose to the investors concerned details of the monetary and non-monetary benefits obtained by the intermediaries in the transactions. HKMA added that AIs were required to conduct their own product due diligence. During on-site examinations, HKMA would check the measures adopted by AIs to address potential conflict of interest. For example, some AIs had conducted a market analysis during the product manufacturing stage, in order to ensure that the prices of their financial products were set at a level comparable to other similar products in the market. AIs were required to exercise prudent risk management in its own trading of financial products by complying with various risk limits and risk management measures established in accordance with the HKMA's requirements. HKMA monitored the risk management arrangements of AIs and had issued guidelines to AIs in this area. SFC added that in all major developed financial markets, intermediaries would not be debarred from selling financial products issued by their principals.</p> <p>(e) SFC and HKMA were requested to provide details of the existing regulatory arrangements to deal with situations where an intermediary (including an AI) had a potential or actual conflict of interest in providing services, and an update on the progress of the review of the arrangements.</p>	<p>The Administration to take action as required in paragraph 2(e) of the minutes.</p>
<p>013432 – 013906</p>	<p>Mrs Regina IP HKMA</p>	<p>(a) Mrs Regina IP remarked that financial innovations might be inhibited if intermediaries were not allowed to sell investment products issued by themselves as principals. Mrs IP was concerned that there might not be a secondary market for ILCL instruments in a financial crisis.</p> <p>(b) HKMA responded that the credit risk of ILCLs issued by an AI was linked to the financial soundness of the AI concerned.</p>	

Time Marker	Speaker	Subject(s)	Action Required
		(c) In response to Mrs Regina IP's enquiry, HKMA remarked that HKMA maintained regular and close dialogue with the banking industry regarding means to enhance investor education.	
013907 – 015218	Mr Ronny TONG SFC Mr Albert HO	(a) Mr Ronny TONG was concerned about the adequacy of the existing disclosure requirements when there were conflict of interest situations (e.g., an intermediary taking an opposite position of the client or the intermediary was the issuer of the investment product etc.). (b) SFC responded that under the existing rules and the Code of Conduct, there were requirements that an intermediary should make disclosures where the intermediary had a material interest in a transaction with or for a client or a relationship gave rise to an actual or potential conflict of interest in relation to the transaction. SFC and HKMA said they would provide the detailed information on the disclosure requirements to members as per paragraph 2(e) in the minutes.	The Administration to take action as per paragraph 2(e) of the minutes
015219 – 015251	Chairman	Date of next meeting	