

**President's ruling on  
Hon KAM Nai-wai's proposed resolution to amend the Securities and  
Futures (Professional Investor) (Amendment) Rules 2011**

Hon KAM Nai-wai has given notice to move a proposed resolution to amend the Securities and Futures (Professional Investor) (Amendment) Rules 2011 ("Amendment Rules") at the meeting of the Legislative Council ("LegCo") on 30 November 2011. In considering whether the proposed resolution is in order under the Rules of Procedure, I invited the Administration to comment on the proposed resolution and Mr KAM to respond to the Administration's comments.

**The Amendment Rules**

2. The Amendment Rules were made by the Securities and Futures Commission ("SFC") pursuant to section 397(1) of the Securities and Futures Ordinance (Cap. 571) ("SFO") to amend the Securities and Futures (Professional Investor) Rules (Cap. 571 sub. leg. D) ("the principal Rules").

3. According to the LegCo Brief on the Amendment Rules, there are two types of professional investors under SFO and they are set out in the definition of "professional investor" in Part 1 of Schedule 1 to SFO. The first type of professional investors are specified entities, such as banks and insurance companies, as stipulated in paragraphs (a) to (i) of the definition. The second type of professional investors are persons belonging to a class as prescribed under the principal Rules ("high net worth professional investors") pursuant to paragraph (j) of the definition. The high net worth professional investors include, among corporations and partnerships meeting certain conditions, an individual (either alone or with his or her associate(s) on a joint account) having a portfolio comprising securities, certificate of deposit issued by a bank and/or money held by a custodian ("portfolio") of not less than \$8 million (or the equivalent in foreign currency) (section 3(b) of the principal Rules).

4. As explained in the LegCo Brief, the principal Rules also set out specific evidential requirements to ascertain whether an investor has the required assets or portfolio. For example, evidence of an individual investor's portfolio must be in the form of a certificate issued by an auditor or a certified public accountant within 12 months before the relevant date as defined by section 2 of the principal Rules, or by

referring to one or more custodian statements issued within 12 months before the relevant date.

5. The purposes of the Amendment Rules are:
- (a) to amend the principal Rules to prescribe additional means of ascertaining whether an investor is a professional investor under the principal Rules; and
  - (b) to modify the conditions to be met by a particular type of corporation to qualify as a professional investor under section 3(d) of the principal Rules.

### **Hon KAM Nai-wai's proposed resolution**

6. Hon KAM Nai-wai's proposed resolution seeks to impose additional requirements for an individual to be qualified as a professional investor under section 3(b) of the principal Rules. These additional requirements, which are currently set out in paragraph 15.3 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("Code of Conduct"), are:

- (a) the individual's expertise and investment products trading experience and knowledge having been assessed as, in light of the nature of the transactions or services envisaged, providing assurance that the individual is capable of making an investment decision on his own with understanding of the risks involved;
- (b) the individual having traded not less than 40 transactions per annum; and
- (c) the individual having traded actively in the relevant market for at least two years.

### **The Administration's comments**

#### Failure to consult

7. The Administration submits that the power of LegCo to amend subsidiary legislation is provided in section 34 of the

Interpretation and General Clauses Ordinance (Cap. 1) (“IGCO”). Section 34(2) provides that LegCo may by resolution amend subsidiary legislation in any manner whatsoever consistent with the power to make such subsidiary legislation. The Administration points out that the Amendment Rules are made by SFC under powers in section 398 of SFO, and that under that section, SFC is required, inter alia, to publish a draft of any rules or amendments to existing rules for the purposes of inviting representations by the public as well as to publish a report on the conclusion of such consultation, setting out in general terms the representations it received and its response to those representations. The Administration explains that the intention of this process is to ensure that the market has an opportunity to comment upon and prepare for the introduction of new subsidiary legislation in order to foster compliance. The Administration argues that as the power of SFC to make rules is subject to the statutory consultation requirements, any amendments by LegCo would be subject to the same statutory consultation requirements in view of the “consistent with the power to make such subsidiary legislation” in section 34 of IGCO, failing which the amendments could be considered ultra vires.

8. The Administration further submits that as Hon KAM Nai-wai’s proposed resolution has never been put to the public for consultation, it will sidestep the due process prescribed in section 398 of SFO. Had SFC purported to do this, it would have been acting ultra vires. The Administration states that SFC has made clearly its undertaking to the subcommittee formed to study the Amendment Rules to conduct a thorough public consultation on the matter. The Administration strongly considers that this is the right course to take and would be consistent with the due process prescribed in section 398 of SFO.

#### Charging effect

9. The Administration is of the view that Hon KAM Nai-wai’s proposed resolution has charging effect under Rule 31(1) of the Rules of Procedure in that the proposed resolution, if passed, will introduce additional factors into the definition of professional investors under the principal Rules. The Administration submits that at present, the requirements for the control of the conduct of intermediaries in respect of professional investors are prescribed in the non-statutory Code of Conduct. If the requirements are to be enshrined in the statute through stipulation in the principal Rules, a breach of the relevant provisions of SFO and the Companies Ordinance (Cap. 32) which rely upon the principal Rules will constitute a criminal offence and give rise to criminal

sanctions upon court conviction. The Administration envisages that as the proposed resolution would introduce additional criminal offences and sanctions, it would result in SFC, the Department of Justice as well as the Judiciary incurring additional resources in investigation, evidence gathering, prosecutions and court hearings.

10. The Administration further argues that under section 14 of SFO, the Government may pay moneys to SFC out of the general revenue appropriated by LegCo. Although such provision has not been invoked since the financial year of 1993-1994 as SFC has so far managed to cover its expenditure by funding from the market and the investing public in the form of transaction levies as well as fees and charges, the expenditure of SFC is dischargeable under general revenue.

#### Drafting considerations

11. The Administration also submits that the language deployed in the proposed resolution would need to be closely scrutinized and refined in order to bring it up to a level suitable for statutory provisions, as a breach of which will constitute a criminal offence and may lead to criminal sanctions including fines and imprisonment. The language needs to be considered in totality with the existing law against any unintended consequences and inconsistencies that may render it inoperable.

#### **Hon KAM Nai-wai's response**

12. Hon KAM Nai-wai does not agree to the Administration's comments. He submits that SFC enjoys financial autonomy. Its revenue is derived from transaction levies as well as fees and charges and does not include appropriation from the Government. In recent years, SFC has deployed its manpower and resources to investigate quite a number of cases and instigated prosecutions against those involved, without overspending its revenue and affecting the Government's finances.

13. Mr KAM points out that at present, the requirement for listed corporations to disclose price sensitive information is set out in the Listing Rules of the Stock Exchange of Hong Kong Limited, and not in the law. To promote effective compliance with and allow effective enforcement of the disclosure obligations, the Securities and Futures (Amendment) Bill 2011 seeks, inter alia, to statutorily oblige listed corporations to disclose such information in a timely manner. Mr KAM

submits that his proposed resolution to the Amendment Rules seeks similarly to enhance compliance with and allow effective enforcement of the Code of Conduct to protect the general public who lack professional investment knowledge and experience.

14. Mr KAM further submits that as SFC had already extensively consulted the public when amending the Code of Conduct, there is no question of his proposed resolution failing to meet the public consultation requirement in section 398 of SFO.

## **My opinion**

### Failure to consult

15. Section 34(2) of IGCO provides that LegCo may by resolution amend subsidiary legislation in any manner whatsoever consistent with the power to make such subsidiary legislation. Noting that section 398 of SFO requires SFC to, inter alia, publish a draft of any proposed rules or amendments to existing rules for the purposes of inviting representations by the public as well as to publish a report on the conclusion of such consultation, setting out in general terms the representations it received and its response to those representations, the Administration submits that as Hon KAM Nai-wai's proposed resolution has never been put to the public for consultation, it is ultra vires.

16. Counsel to the Legislature advises me that besides section 398 of SFO mentioned by the Administration in its submission, section 397 of SFO should also be relevant when considering whether the proposed resolution is in order under the Rules of Procedure.

17. In Counsel's view, the requirements provided in section 398 of SFO as described by the Administration only apply to SFC when it is proposing to make the Amendment Rules. Once the Amendment Rules have been made pursuant to section 397 of SFO, those requirements will have fallen away. Since the Amendment Rules are subsidiary legislation which have to be tabled in the Council, and are subject to the Council's power to amend under section 34(2) of IGCO, there is no doubt in his mind that the Council's power to amend is not subject to those requirements which apply to SFC under section 398 of SFO. If they did, it would give rise to a situation of the Council's power to amend subsidiary legislation being negated, which could not be within the contemplation of section 34(2) of IGCO when it was enacted.

18. Counsel has also drawn my attention to the inconsistency in the Administration's position in its submission with what it did in relation to the Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) (No. 2) Rules 2007 ("2007 Rules"). A subcommittee was formed to study the 2007 Rules and after deliberation, the Administration agreed to move a motion to amend the 2007 Rules. At that time, there was no suggestion that the amendments had to go through the statutory consultation procedure.

19. I concur with Counsel's view and cannot accept the Administration's submission. It should be for the Council to decide, with the knowledge that no consultation has been conducted by SFC on the proposed amendments to the Amendment Rules, whether Hon KAM Nai-wai's proposed resolution should be passed.

#### Charging effect

20. A clear principle has been established in past rulings that an amendment to an item of subsidiary legislation will have charging effect under Rule 31(1) of the Rules of Procedure if the amendment imposes a new statutory function and the performance of the new statutory function will require the spending of an amount of public money that is not nominal or negligible.

21. The Administration argues that Hon KAM Nai-wai's proposed resolution has charging effect mainly on the following grounds:

- (a) the proposed resolution would introduce additional criminal offences and sanctions, hence it would result in SFC, the Department of Justice as well as the Judiciary incurring additional resources in investigation, evidence gathering, prosecutions and court hearings; and
- (b) the Government may need to pay moneys to SFC out of the general revenue if SFC is unable to cover its expenditure by funding from the market and the investing public in the form of transaction levies as well as fees and charges.

22. Counsel advises me that the principal Rules contain no penalty provisions. Rather, SFO contains certain exemptions from compliance with particular provisions when dealing with professional investors, i.e. if an investor is a professional investor, the legal restrictions on issuance of

advertisements in relation to investments (section 103 of SFO), the making of unsolicited calls (section 174 of SFO) and the communication of an offer in relation to securities (section 175 of SFO) do not apply. Breaches of these provisions are criminal offences, as set out in sections 103(1), 174(5) and 175(4) of SFO. In Counsel's view, no new offences will be created if the proposed resolution is passed.

23. As the proposed resolution does not impose a new statutory function, it does not have charging effect within the meaning of Rule 31(1) of the Rules of Procedure. I wish to reiterate the point I made in an earlier ruling that the costs for the administration of justice is not a charge. Even if an amendment may result in prosecutions being required to be undertaken, the Government as a whole already has statutory authority to incur expenditure for the administration of justice<sup>1</sup>.

#### Drafting considerations

24. The Administration's comment that the language of the proposed resolution needs to be considered in totality with the existing law against any unintended consequences and inconsistencies that may render it inoperable is, in my opinion, a point of merit which the President should not consider when making a ruling under the Rules of Procedure.

#### **My ruling**

25. I rule that Hon KAM Nai-wai's proposed resolution may be moved at the Council meeting of 30 November 2011.

(Jasper TSANG Yok-sing)  
President  
Legislative Council

29 November 2011

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<sup>1</sup> President's ruling on Committee stage amendments to the Buildings (Amendment) Bill 2010 proposed by Hon KAM Nai-wai.