

香港特別行政區政府財經事務局的信頭

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本函檔號 OUR REF.: (66) in SU B51/98 V
來函檔號 YOUR REF.:

5 October 1998

Ms Odelia LEUNG
Clerk to Bills Committee
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear Ms Leung,

Bills Committee on Securities (Amendment) Bill 1998
Third Meeting on 7 October 1998

I refer to your letter of 23 September 1998 regarding the above subject. Please be informed that the Administration's attendance will remain unchanged as in the past two meetings. As regards the points raised in your letter, our replies to them are presented below in seriatim.

(a) Types of Claims

According to the Stock Exchange of Hong Kong, the breakdown of the number and value of claims against the Unified Exchange Compensation Fund in relation to the C.A. Pacific (CAP) incident is as follows -

<u>Category</u>	<u>No. of Claims</u>	<u>Total Claimed</u>
Claimants who had account only with CAP Securities Ltd.	905	\$293.8 milli
Claimants who had account with CAP Finance Ltd.	<u>4,268</u>	<u>\$45,057.8 milli</u>
	<u>5,173</u>	<u>\$45,351.6 milli</u>

The Exchange is unable to produce a further classification other than the above at this stage because it requires a detailed assessment of each statement in each claim so as to determine whether claimant with margin account with CAP Finance Ltd. is eligible to compensation under the proposed mechanism. The Exchange is still working on the claims received in respect of the Forlux and Chark Fung cases, which respectively amount to 440 and 2,290 with a total claim amount of \$58 million and \$328 million respectively.

(b) Subrogation and recycling of money recovered from liquidation

The Securities and Futures Commission (SFC) has attempted to illustrate the compensation arrangement in tabular form at *Annex A* for Member's information. This is a hypothetical example of a default involving 352 claimants with total allowed claims of \$81 million. Each successful claimant is paid up to \$150,000, the right of which is then subrogated to SFC. The first \$8 million recovered from the liquidation is recycled for apportionment. The example illustrates that under the proposed compensation arrangement, all eligible claimants would receive more than what they would have got merely from the insolvency proceedings.

(c) Ceiling of compensation

As we have pointed out in our last reply to you, the Administration do not consider it appropriate to specify the ceiling of compensation per eligible claimant in the Bill as this would limit the flexibility in determining claims and may not be conducive to the interest of the claimants at large. Moreover, our legal advice has suggested that such amendment would have "charging effect" to which consent by the Chief

Executive is required. Please refer to our letter dated 22 September 1998 (a copy of which at *Annex B*) for more detailed elaboration.

(d) Draft Committee Stage Amendment (CSA) to section 121A of the Securities Ordinance (Cap. 333)

The Law Draftsman has prepared a draft CSA to section 121A of the Securities Ordinance as per *Annex C*. The Administration is awaiting the comments of the Council of the SEHK, which will consider the draft amendment at its meeting on 7 October.

Yours sincerely

(Bryan P K Chan)

for Secretary for Financial Services

Encl.

**Proposed Compensation Arrangement
under Securities (Amendment) Bill 1998**

Step 1

This is a hypothetical example of a default involving 352 claimants with total allowed claims of \$81 million. Each successful claimant is paid up to \$150,000. Payment can be made as the claims are allowed by the Stock Exchange without waiting until all claims have been determined.

Table 1

<u>Allowed Claims</u>	<u>No. of Claimants</u>	<u>Total Amount</u>	<u>First Payment per Claim</u>	<u>Total Amount Paid</u>
50,000	50	2,500,000	50,000	2,500,000
100,000	100	10,000,000	100,000	10,000,000
150,000	100	15,000,000	150,000	15,000,000
200,000	40	8,000,000	150,000	6,000,000
250,000	30	7,500,000	150,000	4,500,000
300,000	10	3,000,000	150,000	1,500,000
500,000	10	5,000,000	150,000	1,500,000
1,000,000	10	10,000,000	150,000	1,500,000
10,000,000	<u>2</u>	<u>20,000,000</u>	150,000	<u>300,000</u>
Total	352	81,000,000		42,800,000

Step 2 - The \$8 million limit apportioned

As announced, all claimants will receive at least as much as they would have under the old arrangement. The \$8 million limit is apportioned pro-rata in this example and extra payments are made to certain large claims. The Stock Exchange is responsible for the apportionment and is not required to follow a pro-rata approach; this example is therefore illustrative only.

Table 2

<u>Allowed Claims</u>	<u>First Payment per Claim</u>	<u>Claimant's Pro-rata Share of \$8 million¹</u>	<u>Second Payment per Claimant</u>
50,000	50,000	4,938	n.a.
100,000	100,000	9,877	n.a.
150,000	150,000	14,815	n.a.
200,000	150,000	17,753	n.a.
250,000	150,000	24,691	n.a.
300,000	150,000	29,630	n.a.
500,000	150,000	49,383	n.a.
1,000,000	150,000	98,765	n.a.
10,000,000	150,000	987,654	837,654

Step 3 - SFC's subrogated rights

The SFC subrogated to the rights of each claimant up to the extent of the payment made. This example assumes there is a 30% distribution in the insolvency of the broker and shows the amount of this paid to the SFC and where applicable paid to the claimant.

Table 3

<u>Allowed Claim</u>	<u>First Payment per Claim</u>	<u>Second Payment per Claim</u>	<u>Extent of SFC's Sub. Rights per Claimant</u>	<u>Insolvency Distribution Paid to SFC per Claim²</u>	<u>Insolvency Distribution Paid to Claimant</u>
50,000	50,000	n.a.	50,000	15,000	n.a.
100,000	100,000	n.a.	100,000	30,000	n.a.
150,000	150,000	n.a.	150,000	45,000	n.a.
200,000	150,000	n.a.	150,000	60,000	n.a.
250,000	150,000	n.a.	150,000	75,000	n.a.
300,000	150,000	n.a.	150,000	90,000	n.a.
500,000	150,000	n.a.	150,000	150,000	n.a.
1,000,000	150,000	n.a.	150,000	150,000	150,000
10,000,000	150,000	837,654	987,654	987,654	2,012,346

¹ \$8 million / \$81 million or approximately 0.1 times the allowed claim. The amount per claim times the number of claims will total \$ 8 million.

² Limited to 30% of the allowed claim and not greater than payments made by SFC

Step 4 - Recycling (apportioning) of first \$8 million recovered

At the conclusion of the insolvency proceeding, the SFC will recycle (i.e. pay to claimants) up to \$8 million in recoveries; all other recoveries will be returned to the fund. This example assumes the payment of \$8 million in recoveries is apportioned pro-rata to the amount of outstanding claims. A different apportionment could be made by the Stock Exchange. This payment of \$8 million also represents the final apportionment and claims are then discharged. This SFC will not assert any further subrogated rights against claimants.

Table 4

Allowed Claim	First Payment per Claim	Second Payment per Claim	Insolvency Distribution Paid to SFC per Claim	Per Claim ³ Balance	Third Payment ⁴ per Claim
50,000	50,000	n.a.	n.a.	n.a.	n.a.
100,000	100,000	n.a.	n.a.	n.a.	n.a.
150,000	150,000	n.a.	n.a.	n.a.	n.a.
200,000	150,000	n.a.	n.a.	50,000	12,903
250,000	150,000	n.a.	n.a.	100,000	25,806
300,000	150,000	n.a.	n.a.	150,000	38,710
500,000	150,000	n.a.	n.a.	350,000	90,323
1,000,000	150,000	n.a.	150,000	700,000	180,645
10,000,000	150,000	837,654	2,012,346	7,000,000	1,806,452
			Grand Total	31,000,000	

Summary

This example shows the effect of the compensation fund payments under the proposed arrangement in the Bill. All claimants receive more than they would have received in the insolvency. Smaller claims receive more proportionally than larger claims.

³ Allowed claim minus first payment, and minus second payment, and minus insolvency distribution to the claimant. The per claim balances times the numbers of claims total \$31 million.

⁴ Recycled payment calculated as \$8,000,000 / \$31,000,000 or approximately 0.26 times the claim balance. The pro-rata amount per claim times the number of claims will total \$8 million.

Allowed	Total Compen- sation Paid per <u>Claim</u>	Insolvency Distribution Paid per <u>Claim</u>	Total Payment per Claim	Available Insolvency Distribution per Claim ⁵	Ratio of Total Payment vs. <u>Insolvency</u>
50,000	50,000	-	50,000	15,000	3.33
100,000	100,000	-	100,000	30,000	3.33
150,000	150,000	-	150,000	45,000	3.33
200,000	162,903	-	162,903	60,000	2.72
250,000	175,806	-	175,806	75,000	2.34
300,000	188,710	-	188,710	90,000	2.10
500,000	240,323	-	240,323	150,000	1.60
1,000,000	330,645	150,000	480,645	300,000	1.60
10,000,000	2,794,106	2,012,346	4,806,452	3,000,000	1.60

END

⁵ 30% of allowed claim, assuming no compensation fund.

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本函檔號 OUR REF.:

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來函檔號 YOUR REF.:

22 September 1998

Clerk to Bills Committee
(Attn: Ms. Odelia Leung)
Legislative Council Building
8 Jackson Road
Central
Hong Kong.

Dear Ms. Leung

Bills Committee on Securities (Amendment) Bill 1998
Second meeting on 23 September 1998

Thank you for your letter dated 16 September. As regards Members' concerns raised in your letter, our replies are as follows -

Amendment to section 121A of Securities Ordinance (Cap. 333)

Member asked whether section 121A of the Securities Ordinance ("SO") should be amended to enable the Securities and Futures Commission ("SFC") to exercise the power of the committee of the Stock Exchange of Hong Kong (SEHK) in relation to Part X of the SO if the latter proposes an amount of compensation unacceptable to the SFC.

It is a question that concerns in a general sense the checks and balances of the power of the SEHK under Part X of the SO. As we noted at the last meeting of the Bills Committee, at present, section 121A already specifies that the SFC may exercise all or any of the powers, functions and duties of the SEHK committee under Part X of the Ordinance if the SFC is

satisfied that the SEHK has either failed or refused to exercise its functions, or that the SEHK has unreasonably delayed the making of determination of the claims. Furthermore, any claimants may appeal to the Court under section 115 of the SO if their claims have been disallowed or only partially allowed by the SEHK.

In a more general context, section 50 of the SFC Ordinance also empowers the SFC to serve restriction notices on the Exchange Company where the SFC is satisfied that it is in the interest of the investing public or in the public interest, or that it is appropriate to do so for the protection of investors or for the proper regulation of an Exchange Company. Such restriction notices may -

- (a)(ii) require the Exchange Company to take such action relating to the management, conduct or operation of its business as may be so specified; or
- (b) prohibit the Exchange Company doing or causing to be done, during a period so specified, such act or other thing relating to the management, conduct or operation of its business as shall be so specified.

According to our legal advice, such power does cover, inter alia, the performance of the function by the SEHK under Part X of the Securities Ordinance and in our view already provides necessary checks and balances of the power of the SEHK.

The Administration is however not adverse to the proposal that section 121A be amended to the effect that the SFC may also substitute itself for the SEHK committee should the latter exercise its functions under Part X unreasonably.

Charging Effect

Member would like to know whether an amendment to the Bill to provide for the maximum payment level exceeding \$150,000 per eligible claimant will have charging effect. Our legal advice on this subject is as follow.

Clause 2 of the Bill inserts a new section 99(2) in SO empowering the SFC, with the approval of the Financial Secretary, to pay into the compensation fund from its reserves such sum of money as it thinks fit. Clause 3 inserts a new section 101(1)(aa) which adds to the money constituting the compensation fund all money paid by the commission under section 99(2); and Part VII of the SFC Ordinance provides for the Commission to be funded from a combination of levies on share transactions (section 52), appropriation out of the general revenue (section 53), and fees and other charges (section 54). It follows that money injected by the SFC from its reserves under section 92(2) of SO may include money appropriated from the General Revenue.

Accordingly, it is considered that the proposed amendment that individual claimants be compensated with any fixed amount under section 113(5A) may require a disposal of public revenue. Equally, the proposed amendment may entail a charge upon the General Revenue since an obligation to pay individual claimants a fixed amount irrespective of the considerations presently referred to in section 113(5A) may lead to a greater depletion of the compensation fund than would otherwise have been the case. This may require the SFC to inject sums from its reserves into the fund under section 99(2) which in turn may require appropriation out of the General Revenue for the purposes of the SFC under section 53 of SFC Ordinance. Member may wish to note that Rule 57(6) of the Legislative Council Rules of Procedure is worded in terms of an amendment which “may” charge the revenue, thus, in the legal opinion we receive, it is not necessary for any disposal of or charge on the revenue to be forecast with accuracy.

From administration perspective, Members will also appreciate that the \$150,000 upper limit for the C. A. Pacific clients is determined taking into accounts circumstances and factors particular to the case and may not necessarily suit those of the others. Fixing a definite amount in law, be it the minimum or maximum compensation amount, will inevitably limit the flexibility in determining claims and may not be conducive to the interest of the claimants at large.

Questions by Hon. Tsang Yok-shing

The Hon. TSANG Yok-shing inquired in writing about, as I understand it,

- (a) if there are any conflict between the claimants' right to compensation under section 109 of the SO and the surrogation right of the SFC under section 118 of the same Ordinance; and
- (b) the implication of clause 6(c) of the Bill on claimants' rights.

Section 109 of the SO specifies the conditions under which a person, including a client of the defaulting stockbroker, may be entitled to claim compensation from the compensation fund. Subsection 5 also specifies the ceiling of compensation payable from the UECF (\$8 million) per a single defaulting stockbroker.

On the other hand, section 118 enables the SFC to recover the payments made from the UECF through subrogation rights until either such recoveries or the subrogation rights are exhausted. The recovered monies may be paid out again as compensation to the outstanding claims up to the first \$8 million so recovered as provided for under section 109(3) as proposed to be amended. The mechanism allows the compensation ceiling to be exceeded to the extent of the recoveries through the subrogation right and thereby enable the claimants' claims to be met as far as such "recycling" process allows. SFC's subrogation right under, for instance the liquidation process, has to precede that of the claimant from whom the subrogation right derives so as to ensure that claimants will not receive from both the UECF and the liquidation process more than what they are entitled to as well as to preserve the perogative of the UECF over its own resources.

As regards clause 6(c) of the Bill, the purpose of the amendment is to clarify that once all eligible claimants have received payment from the compensation fund under the new arrangement and the apportionment payment has been made under section 120(2), their rights to claims for compensation under section 109 of the SO could be considered absolutely discharged, regardless of whether an individual claimant may or may not receive further payment out of the apportionment payment. The amendment aims to prevent any possible abuse of any ambiguity in the existing provision in such cases that a claimant who has already been fully compensated by discretionary payment under section 113(5A) may continue to seek further compensation under the apportionment process. Clause 6(c) seeks to remove

any such ambiguity while preserving claimants' right as before where discretionary payment is not involved.

It could also usefully be added that the new arrangements would allow all eligible claimants to receive part or all of their compensation in much shorter timeframe than previously. Like previous arrangements, the compensation is made irrespective of the claimants' potential recovery from the liquidation process. Through subrogation, the risk of non-recovery under the liquidation process is transferred from the claimants to the UECF to the extent of the compensation made. Where the liquidation process returns assets less than a claimant's allowed claim, the UECF will in fact have to make a net payout from its funds to that claimant.

I hope the above addresses Members' questions. Enclosed please also find the attendance from the Administration and the DoJ at the next meeting of the Bills Committee at 8:30am, 23 September.

Yours sincerely,

(Bryan P K Chan)

for Secretary for Financial Services

b.c.c. DoJ (Attn.: Lawrence Wong and Monica Law)
SFC (Attn.: Jerry Grenier and John Luff)
SEHK (Attn.: Alec Tsui and Mary Kao)

Encl.

**121A. Commission may act where committee
fails to do so**

Notwithstanding anything in this Part, where the Commission is satisfied that the committee of the Exchange Company has -

- (a) failed or refused to exercise any of its powers, functions or duties under this Part;
- (b) unreasonably delayed the making of any determination under section 113; ~~or~~
- (c) unreasonably exercised its power under section 113 (5A),

it may exercise all or any of the powers, functions or duties of the committee of the Exchange Company under this Part, and any act done or determination made by the Commission pursuant to its powers under this section shall be deemed, for the purposes of this Part, to be an act done or determination made by the committee.