

**Subcommittee on Securities and Futures Ordinance
(Amendment of Schedule 5) Notice 2011 and
Securities and Futures (Financial Resources) (Amendment) Rules 2011**

**The Administration's Response to Issues Raised
at the Subcommittee Meeting Held on 23 March 2011**

This paper presents the Administration's responses to issues raised by Members of the Subcommittee at its meeting held on 23 March 2011, following the order in the letter dated 24 March 2011 from the Clerk to Subcommittee.

I. Regarding the term “reasonable expectation” in the proposed definition of “providing credit rating services”¹, to review whether there is any judicial authority on the interpretation of this term in Hong Kong or other common law jurisdictions, and whether the word “anticipation” (“預期”) would be more appropriate than and thus can replace the word “expectation” in the context of the proposed definition.

2. Our research reveals that there are a number of judicial cases² suggesting that the phrase “reasonable expectation / reasonably be expected” provides an objective test. In fact, the phrases “reasonable expectation”, “reasonably expected”, “reasonably expect” and “reasonably be expected” are widely used in Hong Kong statutes, but we do not find the phrase “reasonable anticipation” in the statutes. The phrase “reasonably anticipated” does appear once in the Table under Schedule 5 to the Air Navigation (Hong Kong) Order 1995 (Cap. 448

¹ “providing credit rating services” (提供信貸評級服務) means-

- (a) preparing credit ratings-
 - (i) for dissemination to the public, whether in Hong Kong or elsewhere; or
 - (ii) with a reasonable expectation that they will be so disseminated; or
 - (b) preparing credit ratings-
 - (i) for distribution by subscription, whether in Hong Kong or elsewhere; or
 - (ii) with a reasonable expectation that they will be so distributed; or
- but does not include...

² These judicial cases include -

- (a) *Leung Chi Keung v Market Misconduct Tribunal* [2010] HKEC 1768;
- (b) *HKSAR v Gurung Krishna* [2010] HKEC 1150; and
- (c) *Wong Chan Oi Ying v Wong Yiu Cho* [2007] HKEC 442 and *R v S* [2010] HKEC 1365.

sub. leg. C)³, but is used in the technical context concerning aircraft equipment. The Order does not have a Chinese translation. With the above, we are of the view that the phrase “reasonable expectation” in the definition of “providing credit rating services” should remain unchanged.

3. On the Chinese rendition of the phrase “reasonable expectation”, there are mixed use of “合理預期” and “合理期望” in our legislation. Since the question will be ultimately determined by an objective test, the Chinese rendition of “合理期望” in the definition of “providing credit rating services” is very unlikely to alter the effect of such an objective test to be adopted by the court. Given the aforesaid and the fact that “合理期望” has been used in the Chinese text of the Securities and Futures Ordinance (Cap. 571, “SFO”) in connection to Type 7 regulated activity (automated trading services), it appears to us the Chinese term can remain unchanged for the sake of consistency.

II. Regarding the proposed definition of “credit ratings” (信貸評級), to consider whether a catch-all clause should be added to the definition to cater for future novel financial products, whose credit rating may be disseminated to the public.

III. Regarding the proposed definition of “debt securities” (債務證券), to confirm whether the present construction of the definition is sufficiently wide to cover financial products that may not involve “indebtedness” (whether in pecuniary form or not) but the credit rating of which may be disseminated to the public.

4. The proposals that have been prepared for the introduction of a regulatory regime for credit rating agencies (“CRAs”) in Hong Kong have taken into account international reforms in this area. Consistent with those reforms and the direction of the G20, the Hong Kong proposals are modelled on the Code of Conduct Fundamentals for Credit Rating Agencies (“IOSCO Code”) issued by the International Organisation of Securities Commissions in May 2008. Under the IOSCO

³ Relevant wording in the Air Navigation (Hong Kong) Order 1995 reads, “A supply of oxygen and the associated equipment to meet the requirements set out in Parts I and II of this scale. The duration for the purposes of this scale shall be:

(i) that calculated in accordance with the operations manual prior to the commencement of the flight, being the period or periods which it is **reasonably anticipated** that the aircraft will be flown in the circumstances of the intended flight at a height where the said requirements apply and in calculating the said duration account shall be taken of...”

Code, a credit rating is defined as an opinion regarding the creditworthiness of an entity, a credit commitment, a debt or debt-like security or an issuer of such obligations, expressed using an established and defined ranking system. In addition, the IOSCO Code clearly indicates that credit ratings are not recommendations to purchase, sell or hold any security. The existing scope of our proposed regime is generally consistent with the one favoured by IOSCO.

5. Our proposed definitions of “credit ratings” and “debt securities” cover a broad range of rating targets, including –

- a wide range of public bodies and other incorporated or unincorporated bodies, by virtue of the definition of “person” contained in section 3 of the Interpretation and General Clauses Ordinance (Cap. 1);
- securities and other instruments acknowledging, evidencing or creating indebtedness. The term “securities” is widely defined in Part 1 of Schedule 1 to SFO to include a wide range of financial products including stocks, bonds, and options; and
- an agreement to provide credit which covers any other financial instrument which creates a credit commitment.

6. It follows that if a financial instrument conveys an obligation to pay a pre-determined amount of money, it is clear that this would create “indebtedness” within its ordinary meaning. Thus, for licensing purposes, preparing credit ratings of such instruments will almost certainly constitute “providing credit rating services”.

7. SFC consulted the public concerning the proposed legislative amendments of SFO, including the draft definitions of “credit ratings” and “debt securities”. The written comments from existing CRAs, rating users, industry and professional associations and market practitioners expressed no concerns as to the scope of the proposed definitions of “credit ratings” and “debt securities” and that they might not capture existing and future financial products. The proposed definitions have also been subjected to international review, particularly by the European Union (“EU”).

8. With the above, we believe that the proposed definitions of “credit ratings” and “debt securities” are wide and clear enough to meet the policy intention that gave rise to the proposal to create a regulatory regime for CRAs in Hong Kong. The introduction of a catch-all clause,

which may extend the scope of the definition of “credit ratings”, could cause concerns on the regulatory certainty.

Financial Services Branch / Financial Services and the Treasury Bureau
Securities and Futures Commission
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