

**立法會**  
**Legislative Council**

LC Paper No. CB(1) 1974/99-00  
(These minutes have been seen  
by the Administration and  
cleared by the Chairman)

Ref: CB1/BC/13/98/2

**Bills Committee on  
Securities (Margin Financing) (Amendment) Bill 1999**

**Minutes of meeting held on  
Thursday, 13 January 2000, at 8:30 am  
in Conference Room A of the Legislative Council Building**

- Members present** : Hon Ronald ARCULLI, JP (Chairman)  
Hon Albert HO Chun-yan  
Hon SIN Chung-kai  
Hon Jasper TSANG Yok-sing, JP  
Hon FUNG Chi-kin
- Member absent** : Hon Bernard CHAN
- Public officers  
Attending** : Mr Bryan CHAN  
Principal Assistant Secretary for Financial Services
- Miss Hanny LAM  
Assistant Secretary for Financial Services
- Mr William MADDAFORD  
Senior Assistant Law Draftsman,  
Department of Justice
- Ms Vicki LEE  
Government Counsel, Department of Justice

- Attendance by invitation** : Securities and Futures Commission
- Mr Andrew PROCTER  
Executive Director of Intermediaries and  
Investment Products
- Mr Leo LEE  
Director of Licensing
- Mr CHUNG Hing-hing  
Associate Director of Licensing
- Mrs Yvonne MOK  
Associate Director of Intermediaries Supervision
- Clerk in attendance** : Ms Leung Siu-kum  
Chief Assistant Secretary (1)4
- Staff in attendance** : Mr KAU Kin-wah  
Assistant Legal Adviser 6
- Ms Connie SZETO  
Senior Assistant Secretary (1)1
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## **I Confirmation of minutes of meetings**

The minutes of the meetings held on 27 July and 17 September 1999 were confirmed.

## **II Meeting with the Administration**

### Contracts with unregistered securities margin financiers (LC Paper No. CB(1) 695/99-00)

2. The Executive Director of Intermediaries and Investment Products, SFC (ED/IIP(SFC)) explained that in view of the concern of the Bills Committee about Division 4 of the Bill which provided clients with the right to rescind contracts entered into with unregistered securities margin financiers (SMFs), the Securities and Futures Commission (SFC) had reviewed the provisions therein and the Administration was preparing draft Committee Stage

Amendments (CSAs) which would be submitted for members' consideration in due course. ED/IIP(SFC) informed that the draft provisions would be modelled on the UK Financial Services and Market Bill (FSMB) presently under consideration by the UK Parliament. He advised that the draft provisions would provide that agreements made between clients and unregistered SMFs would be unenforceable or otherwise enforced by the court under certain circumstances, and that clients could recover money paid or property transferred to the unregistered SMFs and compensation for loss. The proposed provisions would dispense with the difficult concepts of rescission and third party right. Members noted that an extract of the UK FSMB concerning the enforceability of agreements made by unauthorised persons had been circulated vide LC Paper No. CB(1)695/99-00.

3. Responding to the Chairman's enquiry, ED/IIP(SFC) explained that the third party right would not be affected under the UK FSMB. The primary obligation to compensate the client lied with the unlicensed person. In the event that a client's assets had been taken up by the third party and unavailable for recovery, the unlicensed person would be liable to pay an equivalent value to the client. The client could also recover compensation for loss, amount which would either be agreed with the client or as determined by the court.

4. Members agreed that the Bills Committee would examine the provisions when the draft CSAs were ready.

#### Issues raised at the last meeting held on 13 December 1999

##### *Proposal on pooling of clients' assets*

5. The Principal Assistant Secretary for Financial Services (PAS/FS) said that in view of the concern expressed by some members and the industry about the difficulties for SMFs or securities dealers to comply with the proposed statutory requirements to limit the amount of credit facilities that could be obtained by pledging margin clients' securities collateral up to 105% of the aggregate amount of clients' outstanding loans, as well as to adjust their portfolios in three business days, the Administration would review the proposal to allow more flexibility and explore the possibility of implementing the requirement by way of Code of Conduct.

6. The Administration took note of the Chairman's suggestion of consulting the Hong Kong Association of Banks on the revised proposal. PAS/FS undertook to report the Administration's final proposal to the Bills Committee at the next meeting.

Admin

##### *The definition of "audit"*

Admin

7. PAS/FS advised that the Administration had accepted the Bills Committee's suggestion of deleting the proposed definition of "audit" in section 2 of the Securities Ordinance (SO) (Cap. 333). References to "audit" in the Bill would be replaced by "audit and examine". The Administration would move CSAs in this respect.

*Penalties for unregistered SMFs and providing false information upon application for registration - sections 121C and 121F*

Admin

8. As regards the concern about the relative severity of penalties for carrying on the securities margin financing business without a registration and the making of false statement upon application for registration as a SMF, PAS/FS said that the Administration would respond to the issue at the next meeting.

*SFC's inquiry power in respect of matters listed in section 121R(2)(a)-(h) - section 121S(1)*

Admin

9. PAS/FS said that the Administration had accepted members' suggestion of redrafting section 121S(1) to clarify SFC's inquiry power in respect of matters listed in section 121R(2)(a)-(h).

Outstanding issues arising from previous meetings  
(LC Papers No. CB(1) 576/99-00(02), (03))

10. Members continued to examine the list of outstanding items (the list) provided by the Administration. They noted that items 25 to 28 of the list were technical amendments to the Bill.

*Item 29 - a new section on suspension of registration of SMFs or SMF's representatives*

11. PAS/FS explained that in order to address members' concern that a SMF or SMF's representative under suspension or with the registration revoked would be precluded from engaging in activities which were necessary for the protection of the interests of existing clients, a new section would be added after section 121W to enable SFC to suspend the whole or part of the registration of a SMF (or a SMF's representative as the case might be) and make an order specifying the manner in which an existing business was to be carried on and attach to it reasonable conditions as SFC saw fit.

12. Responding to the Chairman's enquiry on how to ensure compliance of SMFs or SMF's representatives with directions issued by SFC, ED/IIP(SFC) said that under the provision, SFC would suspend SMF's operation by issuing a restriction notice which stipulated, amongst other things, the condition for

appointing a third party to oversee the winding down of the business or a reporting requirement on the registrant in this respect. Moreover, SFC could send its staff to supervise the operations of SMF. It might also, with agreement of SMF and its auditor, require the auditor to inspect the accounting records of SMF and report to SFC accordingly. In addition, SFC had power to appoint a receiver to take over the assets from SMF under extreme cases pending the winding-up of the company.

13. Noting that SFC's power to give direction to registered SMFs or SMF's representatives in cases of suspension and revocation of the registration would not be applied to unregistered persons, the Chairman re-iterated his concern about the apparent lack of direct sanction on unregistered persons. He requested the Administration to consider the feasibility of providing in the Bill for SFC to exercise the same regulatory power in respect of registered SMFs and SMF's representatives for dealing with unregistered persons.

14. ED/IIP(SFC) agreed that the Chairman's proposal could protect the investors' interests, yet he cautioned that it might give rise to Bill of Rights issues. While there should be no difficulties in proving that a SMF or a SMF's representative was unregistered, it would not be easy for SFC to prove that the unregistered person had actually been carrying on unregistered activities. Hence, there might be objections to provide SFC with such a general power to subject the unregistered SMFs or SMF's representatives to the same regulatory regime. In respect of SFC's regulatory power over unregistered SMFs, ED/IIP(SFC) said that SFC could apply for court orders to restrain business of suspected unregistered SMFs and to appoint an administrator for the protection of clients' assets. Moreover, SFC could petition the court for expeditious winding up a company if it was in the public interest to do so.

15. While sharing the Chairman's view that it would be in the interest of investors to provide SFC with direct power in dealing with unregistered SMFs, PAS/FS said that it would be necessary to put in place proper checks and balances for such power. As the proposal would likely be controversial and should not be considered in isolation since it would have implication on other classes of registrants, PAS/FS proposed that it should not be pursued under the Bill. ED/IIP(SFC) supplemented that SFC recognized the need to set some lower thresholds for it to seek injunctions or appointment of receivers over the assets of unregistered persons. The proposal was being considered in the context of the composite Securities and Futures Bill.

Admin

16. Members requested the Administration to check for reference the banking and financial services related ordinances on powers of the regulatory authorities over the unregistered business operators.

*Item 30 - section 121Y(1)*

17. Members noted that the proposed amendments in sections 121Y(1)(d) and (e) were in response to the industry's request to relax the statement of account requirement on SMFs. The amendments specifically clarified that a SMF should not be required to provide client with a statement of account merely because of any change in amount outstanding caused by the accrual of daily interest charges.

18. The Assistant Legal Adviser remarked that the Administration's proposed CSA to sections 121Y(1)(d) and (e) appeared to go further than the policy intention. Members agreed that a SMF should provide clients with information on adjustment of the amount or the terms on which financial accommodation was provided as a result of change in market value of securities collateral provided by clients, since the provision of such information could facilitate clients in managing their portfolios, and this was already the practice of the industry. After deliberation, members suggested that section 121Y(1)(d) should be redrafted to the effect that the obligation to supply a client with statement of account under section 121Y(1) should apply, inter alia, to the situation where there was an adjustment of the amount or the terms on which financial accommodation was provided to the client, except as a result of any daily interest charged by the financier. Furthermore, the original subsection (1)(e) should be retained. The Administration agreed to consider members' suggestions.

Admin

*Item 31 - section 121Y(3)*

19. ED/IIP(SFC) explained that the proposed amendment in section 121Y(3)(h) was to clarify that the disposals of securities collateral referred to those initiated by SMF where the SMF had security right over collateral held when clients defaulted. As regards the regulation of other kinds of transactions, he advised that a stand-alone SMF, as it was subject to the sole-business requirement, could not effect sale and purchase of securities for clients. The SMF concerned could only dispose of a client's securities collateral by depositing scrips in or withdrawing them from the client's margin account according to the client's instruction. Information about such transactions would be covered under subsection (3)(g). According to the existing SO, securities dealers had separate reporting obligation to clients in respect of sale and purchase of securities handled on behalf of clients. Under such situation, a client would receive separate statements of account from both SMF and the securities dealer. In the case of a securities dealer which also provided securities margin financing service, its client would receive a combined statement of account showing details of the transactions.

20. Members pointed out that as it had been agreed in the above discussion that SMF should be required to provide clients with statements of account

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pertaining to all kinds of transactions except the mere accrual of daily interest charged by the financier, the original section 121Y(3)(i) of the Bill should be retained. The Administration agreed.

Admin

*Item 32 - section 121Y(4)*

21. Members noted that the proposed amendment at the end of section 121Y(4) was to waive the requirement on SMF to provide a client with a monthly statement when there was no movement in the client's account over the month and when there was no outstanding balance and securities holding in the account at the end of the relevant period. The amendment aimed at relieving the potential administrative burden on the part of SMF to manage dormant accounts.

Admin

22. The Administration took note of the Chairman's suggestion to improve the drafting of the proposed CSA for subsection (4) to replace "movement" by "transaction" and "at the end of" by "during" respectively.

*Item 36 - section 121AA(1)*

23. Members noted that section 121AA sought to restrict the ways by which SMF could dispose of clients' securities collateral for better protection of clients' assets. Subsection (1) required SMF to properly register and deposit in safe custody clients' securities collateral. SMF could deposit clients' scrips in a designated account with an authorized institution, a registered dealer or some other institution approved by SFC. The Hong Kong Securities Clearing Company Limited (HKSCC) would be one of the intended institutions for this purpose.

24. On the Chairman's enquiry about disposition of scrips in street names, ED/IIP(SFC) said that SMF would be required to ensure that such scrips were deposited in safe custody in designated account in accordance with subsection (1)(b). Securities dealers usually maintained separated designated accounts with HKSCC for depositing street names scrips. ED/IIP(SFC) added that currently there were accounts available at HKSCC for four categories of persons, namely, custodians, securities dealers who were members of the exchange, non-exchange dealers and individuals. It was believed that facilities would also be made available in HKSCC for SMF to deposit clients' scrips.

25. Members noted that a new subsection (aa) would be added in section 121AA(1) to allow SMFs to register client's securities collateral in SMF's names or their nominees' names with a view to providing better protection for financiers' collateral interest.

26. On the Chairman's concern that subsection (1) might preclude a SMF from depositing clients' securities collateral with a third party other than a registered securities dealer, an authorized institution, or some other institution approved by SFC to facilitate the provision of financial accommodation by the financier, ED/IIP(SFC) explained that subsection (1) stipulated the basic



obligation of SMF to properly safekeep clients' securities collateral while subsection (4) dealt with ways by which a SMF could dispose of such collateral to facilitate the provision of financial accommodation by the financier. According to subsection (4), subject to clients' authorization or as permitted by SFC rules, a SMF might deposit clients' securities collateral with a securities dealer or an authorized institution for obtaining credits to support SMF's margin financing business. However, a SMF would not be restrained from pledging its own assets to secure lending from any other party. Such activities would not be governed by the Bill.

27. The Chairman said that the Bills Committee would continue to deliberate on this item at the next meeting scheduled for 17 January 2000, at 8:30 am.

### **III Any other business**

28. There being no other business, the meeting ended at 10:30 am.

Legislative Council Secretariat

21 July 2000