立法會
Legislative Council

LC Paper No. CB(1)2143/09-10
(These minutes have been seen by the Administration)

Ref : CB1/PL/FA/1

Panel on Financial Affairs

Minutes of meeting
held on Monday, 3 May 2010 at 10:00 am
in the Chamber 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 Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP 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, JP Hon CHIM Pui-chung Hon KAM Nai-wai, MH Hon Starry LEE Wai-king Dr Hon LAM Tai-fai, BBS, JP Hon Paul CHAN Mo-po, MH, JP Hon CHAN Kin-por, JP Hon Mrs Regina IP LAU Suk-yee, GBS, JP
Public officers attending	**:**	Agenda Item IV Prof K C CHAN, SBS, JP Secretary for Financial Services and the Treasury

Miss AU King-chi, JP
Permanent Secretary for Financial Services and the Treasury (Financial Services)

Mr CHENG Yan-chee, JP
Deputy Secretary for Financial Services and the Treasury (Financial Services)

Ms Beverly YAN
Senior Assistant Law Officer (Civil Law) (Acting)
Department of Justice

Agenda Item V

Mr CHENG Yan-chee, JP
Deputy Secretary for Financial Services and the Treasury (Financial Services)

Mr Anthony LI
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)

Agenda Item VI

Mr CHENG Yan-chee, JP
Deputy Secretary for Financial Services and the Treasury (Financial Services)

Mr Edmond LAU, JP
Executive Director (Monetary Management)
Hong Kong Monetary Authority

Mr K F WONG
Deputy Commissioner (Technical)
Inland Revenue Department

Mr Allen NG
Senior Assessor (Research) 2
Inland Revenue Department

Attendance by invitation	**:**	Agenda Item IV Mr Brian HO Executive Director, Corporate Finance Division Securities and Futures Commission Mr Charles GRIEVE Senior Director, Corporate Finance Division Securities and Futures Commission Ms Daisy LAI Director, Corporate Finance Division Securities and Futures Commission Mr Mark DICKENS Head of Listing Hong Kong Exchanges and Clearing Limited Mr Stephen JAMIESON Vice President, Listing Division Hong Kong Exchanges and Clearing Limited Agenda Item V Mr Brian HO Executive Director, Corporate Finance Division Securities and Futures Commission Mr Charles GRIEVE Senior Director, Corporate Finance Division Securities and Futures Commission Ms Alexandra YEONG Director, Corporate Finance Division Securities and Futures Commission
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

Mr Fred PANG
Council Secretary (1)5

Ms Haley CHEUNG
Legislative Assistant (1)8

Action

I Confirmation of minutes of meeting and matters arising

(LC Paper No. CB(1)1725/09-10 — Minutes of the meeting on 1 March 2010)

The minutes of the meeting held on 1 March 2010 were confirmed.

II Information papers issued since the last meeting

(LC Paper No. CB(1)1545/09-10(01) to (04) — Submission dated 18 March 2010 from the Hong Kong Blind Union (HKBU) expressing concern on the provision of Automatic Teller Machines for the visually impaired and correspondence between HKBU and the Hong Kong Association of Banks (Restricted to Members only) (Chinese version only)

LC Paper No. CB(2)1319/09-10(01) — Equal Opportunities Commission's paper regarding Hong Kong ethnic-Pakistani resident being refused to establish bank account

LC Paper No. CB(1)1652/09-10(01) — Administration's paper on first quarterly report of 2010 on Employees Compensation Insurance — Reinsurance Coverage for Terrorism)

2. Members noted the information papers issued since the last regular meeting on 8 April 2010.

III Date of next meeting and items for discussion

(LC Paper No. CB(1)1728/09-10(01) — List of outstanding items for discussion

LC Paper No. CB(1)1728/09-10(02) — List of follow-up actions)

Regular meeting in June 2010

3. Members agreed that the following items proposed by the Administration would be discussed at the next regular meeting scheduled for 7 June 2010:-

(a) Briefing by the Financial Secretary on Hong Kong's latest overall economic situation; and

(b) Companies Ordinance rewrite.

Special meetings in May 2010

4. The Chairman drew members' attention to the arrangements for the two special meetings in May 2010, and advised that the following two items would be discussed at the special meeting on 20 May 2010 at 2:00 pm:

(a) Briefing on the work of the Hong Kong Monetary Authority (HKMA); and

(b) Financial affairs matters under the Framework Agreement on Hong Kong/Guangdong Co-operation.

5. For the special meeting to be held on 24 May 2010 at 2:30 pm, the Panel would receive views from deputations on the legislative proposals on anti-money laundering in relation to financial institutions. The Chairman said that the Administration would be requested to advise whether it would propose an additional discussion item for the special meeting.

(*Post-meeting note*: Subsequent to the meeting, the Administration advised that no additional item was proposed for discussion at the special meeting on 24 May 2010.)

IV Consultation on the proposed statutory codification of certain requirements to disclose price sensitive information by listed corporations

(LC Paper No. CB(1)1728/09-10(03) — Administration's paper on proposed statutory codification of certain requirements to disclose price sensitive information by listed corporations

LC Paper No. CB(1)1726/09-10 — Background brief on proposals to give statutory backing to major listing requirements prepared by the Legislative Council Secretariat

LC Paper No. CB(1)1498/09-10(01) — Administration's consultation paper on the proposed statutory codification of certain requirements to disclose price sensitive information by listed corporations)

Briefing by the Administration

6. The Secretary for Financial Services and the Treasury (SFST) briefed members that the policy objectives of statutorily codifying the disclosure requirements on price sensitive information (PSI) by listed corporations was to cultivate a continuous disclosure culture among listed corporations. This would help enhance market transparency and quality. Compared with the non-statutory Listing Rules, the proposed statutory regime would specify clearly the disclosure requirements in the statute, enable the Securities and Futures Commission (SFC) to conduct effective investigation into suspected breaches of the disclosure requirements, and allow the Market Misconduct Tribunal (MMT) to impose a series of civil sanctions. The Deputy Secretary for Financial Services and the Treasury (Financial Services) (DS(FS)) then briefed members, through a Powerpoint presentation, the main points of the proposed statutory codification.

(*Post-meeting note*: The notes of the Powerpoint presentation (LC Paper No. CB(1)1802/09-10(01)) were issued to members vide a Lotus Note e-mail on 3 May 2010.)

Price sensitive information

7. The Deputy Chairman was concerned about the difficulty in defining PSI, and in identifying a particular director(s) of a listed corporation for breaches of the disclosure requirements, as usually the whole board of directors of a corporation was accountable for disclosure of PSI.

8. SFST responded that the responsibility of making timely disclosure of PSI would be on the listed corporations, and sanctions would be imposed on the corporation and/or its director(s) based on investigation findings. SFST stressed that

if a listed corporation was found to have breached the statutory disclosure requirements, a director(s)/officer(s) would be held responsible only if such a breach was a result of any intentional, reckless or negligent act or omission on the part of the individual director or officer, or that the individual director or officer had not taken reasonable measures to prevent the breach. The Executive Director, Corporate Finance Division, Securities and Futures Commission (ED(CFD)/SFC) supplemented that the proposed "inside information" concept was borrowed from the concept of "relevant information" as defined under the Securities and Futures Ordinance (SFO) (Cap. 571), which had been used for two decades in the statutory "insider dealing" regime and the market was familiar with it. Paragraph 29 of the draft "Guidelines on Disclosure of Inside Information" in the consultation paper also listed examples of possible inside information concerning a listed corporation. The around 30 cases ruled by the tribunals on insider dealing were also useful reference for understanding what would constitute "inside information". While it was difficult to quantify what constituted "insider information", there were three key factors to assess what could be considered as "inside information", based on past cases dealt with by MMT. First, it was the materiality of the information in question that needed to be considered. Information which was likely to materially affect the price of the securities of a listed corporation should be disclosed. Secondly, people usually involved in trading the securities of the corporation were viewed as the "reasonable investor", and in the opinion of the "reasonable investor", "inside information" was the information which, if disclosed, would have a significant impact on the price of the securities of the listed corporation. Thirdly, “inside information” must be specific information. ED(CFD)/SFC pointed out that in drawing up the draft guidelines on disclosure of PSI, reference had been made to relevant guidelines issued by the European Union (EU), with a view to facilitating the compliance of listed corporations with the disclosure requirements.

9. Mr Andrew LEUNG declared interest as an independent non-executive director of a listed corporation. Pointing out that an independent non-executive director might not be aware of all PSI of the listed corporation concerned, Mr LEUNG enquired about the enforcement criteria against individual directors, especially independent non-executive directors. Mr LEUNG asked whether the directors of listed corporations had been consulted on the legislative proposals as individual directors might be held responsible for non-disclosure of PSI although they might not be involved in the daily operation of the corporation. Mr LEUNG was concerned that it might be unfair to a director/officer if an enforcement agency assessed by hindsight that the director/officer should have disclosed certain information at a certain juncture of the incident. Noting that the definition of "insider information" was borrowed from the concept of "relevant information" in the insider dealing regime, Mr LEUNG further enquired how the implementation of the legislation on disclosure of PSI would differ from that on insider dealing.

10. SFST responded that the proposed legislation aimed to codify the requirements on listed corporations to make timely disclosure of PSI, whereas the legislation relating to insider dealing was to prohibit dealing with “relevant information”. The objective of the proposed codification was to cultivate a

disclosure culture and that directors and officers involved in the management of listed corporations would be required to take all reasonable measures from time to time to ensure compliance with the disclosure requirements. SFST said that the Government recognized the need to strike a reasonable balance between ensuring market transparency and fairness in the provision of information to investors, and safeguarding the legitimate interests of listed corporations in preserving certain information in confidence to facilitate their operation and business development. To cater for legitimate circumstances where non-disclosure or delay in disclosure would be permitted, safe harbours were proposed, and the views of the listed corporations, including their directors, would be welcome. ED(CFD)/SFC supplemented that the practice in overseas financial markets had been taken into consideration in working out the proposed safe harbours. Paragraphs 22 to 25 of the Draft Guidelines on Disclosure of Inside Information (Draft Guidelines) indicated that the assessment on the timely disclosure of PSI would take into account the events surrounding the time when the PSI was available and the time when a decision was made as to whether the PSI should be disclosed, rather than making assessment by hindsight.

11. Mr Jeffrey LAM declared interest as an independent non-executive director of a listed corporation. Mr LAM remarked that the non-executive directors might not be directly involved in the daily operation of a listed corporation, although they would be involved in deliberating issues affecting the share price and development of the listed corporation. Mr LAM opined that in case of a breach of the disclosure requirement, only the director(s)/officer(s) directly involved in the incident should be held responsible for the non-disclosure, rather than all directors of the listed corporation. Pointing out that related parties other than directors and officers of the listed corporation might also have access to PSI, e.g. the company accountants and lawyers, Mr LAM asked what measures would be taken against the related parties for leakage of PSI. Mr Paul CHAN shared Mr LAM's concern. He pointed out that other people might make use of the PSI leaked by the professional service providers of a listed corporation to gain benefits, and under such circumstances the professional service providers might not be liable to charges for insider dealing.

12. SFST responded that the purpose of the legislative proposals was for the cultivation of a continuous disclosure culture of PSI among listed corporations, by obliging listed corporations to make available information for investors in making their investment decisions on listed corporations. SFST remarked that enforcement actions against a listed incorporation and individual director(s)/officer(s) regarding breaches of the disclosure requirements would be based on evidence as to whether such a breach was a result of intentional, reckless or negligent act of the individual director(s)/officer(s). SFST added that if a professional service provider breached the confidentiality agreement with a listed corporation and leaked PSI to other parties, the professional service provider would be in breach of the relevant professional code of conduct, and subject to disciplinary action by the relevant professional body. Persons making use of PSI leaked by the professional service providers for trading in the securities concerned might be subject to enforcement action by the SFC under the insider dealing regime of the SFO.

13. Mr CHAN Kin-por expressed concern as to how a director/officer would be judged as committing a negligent act in breaching the disclosure requirements. Mr CHAN asked whether there would be different arrangements for assessing executive directors' and non-executive directors' compliance with the disclosure requirements, as non-executive directors were not involved in the daily operation of the listed corporation. Mr CHAN further enquired whether the directors would be held responsible for failing to disclose PSI, if they had already set up a system for the disclosing PSI to the public and yet certain officers of the corporation failed to follow with the system.

14. SFST responded that directors had the obligation to establish an effective PSI disclosure mechanism in the listed corporation concerned. The Permanent Secretary for Financial Services and the Treasury (Financial Services) (PS(FS)) added that in order to prevent directors from shirking their responsibilities on the disclosure requirements, an individual director would be held responsible if he had not taken all reasonable measures to prevent the listed corporation from breaching the disclosure requirements. As stipulated in the Draft Guidelines, directors and officers of listed corporations should ensure that an effective system was set up in the listed corporation to allow directors and/or officers to have timely access to PSI, so as to decide whether the information should be disclosed to the public. The Senior Assistant Law Officer (Civil Law) (Acting), Department of Justice (SALO(CL)(Atg)) advised that the negligence of individual directors/officers would be assessed based on the "reasonable man" principle, i.e. whether the directors/officers had acted reasonably in handling and disclosing the PSI. PS(FS) added that under the Companies Ordinance (Cap. 32), the obligations of executive and non-executive directors were the same, and all directors would have to observe the same disclosure requirements under the current proposals. The Head of Listing, Hong Kong Exchanges and Clearing Limited (H(L)/HKEx) supplemented that the directors had a duty to ensure that the system for reporting PSI to shareholders and investors was being implemented, and in normal circumstances, the executive directors, who were involved in the daily operation of the listed corporation, would be held accountable for non-compliance with the disclosure requirements.

Civil sanctions

15. Given the Court of Final Appeal's ruling that imposition of fines should be a sanction for criminal proceedings, the Deputy Chairman expressed concern that the proposed civil sanction of imposing a maximum fine of $8 million for breaches of the disclosure requirements might be subject to judicial review.

16. SALO(CL)(atg) explained that the CFA's ruling concerned with an insider dealing case whereas the proposed regulatory fine was for a breach of PSI disclosure requirements. The penalty for insider dealing could be applicable to any persons involved in insider dealing, while the proposed regulatory fine would only be imposed on listed corporations and/or their directors. Based on the CFA ruling and human rights cases in Europe, fines which were punitive in nature and which could be imposed on any person were criminal, whereas fines for a regulatory,

compensatory or protective purpose and targeting a limited group of persons were likely to be regarded as civil.

17. Mr Albert HO enquired why, unlike the insider dealing regime, only civil sanctions but not criminal sanctions such as imprisonment, were proposed for the disclosure requirements.

18. SFST responded that the proposed codification arrangements, including the civil sanctions, were made having regard to the practices and procedures in the United Kingdom and other EU countries. SFC was responsible for investigation of each case. And if other misconduct on the part of the directors and related parties in dealing with "inside information" was identified during the investigation, criminal sanctions could be imposed under the existing provisions of the SFO.

19. Ms Starry LEE enquired about the factors being taken into consideration in setting the maximum level of regulatory fine at $8 million, and given that the maximum fine might not be imposed in all cases, whether different levels of fines would be set based on the gravity of the breaches involved.

20. Mr Paul CHAN declared interest as a non-executive director of a number of listed corporations. He expressed concern on whether the maximum regulatory fine of $8 million was appropriate for serious breaches of the disclosure requirements. PS(FS) said that the maximum fine level of $8 million was set based on legal advice and having regard to the maximum fine level of $10 million for a criminal offence under the SFO. The proposed maximum fine level was considered suitable for a civil sanction. The amount of fines to be imposed would be based on, among other things, the seriousness of the misconduct involved, and past non-compliance record of the corporation/person concerned. PS(FS) pointed out that the civil sanctions were proposed as a package as the MMT might impose one or a combination of sanctions on the corporation/person in breach of the disclosure requirements. In response to Mr CHAN's enquiry, PS(FS) said that a person could appeal to the court regarding the judgment of MMT.

21. At the request of Mr Paul CHAN, the Administration agreed to provide information on the fines imposed in the convicted criminal cases instigated under the SFO since its enactment in 2003.

(*Pos-meeting note*: The Administration's response was circulated to members vide LC Paper No. CB(1)2094/09-10(01) on 31 May 2010.)

Codification of other Listing Rules

22. Noting that the current proposal only involved codification of disclosure requirements on PSI into the statute, Ms Starry LEE asked whether consideration would be given to the codification of the financial reporting requirements for listed corporations. Mr Paul CHAN also asked whether the Government would review the priority in codifying the Listing Rules so that priority would be given to codifying the

financial reporting requirements.

23. SFST responded that given the technical difficulty in codifying the Listing Rules, attempts were made to codify the disclosure requirements on PSI in the first instance, and consideration would be given to codifying other parts of the Listing Rules, e.g. the financial reporting requirements, at a later stage. At present, the Government focussed on codifying the PSI disclosure requirements, and had no time-table for codifying the other parts of the Listing Rules. The Administration would however consider members' views on codifying other parts of the Listing Rules.

Safe harbours

24. Mr Albert HO said that Members belonging to the Democratic Party supported the proposed statutory codification for certain requirements to disclose PSI by listed corporation. Mr HO enquired about the rationale for providing a safe harbour for cases where the Government's Exchange Fund or a central bank would provide liquidity support to a listed corporation. Mr HO also asked, when a listed corporation experienced financial difficulty which might lead to the collapse of the corporation, whether the corporation could withhold disclosure of the information on grounds that the corporation was seeking a resolution to rescue the corporation.

25. SFST remarked that a safe harbour was proposed for cases where the Exchange Fund or a central bank provided liquidity support to a listed corporation, as usually such cases involved a systemic issue, and there was a need to maintain the stability of the financial market. ED(CFD)/SFC remarked that as stipulated in paragraph 56 of the Draft Guidelines, a listed corporation in financial difficulty had to make timely disclosure of its financial situation, although information on negotiations or proposed actions being taken to rescue the corporation might fall within the second safe harbour so that there might be a delay for disclosure. The issue would be further considered based on the views collected during the public consultation exercise.

26. Mr CHIM Pui-chung declared interest as a major shareholder of several listed corporations. While supporting the statutory codification of the disclosure requirements in order to protect the interest of minority shareholders and investors, Mr CHIM expressed concern that premature disclosure of a business plan or negotiation on a transaction might adversely affect the business of a listed corporation, and undermine the interest of the shareholders/investors. Mr CHIM was concerned that a listed corporation might be accused of failing to disclose the negotiation on a major purchase, but if the transaction had failed to materialize, the listed corporation might be accused of fabricating false information to manipulate stock prices.

27. SFST responded that safe harbours had been proposed to exempt the listed corporations from disclosing certain inside information. These included trade secret, and information related to impending negotiations or incomplete proposals the

outcome of which might be prejudiced if the information was disclosed prematurely. SFST pointed out that relevant parties were welcomed to give their views on the proposed arrangements, including the safe harbours to be provided.

28. Noting that the proposal involved empowering the SFC to prescribe further safe harbours by way of subsidiary legislation, Mr Paul CHAN suggested that the legislative proposals on such further safe harbours be considered by Legislative Council by way of the positive vetting procedure. PS(FS) said that the Government would discuss with SFC and HKEx regarding the legislative procedure for prescribing further safe harbours, in light of the need to cater for unforeseen circumstances as a result of financial market development.

V Legislative proposals to transfer the authorization of offering documentation in relation to structured products from the Companies Ordinance (Cap. 32) to the Securities and Futures Ordinance (Cap. 571)

(LC Paper No. CB(1)1728/09-10(04) — Administration's paper on legislative proposals to transfer the regulation of public offers of structured products from the Companies Ordinance to the Securities and Futures Ordinance

LC Paper No. CB(1)1727/09-10 — Background brief on legislative proposals to transfer the authorization of offering documentation in relation to structured products from the Companies Ordinance to the Securities and Futures Ordinance prepared by the Legislative Council Secretariat

29. At the invitation of the Chairman, Deputy Secretary for Financial Services and the Treasury (Financial Services) (DS(FS)) briefed members that at present, investment product issuers might seek the SFC's authorization of public offer documents and marketing materials of such products under either the prospectus regime in the Companies Ordinance (Cap. 32) (CO regime) or the offers of investment regime of the Securities and Futures Ordinance (Cap. 571) (SFO regime), depending on the legal form of the investment products. The Administration proposed to transfer the regulation of public offers of structured products from the CO regime to the SFO regime ("proposed transfer"), so that all offers of structured products, regardless of the legal form of the structured products, would be regulated under the SFO regime. A definition of "structured product" would be introduced into the SFO for the purpose of regulating the public offers of structured products. SFC had proposed to issue codes and guidelines to set out certain basic structural features

and disclosure requirements for the unlisted structured products commonly seen in the market. Taking into account the importance of investor protection and the market development of structured products in recent years, the Administration considered it inappropriate to relax the SFO regime by replicating in the SFO the CO safe harbours currently applicable to shares and debentures. SFC had conducted public consultation on the proposed transfer from October to December 2009 and issued a report on the consultation conclusions on 22 April 2010. SFC had received 13 written submissions during the consultation period and held more than 16 meetings to discuss the consultation proposals with industry representatives. The respondents generally supported the proposed transfer in principle. The Administration and the SFC had taken into account the views received in formulating the current legislative proposals, and planned to introduce an amendment bill into the Legislative Council within 2010 to give effect to the proposed transfer.

30. At the invitation of the Chairman, the Executive Director, Corporate Finance Division, SFC (ED(CFD)/SFC) supplemented that as more than 90% of structured products were securities-based, SFC had proposed to include structured products in the definition of "securities" so that all structured products marketed to the public would be subject to the regulatory requirements that applied to “securities” under the SFO. The proposal was in line with the six pillars that supported the regulatory functions of SFC, namely disclosure, licensing, supervision of intermediaries' conduct, inspection, law enforcement and investor education. However, there was concern in the market that the proposal would have negative repercussions on the SFO especially its licensing regime, because bilateral contracts between institutions and institutional investors would also fall within the definition of "securities". To strike a balance between the need to address the market concern and the need to strengthen the regulatory regime, SFC had revised the proposed definition of "securities" so that the definition would only include structured products offered to the public but not bilateral contracts between institutions and institutional investors.

Investor Protection

31. Mr Paul CHAN said that he supported the proposed transfer and opined that the legislative proposals should accord priority consideration to enhancing protection of the investing public and preventing them from being misled. He concurred with the Administration that it was not necessary to replicate the CO safe harbours in the SFO.

32. Mrs Regina IP said that she welcomed the legislative proposals which were in line with her suggestions made in the Subcommittee to Study Issues Arising from Lehman Brothers-related Minibonds and Structured Financial Products. Many investors had complained that they had been misled by the prospectuses and marketing materials on equity-linked notes offered to them under the CO safe harbours. She enquired how the proposed transfer could enhance investor protection. Mr KAM Nai-wai raised the same query.

33. DS(FS) advised that SFC currently applied administrative measures to require issuers of structured products to satisfy eligibility requirements in the authorization process. After the proposed transfer took effect, all structured products including structured notes would be regulated under the SFO regime, under which SFC would issue a new "Code on Unlisted Structured Investment Products" (new Code) to set out the criteria that the SFC would normally consider before exercising its power to authorize the issue of offer documents or advertisements for unlisted structured products commonly seen in the retail market at present. ED(CFD)/SFC said that SFC had been conducting consultation exercises since late 2009 on a number of initiatives for rationalizing various aspects of the existing regulatory regime, such as the regulation of the conduct and selling practices of intermediaries. Hong Kong was the first jurisdiction that had prepared the new Code for public consultation. The new Code codified the administrative measures being adopted by SFC under the CO and other new measures introduced in light of the experience gained by regulatory bodies around the world since the outbreak of global financial crisis. DS(FS) further advised that the regulatory requirements contained in the new Code covered eligibility requirements on collateralized structured products, disclosure requirements in offering documents in respect of product features and risks, advertising guidelines and continuing disclosure obligations.

34. Mr KAM Nai-wai said that he supported the objective of enhancing investor protection but the Administration should provide information in its paper on how the proposed transfer could enhance investor protection. DS(FS) said that the Administration would provide supplementary information in this regard after the meeting.

(*Post-meeting note*: The Administration's response was circulated to member vide LC Paper No. CB(1)2094/09-10(02) on 31 May 2010.)

Safe harbours

35. Mr KAM Nai-wai enquired about the meaning of "public offer" and how a public offer was different from an offer to experienced or institutional investors. ED(CFD)/SFC advised that both the CO and the SFO included the concept of "public offer". In the CO, a bright line test was adopted to define a public offer. Under the test, an offer to not more than 50 persons was not regarded as a public offer. The "not more than 50 persons" rule was introduced into the CO in 2004. In the 2004 amendment bill, the numerical limit of 50 was determined with reference to the legal conventions adopted in Hong Kong and other jurisdictions. ED(CFD)/SFC further advised that while the SFO contained the concept of "public offer", a numerical limit was not specified.

36. Mr KAM Nai-wai noted in the Administration's paper that the SFO would not replicate the CO safe harbours but exemptions were provided in the SFO. He expressed concern whether issuers of investment products could make use of the exemptions to circumvent the regulatory requirements to trap investors. He enquired about the contents of the exemptions and under what circumstances SFC would grant

exemption to issuers of investment products. ED(CFD)/SFC advised that SFC proposed not to transfer two safe harbours from the CO regime to the SFO regime, viz. "offer in respect of which the minimum denomination of investment was not less than HK$500,000" and the 50-person safe harbour rule. ED(CFD)/SFC said that the safe harbours for "offer to professional investors" and for "private placement" were broadly accepted by the public and other jurisdictions. Under the current proposals, an offer of structured products would require SFC's authorization unless the offer was a "private placement" or an "offer to professional investors".

37. ED(CFD)/SFC further advised that another commonly used exemption was specified in section 103(2)(a) of the SFO under which the offering documents of securities-based products could be issued via licensed intermediaries without having to seek SFC's authorization. Under the current proposals, this exemption would be removed with respect to unlisted structured products. The issuers of such structured products would be required to obtain SFC's authorization for their offering documents, unless the products concerned were offered to professional investors or for private placement only. ED(CFD)/SFC also said that under the current and proposed regulatory regimes, bank products such as deposits offered to the public were exempted from having to obtain SFC's authorization. On Mr KAM's request, the Administration agreed to explain in writing details of the changes to the safe harbour arrangements upon the proposed transfer, and under what circumstances the exemptions under the SFO would be applicable to structured products after the transfer. In reply to Mrs Regina IP's enquiry, ED(CFD)/SFC advised that whether an investor was regarded as a professional investor or not would not be simply determined by the value of assets owned by the investor.

(*Post-meeting note*: The Administration's response was circulated to members vide LC Paper No. CB(1)2094/09-10(02) on 31 May 2010.)

38. Mrs Regina IP said that issuers commonly relied on the existing safe harbours to offer equity-linked notes with minimum denomination of not less than $500,000. She enquired whether and how SFC would regulate the offer of equity-linked notes under the proposed legislative framework. ED(CFD)/SFC advised that the current safe harbour provisions for structured products offered to the public with minimum denomination of not less than $500,000 would not be transferred to the SFO regime. The 50-person safe harbour rule would not be prescribed in the SFO as well. The numerical limit of 50 would no longer serve as a benchmark for private placement exemption but would be taken into account by SFC in determining whether an offer was a public or private one. For example, SFC might consider whether the aggregate effect caused by repeated issues of the same structured product might constitute a public offer even though each issue involved an offer to less than 50 investors. Private placements for structured products, such as an offer of a structured product to a small number of investors, would continue to be regulated under other SFC's regulatory pillars of licensing and regulation of the conduct of intermediaries.

Regulation of investment products offered by insurance companies

39. Ms Starry LEE opined that, in view of the extensive amount of financial innovations and complicated designs of investment products, the Administration should conduct a comprehensive review to identify possible loopholes existed in the current regulatory regime for investment products and to ascertain whether existing regulations governing investment products were in tandem with market changes. She asked how investment funds and structured products offered by insurance companies were regulated under the current and proposed legislative frameworks. ED(CFD)/SFC advised that the SFO did not contain detailed provisions for regulating investment funds, which were currently regulated under the SFO based on some general principles such as protection of the investing public and disclosure of information to investors. Structured products offered by insurance companies would be regulated under the SFO. To cater for extensive financial innovations, SFC maintained its flexibility in regulating investment products by means of its codes and guidelines.

Regulation of listed structured products

40. Ms Starry LEE noted that the Stock Exchange of Hong Kong (SEHK) was the frontline regulator responsible for vetting and approving listed structured products such as derivative warrants and callable bull/bear contracts. Callable bull/bear contracts were so popular that many advertisements on them were found in the market. Some investors had expressed concern that the volatility of callable bull/bear contracts stated in advertisements did not reflect their implied volatility. Ms LEE asked what measures would be taken to enhance investor protection with regard to these products. ED(CFD)/SFC advised that SEHK was obliged to liaise and discuss with SFC about the appropriateness of introducing any new listed structured product to the market. SEHK was also the frontline regulator for listed structured products and its Listing Committee was responsible for overseeing the relevant listing matters.

41. Ms Starry LEE expressed concern whether SEHK had a conflict of interest in the regulation of callable bull/bear contracts if it acted as the regulator for authorizing the contracts on the one hand and as the platform for the trading on the contracts on the other. Ms LEE queried whether SFC would take action to protect investors' interests if investors complained that the actual content of a callable bull / bear contract did not match with the description about the contract in its offering document. ED(CFD)/SFC advised that SEHK was the frontline regulator for listed products under the current regulatory framework, and SFC was not in the position to give views on this aspect of the regulatory framework. DS(FS) advised that no adverse comments about the proposal of maintaining SEHK as the frontline regulator for listed structured products had been received during the processes of review and consultation. The Administration supported the proposal based on the justifications mentioned in paragraph 10 of the Administration's paper. If members had different views towards the proposal, the Administration was willing to review it.

Overseas issuers of investment products

42. Mr KAM Nai-wai enquired whether the proposed legislative framework would provide sufficient safeguards to regulate or prohibit the offer of structured products by issuers located overseas. One case in point was that, under the current legislative framework, it was difficult for investors who had purchased equity-linked notes offered by an issuer located in the Netherlands to claim for loss after the collapse of Lehman Brothers. ED(CFD)/SFC advised that a new requirement was included in the proposed new Code to require an issuer located overseas to have a licensed person or an arranger in place in Hong Kong to take care of the matters concerning the offer of structured products.

Regulatory arbitrage

43. Mrs Regina IP enquired whether the department in SFC responsible for regulating the public offer of structured products to the retail investors was different from the department that regulated the offer to institutional investors. Recalling that a former SFC's senior staff had commented about the problem of regulatory arbitrage in SFC, Mrs IP expressed concern that if the same type of structured products was regulated by different departments in SFC, it would give rise to the problem of regulatory arbitrage. ED(CFD)/SFC advised that in SFC, the Corporate Finance Division was responsible for the products regulated under the CO while the Investment Product Department was responsible for other products. Following the changes brought by the proposed transfer, the Corporate Finance Division would be responsible for investment products such as ordinary shares and debentures of non-structured types while the Investment Product Department would take care of other investment products including structured products.

Legislative timetable

44. Mrs Regina IP asked whether the legislative amendments for the proposed transfer would be taken forward separately from the CO rewrite exercise and how the two initiatives dovetailed. DS(FS) advised that the Administration was taking forward the two initiatives in parallel. The objective of the proposed transfer was to place all structured products under the SFO regulatory regime. The CO rewrite exercise mainly aimed at strengthening corporate governance and had just completed the first phase consultation on the draft Companies Bill. The Administration planned to introduce an amendment bill for the proposed transfer within 2010.

VI Islamic finance – proposed amendments to the Inland Revenue Ordinance (Cap. 112) and Stamp Duty Ordinance (Cap. 117)

(LC Paper No. CB(1)1728/09-10(05) — Administration's paper on Islamic finance – proposed amendments to the Inland Revenue Ordinance (Cap. 112) and Stamp Duty Ordinance (Cap. 117)

FS19/09-10 — Fact sheet on overview of Islamic finance prepared by the Research and Library Services Division of the Legislative Council Secretariat)

45. DS(FS) briefed members on the proposed framework and latest schedule of the legislative exercise to amend the Inland Revenue Ordinance (Cap. 112) (IRO) and Stamp Duty Ordinance (Cap. 117) (SDO). The legislative amendments in question aimed to level the playing field for common types of Islamic bonds (Sukuk) vis-à-vis conventional bonds in terms of tax liabilities.

46. While supporting the initiative to develop the local Islamic financial market, Mrs Regina IP enquired what other measures, in addition to the current legislative exercise, would be taken to facilitate the development of Islamic finance in Hong Kong. Mrs IP also asked whether, apart from bonds, the Administration would develop the market for other Islamic financial products. Pointing out that Malaysia had already developed a sizable Islamic financial market since 2002, and Singapore had joined the Islamic Financial Services Board in 2005, Mrs IP enquired, given the small Islamic population in Hong Kong, whether Hong Kong would join the Islamic Financial Services Board. Mrs IP further asked whether adequate professionals, such as lawyers and accountants, with knowledge of the Shariah were available for the purpose of developing the Islamic financial market.

47. DS(FS) said that development of Islamic finance in Hong Kong could help diversify Hong Kong's financial platform and enhance Hong Kong's competitiveness as an international financial centre. Against this backdrop and given the market-led nature of the initiative, the Government's guiding policy principle was to level the playing field for the Islamic financial industry when compared with the conventional financial industry. This was in line with the approach adopted by other non-Islamic financial centres such as the United Kingdom. The Government would focus on developing the Sukuk market as the first step of developing Islamic finance in Hong Kong.

48. The Executive Director (Monetary Management), HKMA (ED(MM)/HKMA) said that apart from the current legislative exercise, measures had been and would be taken in collaboration with the financial sectors concerned to enhance training of professionals on Islamic financial services, develop diverse Islamic financial products, and promote Hong Kong's Islamic financial market. In particular, Hong Kong had joined the Islamic Financial Services Board as an associate member. Given the small Islamic population in Hong Kong, the Government would concentrate on the development of a wholesale capital Islamic

financial market, rather than retail Islamic financial services, in order to provide a platform for investors from the Middle East to invest in the financial markets of Hong Kong, the Mainland and neighbouring areas. ED(MM)/HKMA stressed that the provision of a level playing field for the Islamic financial industry vis-à-vis the conventional financial industry, through the amendment of the relevant tax legislation, was a pre-requisite for development of the Islamic financial market in Hong Kong.

49. Mr Paul CHAN said that he supported the initiative to develop Islamic finance in Hong Kong. The Government should expedite the efforts and aim to develop a market for diversified Islamic financial products, taking into account the potential of the market in the Mainland. The Government should also enhance development of relevant expertise in Islamic finance. As far as accountants were concerned, local expertise was available to support the development of Islamic finance. Regarding the interim arrangements pending the implementation of the proposed legislative amendments, Mr CHAN requested the Administration to provide information on the number of cases and amount of tax involved in applications for profits tax, property tax and stamp duty exemptions for Sukuk issuance and transactions under section 87 of IRO and section 52 of SDO. Mr CHAN remarked that the Government should assess the economic benefits brought about by the development of Islamic finance.

50. DS(FS) responded that since the exemption applications involved private commercial information, it would not be appropriate for the Government to disclose the relevant details. He added that the Government was taking a pragmatic approach in developing Islamic finance in Hong Kong and would assess the effectiveness of the strategy adopted at an appropriate juncture. It would take time to take forward and reap the economic benefits of the initiative.

(*Post-meeting note*: The Administration's response to Mr Paul CHAN's enquiry was circulated to members vide LC Paper No. CB(1)1902/09-10 on 14 May 2010.)

51. In view of the large and developed Islamic financial market in Malaysia, and the potential competition from the Mainland, Mr CHAN Kin-por enquired whether the Government had set a timetable for development of an Islamic financial market in Hong Kong and made projections on the business volume. He also enquired about the next steps to be taken after the current legislative exercise.

52. ED(MM)/HKMA responded that Hong Kong had great potential for developing an Islamic financial market as investors from the Middle East would be able to make use of the platform in Hong Kong to invest in the Mainland enterprises. Since 2008, financial institutions in Malaysia had been promoting Islamic investment instruments linked to the Mainland enterprises. After the outbreak of the global financial crisis, investors from the Middle East were keen to diversify their investments from the US and Europe to other regions of the world.

53. Mrs Regina IP expressed concern that in the absence of a uniform regulatory regime for Islamic finance, investors might have difficulty in seeking remedy in the case of default of an Islamic financial institution/product. Pointing out that the Singapore government had drawn up its Islamic finance strategy in 1999, Mrs IP was concerned about the lack of such a strategy for Hong Kong, including training of professionals in Islamic finance. Mrs IP asked whether the Government had liaised with the relevant Mainland authorities to arrange Hong Kong professionals involved in Islamic financial services to visit the Islamic community and experts in the Mainland, with a view to acquiring better understanding of the Islamic culture and Shariah.

54. ED(MM)/HKMA responded that the Islamic Financial Services Board had laid down standards and guidelines for participants in the Islamic financial industry. The Treasury Markets Association (TMA), in conjunction with universities in Hong Kong, had jointly organized training courses for professionals on the operation of the Islamic financial markets. Recently, TMA was discussing with an Islamic finance university in Malaysia regarding the provision of professional Islamic finance certificate courses to participants in Islamic finance in Hong Kong. Furthermore, HKMA had arranged exchange programme with the Islamic experts in the NingXia branch of the China Banking Regulatory Commission to discuss issues relating to Islamic finance. As regards the Government's strategy to develop Islamic finance, DS(FS) said that the Government was pressing ahead with the development of Islamic finance in Hong Kong on various fronts. Efforts included visits paid by senior government officials to Islamic economies to enhance cooperation between Hong Kong and these economies as well as to raise Hong Kong's profile as an Islamic financial platform.

VII Any other business

Investment of the Exchange Fund

55. Mrs Regina IP said that there were media reports that the HKMA had formed a subsidiary company for high risk investments for a portion of the Exchange Fund. She requested that the HKMA be asked to provide detailed information to the Panel on the arrangement.

56. The Chairman suggested and members agreed that the HKMA be requested to provide the relevant information to the Panel before the special meeting on 20 May 2010 when HKMA would brief the Panel on its work.

57. There being no other business, the meeting ended at 12:17 pm.

Legislative Council Secretariat
3 June 2010