

立法會
Legislative Council

LC Paper No. CB(1) 2032/99-00
(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
Wednesday, 19 January 2000, at 10:45 am
in Conference Room B 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 CHUNG Hing-hing
Associate Director of Licensing
- 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 Meeting with the Administration

Outstanding issues arising from previous meetings
(LC Paper Nos. CB(1) 576/99-00(02) and 774/99-00(01))

The Bills Committee continued to study the list of outstanding items and the sixth draft of the Committee Stage Amendments (CSAs) provided by the Administration.

Item 52 - new clause 3A

2. The Principal Assistant Secretary for Financial Services (PAS/FS) said that the Administration would move a CSA to add a new Schedule 4 under the new clause 3A to list out the kinds of activities to be exempted from regulatory measures under the Bill. The Schedule could be amended by the Securities and Futures Commission (SFC) by way of subsidiary legislation under the provision of the proposed section 121B(4). The Executive Director for Intermediaries and Investment Products, SFC (ED/IIP(SFC)) added that Schedule 4 included the proposed exempted activities listed under the original section 121B(2) of the Bill and some of the suggestions made by the Law Society of Hong Kong as well as the Bills Committee.

*Item 53 - schedule 1 item 1
section 2 of the Securities Ordinance (SO) (Cap.333)*

3. ED/IIP(SFC) explained that the proposed CSA was to address members' concern that the amendment proposed originally to the definition of "dealer" was too narrowly drafted and might inadvertently capture securities margin financiers (SMFs) in their ordinary business. The CSA aimed at putting beyond doubt that registered SMFs conducting a business solely for providing financial accommodation to their clients to facilitate the acquisition of securities would not be regarded as dealers and the requirement to be registered as dealers under SO would not apply to them.

4. Responding to the Chairman's concern about the possibility that the proposed CSA would enable registered SMFs to carry on "dealing in securities", ED/IIP(SFC) clarified that a person engaging in "dealing in securities" would need to be registered as a dealer. Brokers who coached clients and referred them to dealer firms would also be regarded as "dealers" and required to be registered. A SMF advising clients on the purchase of securities would be regarded as an "adviser" and be subject to certain reporting requirements imposed by SFC under the Code of Conduct.

*Items 58 and 59 - schedule 1 item 20
section 75A(1) and subsection (3) of SO*

ALA6 5. PAS/ES informed that the proposed CSAs for section 75A(1) and subsection (3) of SO mirrored those proposed for section 121Y(1) and subsection (3) of the Bill. The Chairman requested the Assistant Legal Adviser to check the consistency of the proposed CSAs against each other.

*Item 66 - schedule 1 item 25
section 81 of SO*

6. Mr FUNG Chi-kin reiterated his concern about section 81(4) of SO which did not allow dealers using clients' securities held in safe custody for other purposes, such as stocks lending and borrowing. He pointed out that it was a common practice of the industry to lend or deposit the securities as collateral in securities borrowing and lending activities with the clients' authority. The provision under section 81(4) would be inconsistent with the Administration's policy intention to encourage participation in the Hong Kong Securities Clearing Company's Stocks Lending and Borrowing scheme.

7. ED/IIP(SFC) explained that the existing section 81 of SO required a dealer to properly safekeep clients' securities. The proposed section 81(2) specified the ways the dealer could dispose of clients' securities held in safe custody. The Administration's legal advice confirmed that SFC's rules could

override the requirements set under subsection (2). Moreover, consequential amendment to section 55A of the Securities and Futures Commission Ordinance (SFCO) (Cap. 24) would empower SFC to modify the application of sections 81 and 81A of SO.

8. ED/IIP(SFC) explained that subsection (4) provided that clients' securities could not be used for other purposes. It would not allow dealers and clients from varying the terms on which securities were held purely for safe custody. The dealer and client were however free to make arrangements regarding the disposal of securities and, in such case, section 81 would cease to apply. He added that there was reservation to simply provide that, with clients' authority, dealers would be freed from the requirements set under subsection (2), as this would undermine the protection for clients' assets held in safe custody and allow discretion for dealers to deal with the securities, like pledging them to banks.

9. As regards the concern about the inflexibility of section 81(4), ED/IIP(SFC) stressed that there was no intention to restrict stocks lending and borrowing activities. SFC would make rules to permit such activities with clients' written authority.

Admin 10. Recognizing that it was not the Administration's intention to restrict stocks lending activities for securities deposited in safe custody with dealers, the Chairman suggested that, for the sake of clarity, it would be desirable to expressly state in section 81 that such activities would be permitted by SFC's rules or with written authority by clients, and to provide that SFC's rules could override the requirements in subsection (2). The Administration agreed to consider the suggestion to improve the drafting of the section.

11. On the Chairman's enquiry about pledging the securities held in safe custody to banks under section 81(3), ED/IIP(SFC) advised that it would be extremely rare that clients would give the consent under section 81(3) to allow dealers to pledge their securities kept in safe custody to banks except for facilitating the provision of securities margin financing. Securities deposited as collateral with dealers to facilitate the provision of financial accommodation by the dealers would be protected under the proposed section 81A. In this connection, Mr FUNG Chi-kin remarked that it was not the industry practice to pledge securities deposited in clients' cash accounts to banks.

*Item 67 - schedule 1 item 25
section 81A of SO*

12. Members noted that while the proposed new section 81 of SO would apply to registered dealers when dealing with securities deposited in clients' cash accounts, the new section 81A dealt with clients' securities deposited in

margin accounts. The new section 81A was analogous to the proposed section 121AA of the Bill. Both sections sought to impose restrictions on dealers and SMFs in disposing of clients' securities which had been deposited as collateral for the provision of financial accommodation. Section 81A would apply to dealers who also provide securities margin financing while section 121AA would apply to registered SMFs.

13. ED/IIP(SFC) explained that section 81A required the dealer to offer the same level of protection to securities collateral as clients' securities held under his safe custody except with the written authority of clients which allowed him to dispose of the securities to facilitate the provision of margin financing including pledging the securities to banks. SFC would prescribe rules to permit the lending and borrowing of securities collateral held by dealers.

Admin 14. The Administration noted members' suggestions made in respect of section 121AA of the Bill at the last meeting, and agreed to consider the appropriateness for adopting them in the new section 81A.

*Item 69 - schedule 1 item 27
section 83 of SO*

Admin 15. Members noted that the Administration, after consideration, maintained its stance that since under the proposed sections 81 and 81A, dealers could no longer deposit clients' securities with a third party as security for loans or advances made to related corporations, the phrase "or any related corporation" in section 83(3)(a)(vi) of SO relating to keeping of records of these securities could be deleted. In view of this, the Chairman requested the Administration to ensure that the proposed amendment would not free dealers from the obligation of keeping records which might facilitate the monitoring of their activities by SFC.

Admin 16. On the proposed new section 83(3)(a)(viii), the Administration agreed to consider the Chairman's suggestion of improving the drafting of the provision by requiring a dealer to keep records showing all securities margin financing conducted by him.

*Item 70 - schedule 1 item 36
section 94 of SO*

17. The Chairman noted that the purpose of the existing section 94 of SO was to deter the auditor appointed by SFC and his employees from divulging information, which came to their knowledge in the course of performing their duties, to unrelated parties. The section provided that the auditor and his employees could only disclose such information to SFC, or in the case of employees, to the auditor. The Bills Committee, after scrutinizing the proposed

amendment to section 94, had considered that the provision was too restrictive and would prevent communication of information among employees of the auditor who were involved in the same case. The Administration had been requested to review the provision taking into consideration of the existing section 59 of SFCO which concerned preservation of secrecy.

18. The Chairman expressed concern that the present proposed new section 94(b) of SO which allowed disclosure of information for the purposes of "any legal proceedings" would widen the disclosure of information.

Admin/
SFC 19. ED/IIP(SFC) explained that the proposed new section 94(b) would allow disclosure of information to facilitate both criminal and civil proceedings, as well as disciplinary proceedings, such as hearings of the Insider Dealing Tribunal, under which SFC was a party. He added that the section reflected a proposal under the Composite Securities and Futures Bill that SFC could give evidence in third party proceedings. Nonetheless, he undertook to reconsider the provision.

II Any other business

20. The Chairman reminded members that the next meeting would be held on 21 January 2000, at 10:45 am.

21. Members also agreed to schedule another meeting for 22 January 2000, at 11:00 am to discuss the draft CSAs on Division 4 of the Bill.

22. There being no other business, the meeting ended at 12:50 pm.

Legislative Council Secretariat

7 September 2000