

**立法會**  
**Legislative Council**

LC Paper No. CB(1)2570/11-12  
(These minutes have been seen  
by the Administration)

Ref : CB1/SS/14/11/2

**Subcommittee on Securities and Futures (Futures Contracts) Notice 2012**

**Third meeting on**  
**Wednesday, 13 June 2012, at 8:30 am**  
**in Conference Room 2B of the Legislative Council Complex**

- Members present** : Hon James TO Kun-sun (Chairman)  
Hon Audrey EU Yuet-mee, SC, JP  
Hon KAM Nai-wai, MH
- Member absent** : Hon CHIM Pui-chung
- Public officers attending** : Mr Anthony LI  
Principal Assistant Secretary for  
Financial Services and the Treasury (Financial Services) 2
- Mr Daryl HO  
Head, Market Development Division  
Hong Kong Monetary Authority
- Attendance by invitation** : Mr Keith LUI  
Executive Director, Supervision of Markets  
Securities and Futures Commission
- Mr Rico LEUNG  
Senior Director, Supervision of Markets Division  
Securities and Futures Commission

Ms Daphne DOO  
Director, Supervision of Markets Division  
Securities and Futures Commission

Mr Gerald D GREINER  
Chief Operating Officer  
Hong Kong Exchanges and Clearing Limited

Mr Kelvin LEE  
Vice President, Platform Development and Strategy Department  
Hong Kong Exchanges and Clearing Limited

Mr Ketan PATEL  
Senior Vice President  
Head of OTC Clearing Risk Management  
Hong Kong Exchanges and Clearing Limited

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

**Staff in attendance** : Miss Evelyn LEE  
Assistant Legal Adviser 10

Mr Hugo CHIU  
Council Secretary (1)5

## **I Meeting with the Administration**

### Follow-up to issues arising from previous meeting

(LC Paper No. CB(1)2155/11-12(01) — List of follow-up actions arising from the discussion at the meeting on 4 June 2012

LC Paper No. CB(1)2155/11-12(02) — Administration's response to issues raised at the meeting on 4 June 2012 (Confidential, restricted to members only)

- LC Paper No. CB(1)2155/11-12(03) — Administration's further response to issues raised at the meeting on 4 June 2012
- LC Paper No. CB(1)2155/11-12(04) — Letter dated 6 June 2012 from Assistant Legal Adviser to the Administration)

Other relevant papers

- (issued on 2 May 2012* — Legislative Council Brief on Securities and Futures (Futures Contracts) Notice 2012 issued by the Financial Services and the Treasury Bureau, Hong Kong Monetary Authority and Securities and Futures Commission
- L.N. 81 of 2012 — Securities and Futures (Futures Contracts) Notice 2012
- LC Paper No. LS60/11-12 — Report of the Legal Service Division on subsidiary legislation gazetted on 4 May 2012
- LC Paper No. CB(1)1933/11-12 — Background brief prepared by the Legislative Council Secretariat)

Discussion

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

Follow-up actions to be taken by the Administration

- Admin 2. The Administration and the Hong Kong Exchanges and Clearing Limited ("HKEx") are requested to:
- (a) confirm that the HKSAR Government will not in any event or circumstances be liable in tort for any losses sustained by any over-the-counter central counterparty ("OTC CCP") approved as a

recognized clearing house ("RCH") or for any losses sustained by the clearing members of such OTC CCP;

- (b) examine whether the existing provisions under the Securities and Futures Ordinance (Cap. 571) ("SFO") and/or other ordinances provide sufficient protection for the Government and the Securities and Futures Commission as well as their officers from any legal liability for losses sustained by any person attributable to an act interfering the operation of a RCH made by the Government or SFC or an officer of the Government/SFC pursuant to the powers conferred on them under the relevant statutes;
- (c) examine whether SFC, under the existing legislation, has the authority to implement the limited recourse winding down arrangement as specified in the Administration's further response to issues raised at the meeting on 4 June 2012 (LC Paper No. CB(1)2155/11-12(03));
- (d) consider the feasibility of specifying the liability and any immunity of liability of a RCH for the losses of its members through legislation instead of the RCH's clearing rules/contracts;
- (e) clarify the effect of section 380 and any other relevant provisions in SFO regarding the immunity of the HKSAR Government from any liability to the losses sustained by parties due to the default of one or more clearing members of HKEx's OTC CCP; and
- (f) explore the feasibility of introducing arrangements similar to the practice of reinsurance in the insurance industry in the proposed regime (e.g. HKEx's OTC CCP reduces its risk exposure by becoming a member of an overseas CCP), and advise on the relevant practice in other major international financial centres.

Other follow-up action

3. The Chairman instructed the Clerk to relay his request to the Committee on Rules of Procedure for examination of the issue that despite the Subcommittee's decision to extend the scrutiny period of the Securities and Futures (Futures Contracts) Notice 2012, the motion could not be moved at the relevant Council meetings because the agenda items that took precedence over the motion were not completed at those Council meetings.

### **III Any other business**

#### Way forward

4. The Chairman said that the Subcommittee had completed scrutiny of the Securities and Futures (Futures Contracts) Notice 2012 and no further meeting would be required.
5. There being no other business, the meeting ended at 10:02 am.

Council Business Division 1  
Legislative Council Secretariat  
11 September 2012

**Proceedings of the  
Subcommittee on Securities and Futures (Futures Contracts) Notice 2012  
Third meeting on Wednesday, 13 June 2012, at 8:30 am  
in Conference Room 2B of the Legislative Council Complex**

Time Marker	Speaker	Subject(s)	Action Required
000435 – 000658	Chairman	Opening remarks	
000659 – 001929	Administration Hong Kong Exchanges and Clearing Limited (HKEx) Securities and Futures Commission (SFC)	Briefing by the Administration, the Securities and Futures Commission ("SFC") and the Hong Kong Exchanges and Clearing Limited ("HKEx") on LC Paper No. CB(1)2155/11-12(03)	
001930 – 003146	Mr KAM Nai-wai Administration Chairman	<p>Mr KAM enquired under what situation the Administration would use public money to bail out a recognized local central counterparty ("CCP") for clearing of over-the-counter ("OTC") derivatives transactions. Referring to the clause <i>"it is unlikely that the Government will be liable in tort for any losses sustained by the OTC CCP or its clearing members"</i> in item 5 of paragraph 3 of the LC Paper No. CB(1)2155/11-12(03), Mr KAM sought clarification on the meaning of the clause.</p> <p>The Administration replied as follows:</p> <p>(a) The maintenance of the stability and integrity of Hong Kong's financial system would be the Administration's main consideration in deciding whether to use public money to bail out a recognized OTC CCP in Hong Kong, including HKEx's OTC CCP. However, the Administration would not commit itself on using public money to bail out such OTC CPP or otherwise; and</p> <p>(b) While the Administration, upon consulting the Department of Justice ("DoJ") and SFC, concluded that the Government would not be liable in tort for any losses sustained by HKEx's OTC CCP or its clearing members, a more conservative expression (i.e. "it is unlikely") was used in preparing the paper.</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>The Chairman requested the Administration to clarify the issue in writing.</p> <p>The Chairman considered that the arrangements set out in item 5 of paragraph 2 of LC Paper No. CB(1)2155/11-12(03) could guard against the situation that members of HKEx's OTC CCP deliberately conducted a huge amount of trading such that the Government would be forced to bail out the CCP to compensate for their losses.</p>	<p>The Administration to take action as per paragraph 2 of the minutes.</p>
<p>003147 – 005010</p>	<p>Mr KAM Nai-wai SFC Chairman ALA10</p>	<p>Mr KAM enquired whether members of HKEx's OTC CCP would be informed of the fact that the HKSAR Government did not have any legal obligation to provide any financial assistance to the OTC CCP or its clearing members, as mentioned in item 1 of paragraph 1 of LC Paper No. CB(1)2155/11-12(03).</p> <p>SFC responded as follows:</p> <p>(a) The arrangements would be clearly specified in the clearing rules of HKEx's OTC CCP; and</p> <p>(b) The OTC derivatives market was a wholesale market and most of its participants would be banks and large financial institutions, which should be well aware of their obligation to comply with the clearing rules of the OTC CCP.</p> <p>The Chairman enquired whether, under the existing legislation, the Chief Executive ("CE"), Secretaries of Departments, Directors of Bureaux, SFC and/or HKMA had the power to cease/suspend the clearing service of a recognized CCP. SFC advised that section 11 of SFO allowed CE to give directions to SFC and section 29 of SFO allowed SFC to cease the provision of facilities or services in emergencies for a period not exceeding five business days or 10 business days if extended.</p> <p>The Chairman expressed concern that the Government might be liable to the losses sustained by HKEx's OTC CCP if the CE ordered SFC to suspend the CCP's operation. SFC advised that there were relevant sections in SFO on the immunity of SFC.</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>ALA10 enquired and the Administration confirmed that paragraph 3 of LC Paper No. CB(1)2155/11-12(03) was intended to address the issues raised in ALA10's letter dated 6 June 2012 to the Administration.</p> <p>ALA10 made the following points:</p> <p>(a) Sections 28 and 29 of SFO should be read together and SFC could only cease the provision of facilities or services of a recognized exchange company for a period of not exceeding five business days, or 10 business days if extended;</p> <p>(b) Sections 39 and 380(1) of SFO concern with the issue of immunity. Under both sections, immunity would only apply to a party if he acted in good faith. Further, for the immunity under section 39 to apply, a person needed to act on behalf of the RCH. However, it was possible that the Government did not act on behalf of the RCH. In that situation, one had to refer to section 380, which in turn referred to section 11 of the SFO;</p> <p>(c) Under section 11 of SFO, CE could give directions to SFC. If CE was satisfied that it was in the public interest to do so, the act would be covered by the immunity protection provided under section 380 of SFO.</p> <p>The Chairman expressed concern that the directions given by CE to SFC on the operation of HKEx's OTC CCP might not be covered by the immunity protection set out in section 380 of SFO if a claim was filed by a member of the CCP.</p> <p>The Chairman requested the Administration and SFC to:</p> <p>(a) examine whether the existing provisions under SFO and/or other ordinances provided sufficient protection for the Government and SFC as well as their officers from any legal liability for losses sustained by any person attributable to an act interfering the</p>	<p>The Administration to take action as per paragraph 2 of the minutes.</p>

Time Marker	Speaker	Subject(s)	Action Required
		<p>operation of a RCH made by the Government or SFC or an officer of the Government/SFC pursuant to the powers conferred on them under the relevant statutes; and</p> <p>(b) examine whether SFC, under the existing legislation, had the authority to implement the limited recourse winding down arrangement described in LC Paper No. CB(1)2155/11-12(03).</p>	
005011 – 010007	ALA10 Chairman SFC	<p>Briefing by ALA10 on her letter dated 6 June 2012 to the Administration (LC Paper No. CB(1)2155/11-12(04)).</p> <p>ALA10 enquired and the Administration confirmed that section 39 was not relevant to the issue of immunity of an RCH from the liability to the loss sustained by a party due to the default of any of its clearing members.</p> <p>The Chairman enquired whether CCPs in other relevant jurisdictions specified their liabilities and any immunity of liability for the losses of their members through legislation or contracts. SFC responded that LCH.Clearent specified such immunity through contracts, i.e. the clearing rules. The Chairman requested the Administration to consider the feasibility of specifying the liability and any immunity of liability of an RCH for the losses of its members through legislation instead of the RCH's clearing rules/contracts. The Chairman also pointed out that if HKEx's OTC CCP made a wrong decision, its members might file claims against the CCP on the ground that such decision constituted a breach of contract.</p> <p>Regarding the immunity of the civil liability of the Government, ALA10 pointed out that the Government was not a party to the clearing rules, and the clearing rules did not impose any express or implied contractual duty or liability on the Government. ALA10 enquired and the Administration confirmed that such immunity was set out in section 380 instead of section 39 of SFO. The Chairman remarked that the Administration should clarify the effect of section 380 and any other relevant provisions in SFO</p>	<p>The Administration to take action as per paragraph 2 of the minutes.</p> <p>The Administration to take action as per paragraph 2 of the minutes.</p>

Time Marker	Speaker	Subject(s)	Action Required
		regarding the immunity of the Government from any liability to the losses sustained by parties due to the default of one or more clearing members of HKEx's OTC CCP.	
010008 – 010821	Chairman HKEx SFC	<p>The Chairman enquired whether the proposed regime included any arrangement similar to the practice of reinsurance in the insurance industry (i.e. the HKEx's OTC CCP became a member of an overseas CCP to lower its risk exposure) and, if not so, whether the Administration/SFC planned to implement such arrangement. HKEx advised that it would be more practical and effective if the clearing members establish their own arrangement with other CCPs. SFC added that such arrangement was not found in overseas CCPs. The Chairman requested the Administration to explore the feasibility of introducing arrangement similar to the practice of reinsurance in the insurance industry in the proposed regime (e.g. HKEx's OTC CCP reduced its risk exposure by becoming a member of an overseas CCP), and advise on the relevant practice in other major international financial centres.</p> <p>In response to the Chairman's enquiry, SFC advised that there was no precedent of an overseas CCP transferring its contracts to another CCP before it issued margin calls on such contracts so as to reduce its risk exposure of such contracts.</p>	The Administration to take action as per paragraph 2 of the minutes.
010821 – 012532	Closed meeting		
012533 – 012637	Chairman	<p>The Chairman summarized the discussion at the closed meeting as follows:</p> <ul style="list-style-type: none"> <li>(a) the Subcommittee had discussed the information provided by HKEx on the estimated expenditures of HKEx's OTC CCP and the fees information of certain overseas CCPs; and</li> <li>(b) the Subcommittee noted the business model of HKEx's OTC CCP and how it would become break-even.</li> </ul>	

<b>Time Marker</b>	<b>Speaker</b>	<b>Subject(s)</b>	<b>Action Required</b>
012638 – 013101	Chairman	<p>The Chairman thanked the Administration for providing relevant information on whether the Government would incur legal liability in respect of HKEx's OTC CCP.</p> <p>The Chairman considered that the OTC CCP could be run on a trial basis. While the Administration declined to make a public statement that the Government would not in any circumstances use public money to bail out any CCP established in Hong Kong for clearing of OTC derivatives transactions as an RCH under the SFO, he believed that the Administration would strike a balance between maintaining the stability and integrity of Hong Kong's financial system and the prudent use of public money. Since the Government was not legally liable to losses sustained by HKEx's OTC CCP, he considered that the Administration would not have sufficient grounds to use a huge amount of public money to bail out the CCP. He supported the Securities and Futures (Futures Contracts) Notice 2012.</p> <p>The Chairman requested the Administration and HKEx to consider his suggestion of specifying the liability and any immunity of liability of an RCH for the losses of its members through legislation instead of the RCH's clearing rules/contracts.</p> <p>The Chairman remarked that while no further meeting would be held, the Administration was requested to provide written response on the issues raised during the meeting.</p>	