

立法會
Legislative Council

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Panel on Financial Affairs

**Minutes of special meeting
held on Monday, 28 March 2011 at 4:30 pm
in the Chamber of the Legislative Council Building**

- Members present** : Hon CHAN Kam-lam, SBS, JP (Chairman)
Hon CHAN Kin-por, JP (Deputy Chairman)
Hon Albert HO Chun-yan
Hon James TO Kun-sun
Dr Hon Philip WONG Yu-hong, GBS
Hon Emily LAU Wai-hing, JP
Hon LEE Wing-tat
Hon Jeffrey LAM Kin-fung, SBS, JP
Hon Andrew LEUNG Kwan-yuen, GBS, JP
Hon Ronny TONG Ka-wah, SC
Hon CHIM Pui-chung
Hon KAM Nai-wai, MH
Hon Starry LEE Wai-king, JP
Hon Paul CHAN Mo-po, MH, JP
- Members absent** : Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP
Dr Hon David LI Kwok-po, GBM, GBS, JP
Hon Abraham SHEK Lai-him, SBS, JP
Hon Vincent FANG kang, SBS, JP
Hon WONG Ting-kwong, BBS, JP
Dr Hon LAM Tai-fai, BBS, JP
Hon Mrs Regina IP LAU Suk-ye, GBS, JP

Public officers attending : Agenda Item I
Miss Mandy WONG
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services)

Attendance by invitation : Agenda Item I
Mr Martin WHEATLEY
Chief Executive Officer
Securities and Futures Commission

Mr Andrew WAN
Chief Financial Officer and Senior Director,
Corporate Affairs
Securities and Futures Commission

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

Staff in attendance : Mr Noel SUNG
Senior Council Secretary (1)5

Ms Clara LO
Legislative Assistant (1)10

Action

I Budget of the Securities and Futures Commission for the financial year of 2011-2012

(LC Paper No. CB(1)1458/10-11(03) — Administration's paper on "Securities and Futures Commission Budget for the Financial Year 2011-12"

LC Paper No. CB(1)1446/10-11 — Background brief on the annual budgets of the Securities and Futures Commission prepared by the Legislative Council Secretariat

LC Paper No. CB(1)1693/10-11(01) — Extract of draft minutes on the discussion of the item on "Budget of the Securities and Futures Commission for the financial year 2011-2012" at the Panel meeting on 7 March 2011)

Declaration of interest

The Chairman declared interest that he was a non-executive director of the Securities and Futures Commission (SFC).

Discussion

2. The Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) (PAS(FS)) said that the Government supported in principle the SFC's proposed budget for 2011-12, and noted that as in the past years, SFC did not request for appropriation from the Legislative Council.

Levies and fees

3. Mr James TO opined that since SFC had a surplus of about \$700 million in 2010-11 and a reserve of about \$6,750 million, SFC should actively consider reducing the level of transaction levies, instead of using the reserve for other purposes such as purchase of office premises.

4. The Chief Executive Officer, SFC (CEO/SFC) responded that although SFC had a reserve equivalent to about seven times of its annual operation costs, SFC had worked out its annual budgets in a pragmatic manner and the expenditure for 2011-12 was budgeted based on actual needs rather than the amount of the reserve. SFC had regularly reviewed the transaction levies, and since the levies on securities transactions and futures and options contracts had been reduced by 25% in October 2010, SFC did not recommend to the Financial Secretary (FS) a reduction of the levies in 2011-12. On the basis of the transaction volume in 2011-12, SFC would make a recommendation to FS regarding the appropriate level of the levies in the next budget.

5. Mr CHIM Pui-chung opined that given that SFC had a large reserve and it should not retain a reserve of more than three times of its annual expenses, SFC should waive all the levies immediately. Mr CHIM was of the view that the transaction levies should be reduced or waived once SFC's reserve had

been built up to \$3,000 million, and SFC might resume imposing the levies when its reserve amounted to less than \$3,000 million.

6. Mr LEE Wing-tat said that SFC should take the initiative to seek FS's view regarding the waiving or reduction of the transaction levies in view of its large reserve.

7. CEO/SFC responded that under the Securities and Futures Ordinance (Cap. 571) (SFO), if the reserves of SFC had reached a level more than twice its estimated operating expenses for the following financial year, SFC had a statutory duty to consult FS on reduction of the levy rates. In view that a reduction of levies had been implemented since October 2010, SFC had reviewed the situation and did not recommend further reduction of levies in the context of the Budget for 2011-12. PAS(FS) supplemented that in the past years, SFC had complied with the requirement under section 396 of SFO, and made a recommendation to FS regarding the level of transaction levies when its reserve had reached a level of more than two times of the annual operation expenditure of SFC. PAS(FS) said that the Administration would consider Mr CHIM's suggestion.

8. Noting that SFC had reduced the transaction levies with effect from 1 October 2010, Ms Starry LEE enquired whether a review of the levies would be conducted and a recommendation would be made to FS regarding further reduction of levies in October 2011.

9. CEO/SFC responded that a review of the levies would be conducted in 2011 taking into consideration members' views and SFC's financial situation, and SFC was obliged to make a proposal to FS by 31 December each year regarding the level of levies.

Overall manpower requirement

10. Noting that SFC proposed an increase of 61 posts in 2011-2012, Mr Jeffrey LAM enquired about the respective numbers of posts created for dealing with complaints and for handling other new functions. Mr LAM further enquired whether the additional manpower was required to deal with, apart from the Lehman Brothers Minibond cases, cases arising from any loophole identified in the regulatory system and to expedite the investigation/enforcement process. Mr LAM remarked that with the additional manpower, SFC should enhance its performance pledges and transparency.

11. The Chief Financial Officer and Senior Director, Corporate Affairs, SFC (CFO&SD/SFC) responded that 7 and 15 additional posts were proposed in the 2011-12 budget for the Corporate Affairs Division and the Enforcement Division respectively to deal with, among other things, complaints and enforcement cases. CFO&SD/SFC pointed out that the additional staff were required to meet the increased volume, scope and complexity of work handled by SFC. For instance, the total capitalisation of the Hong Kong stock market had nearly doubled in the previous two years. CEO/SFC said that SFC regularly reviewed its performance pledges which were published in its annual reports. SFC would ensure high transparency of its work to the extent possible under the statute.

12. Mr Paul CHAN expressed concern about the significant increases in headcounts and staff costs from 2008-09 to 2011-12. Mr CHAN requested that more information should be provided on the reasons for such marked increases, with details of the increases in workload and new initiatives in various work areas.

(Post-meeting note: SFC's response was circulated to members vide LC Paper No. CB(1)2060/10-11 on 29 April 2011.)

13. Given that the number of staff in the Enforcement Division would increase from 125 officers to 140 officers to deal with current and new cases, the Deputy Chairman enquired about the future deployment of the staff after the completion of the investigation of a large number of complaints relating to the Lehman Brothers Minibonds Incident. He was concerned that a large number of enforcement staff would be maintained on a permanent basis, although incidents like the Lehman Brothers Minibonds Incident would unlikely and should not be allowed to occur again.

14. CEO/SFC responded that the number of enforcement cases had been increasing in the past years and the proposed additional staff were required to cope with the increased workload. The Enforcement Division dealt with a wide range of cases, including market manipulation, insider trading, and misconduct cases.

15. Mr KAM Nai-wai opined that the Government should request SFC to trim down its manpower requirements, especially in the Enforcement Division, the Office of the Chief Executive Officer and the Commission Secretariat, and the Corporate Finance Division, in view that the operation of SFC lacked transparency, and basic information on the progress of its investigation work was not provided. Mr KAM opined that the number of staff in the Enforcement Division should be reduced after completion of the investigation

of cases relating to the Lehman Brothers Minibonds Incident. The workload of the Corporate Finance Division should have decreased as the number of applications for authorization of offering documents for public offer of structured products had reduced considerably after the Lehman Brothers Minibonds Incident. Detailed information to justify the additional staff for the Office of the Chief Executive and Commission Secretariat was also lacking. Mr KAM remarked that unless SFC could enhance the transparency of its operation, such as providing statistical reports on the progress of its investigation into complaints, it would only be concordant with public demands for SFC to cut down its expenses.

16. PAS(FS) responded that the Government had vetted SFC's budget proposals and supported the proposals in principle. As far as the Enforcement Division was concerned, the requested increase in headcount was justified by the increase in workload over the past few years. For example, the number of inquiries undertaken on the conduct of intermediaries and the number of investigations started had respectively increased by 47% and 32% in 2009-10 as compared to the previous year. During the same period, the number of criminal and civil prosecution cases relating to misconduct and company directors failing to perform their duties had also increased significantly.

Regulatory and enforcement work

17. Mr James TO pointed out that despite the recent announcement by a number of banks of a final resolution proposal for certain series of the Lehman Brothers Minibonds, there were buyers of Lehman Brothers products who would not be covered by the settlement or refused to accept the arrangement. Mr TO opined that SFC was acting irresponsibly in refraining from investigating into individual complaints. Mr TO enquired whether SFC would co-operate with the Police and/or other regulatory bodies to investigate into cases which had not been resolved through the settlement arrangement, and consider, where appropriate, taking prosecution actions under section 107 of SFO. Mr TO enquired whether any provision had been included in SFC's current proposed budget for investigation of complaints relating to the Lehman Brothers Minibonds Incident.

18. CEO/SFC responded that there had not been a better offer in any financial market than the proposal of the sixteen banks to pay back to investors of the Lehman Brothers Minibonds of up to 96% of their original investment. Investors who refused to accept or were not covered by the settlement arrangement might pursue their cases with the court. SFC would co-operate with the Police and other regulatory bodies in investigation of complaints where appropriate. Provisions in the 2011-12 budget were made for general

enforcement purposes and no specific provision had been made in the budget for investigation of complaints relating to the Lehman Brothers Minibonds Incident. CEO/SFC pointed out that in handling the Incident, SFC had expeditiously arranged settlements between about 30 000 investors and the banks concerned, which could not be achieved through other approaches in dealing with the complaints.

19. Mr LEE Wing-tat opined that while the investors of the Lehman Brothers Minibonds could seek redress in court, SFC should make use of its statutory powers to investigate into the complaints, especially for investors who had refused to accept the settlement arrangement. Mr LEE remarked that some investors did not agree that the settlement arrangement was the best option for them, and SFC's approach to handling the Lehman Brothers Minibonds Incident was unfair to these investors, who might have to spend a lot of money and time to seek redress in court.

20. CEO/SFC responded that the settlement agreement reached with the banks covered investors who bought Lehman Brothers Minibonds from the banks. It would not have been fair to the majority of investors who chose to accept the re-purchase payments if the top-down approach was not adopted and the settlement agreement with the banks had not been reached. When a settlement had been reached between the investors and the banks concerned, SFC would not continue investigating into the relevant complaint cases relating to the banks. SFC considered that adopting the top-down approach and entering into a settlement between the investors and the banks was a better solution than SFC continuing the investigation of individual cases for a period of time and the investors not knowing whether they would be able to receive any payment.

21. Noting that SFC would co-operate with the Commercial Crime Bureau (CCB) of the Police in investigation of complaints against mis-selling of structured financial products by financial institutions, Ms Starry LEE enquired about the mode of co-operation between SFC and CCB, and under what situation would such co-operation be triggered.

22. CEO/SFC remarked that in some cases SFC would offer information to the CCB regarding certain complaints whereas in other cases, SFC would provide information to CCB upon request. SFC could not disclose the outcome of individual cases until the completion of the investigation of the cases. CEO/SFC undertook to provide, in respect of the complaints against financial institutions on mis-selling of Lehman Brothers Minibonds and related structured products, information on the legal basis, mode and present position of the co-operation between SFC and CCB of the Police in the investigation of relevant cases.

(*Post-meeting note:* SFC's response was circulated to members vide LC Paper No. CB(1)2060/10-11 on 29 April 2011.)

23. Noting that SFC proposed to create 15 new posts in the Enforcement Division to provide a new team to cope with both the new cases and a wide portfolio of current ones, and to strengthen support in dealing with the increasing number of potential cases for disciplinary action, Mr KAM Nai-wai enquired about the number of cases handled by the Enforcement Division in 2010-2011 and the anticipated number of cases in 2011-2012, and the number of cases which were related to the Lehman Brothers Minibonds Incident. Mr KAM also enquired about the number of banks which were subject to investigation of systemic mis-selling of structured financial products. Mr KAM was dissatisfied that, unlike the practice of the Hong Kong Monetary Authority (HKMA), SFC had not regularly published reports on the progress of investigation of the complaints relating to the Lehman Brothers Minibonds Incident. Mr KAM asked about the number of criminal prosecution cases under section 107 of SFO since the inception of SFC.

24. CEO/SFC responded that SFC disclosed on a regular basis the outcome of investigation of misconduct cases, including any criminal or civil prosecutions and/or disciplinary actions taken against the parties concerned. SFC would not disclose the details of cases before the completion of the investigation. CEO/SFC pointed out that while HKMA provided updates on the handling of complaints, SFC disclosed results of the investigations. CFO&SD/SFC supplemented that SFC provided statistics on investigation of cases, e.g. the bi-monthly Enforcement Report and the SFC annual report provided statistics on the work of SFC. CFO&SD/SFC remarked that the workload of the Enforcement Division had increased by about 50% in 2011 on a year-to-date basis over the previous year.

25. Mr Ronny TONG remarked that from a macro point of view, the settlement reached between sixteen banks and investors of the Lehman Brothers Minibonds and related structured products should be welcomed as any civil proceedings of such a sizable volume would involve enormous social resources and litigants were unlikely to be able to obtain such high level of settlement payments as in the Minibond settlement. Mr TONG enquired about the impact of the settlement on SFC's strategy in investigation of the relevant complaints. Mr TONG opined that as a regulatory body, SFC had the statutory obligation to investigate and take prosecution action against any misconduct and/or mis-selling activities. Mr TONG enquired, if investors refused to accept the settlement arrangement and there was evidence to substantiate an offence against the law, whether SFC would proceed on prosecution of the

parties concerned. Mr TONG pointed out that the Police had initiated three prosecution cases relating to the Lehman Brothers Minibonds Incident, and the level of evidence for criminal prosecution undertaken by the Police and SFC should be the same.

26. CEO/SFC responded that the settlement arrangement had addressed the concern raised relating to the compliance of the code of conduct for financial institutions. There was no suspicion of any criminal behaviour on the part of the banks. CEO/SFC pointed out that the level of evidence required for criminal prosecution under the SFO was relatively high, involving evidence to show that there was fraudulent or reckless misrepresentation on the part of the parties concerned, and so far there was no evidence to suggest that a criminal prosecution was warranted. CEO/SFC remarked that notwithstanding the prosecutions made by the Police, so far SFC had not received any evidence relating to the Lehman Brothers Minibonds Incident which met the threshold for criminal prosecutions under the SFO.

Professional and other Expenses

27. In relation to Mr Paul CHAN's concern about the significant increase in professional and other expenses, and Mr CHAN's request for more details on the increases, CEO/SFC undertook to provide detailed information on the increase in demand for external expert services with a breakdown by the relevant work areas.

(Post-meeting note: SFC's response was circulated to members vide LC Paper No. CB(1)2060/10-11 on 29 April 2011.)

Investment of reserve fund

28. Mr Paul CHAN expressed concern that the average return of 2% on investment of SFC's reserve funds was relatively low. Mr CHAN enquired whether SFC would consider ways to enhance the return of its investment of the reserve funds, such as adopting the investment arrangement of the Exchange Fund.

29. CEO/SFC responded that SFC had a statutory obligation to adopt a very cautious investment strategy for the reserve funds. SFC had made proposals to the Government regarding the investment strategy of the reserve funds, and the possibility of outsourcing the investment responsibility to external parties, including the management model of the Exchange Fund.

Internship

30. Noting that 30 graduates had been recruited under the internship programme in the past two years, the Deputy Chairman enquired about the turnover situation of the interns in recent years. Mr Paul CHAN echoed the Deputy Chairman's concern and requested that the Administration/SFC should provide more details of the arrangements of the internship programme.

31. CFO&SD/SFC responded that the retention rate for graduate interns had been satisfactory, as arrangement had been made for the interns to work in different divisions in the SFC. CFO&SD/SFC undertook to provide the information requested by the Deputy Chairman and Mr Paul CHAN.

(Post-meeting note: SFC's response was circulated to members vide LC Paper No. CB(1)2060/10-11 on 29 April 2011.)

II Any other business

32. There being no other business, the meeting ended at 5:30 pm.

Council Business Division 1
Legislative Council Secretariat
15 June 2011