

立法會
Legislative Council

LC Paper No. CB(1) 1522/99-00
(These minutes have been seen
by the Administration)

Ref: CB1/BC/13/98/2

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

**Minutes of meeting held on
Tuesday, 20 July 1999, at 8:30 am
in the Chamber 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 Richard YIN
Director of Intermediaries Supervision
- Mr CHUNG Hing-hing
Associate Director of Licensing
- Clerk in attendance** : Ms Estella CHAN
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 Discussion with the Administration

Follow-up on outstanding issues arising from previous meetings (LC Paper No. CB(1)1726/98-99(01))

The Principal Assistant Secretary for Financial Services briefed members on the Administration's response paper on outstanding issues arising from previous discussions. He highlighted the following points -

- (a) The Administration remained of the view that the Securities and Futures Commission (SFC) did have sufficient power under existing laws to take investigatory actions against suspected unregistered dealing activities and to seek injunction orders from the Court if circumstances warranted. The proposal to extend the injunction powers of SFC was being considered under the composite Securities and Futures Bill.
- (b) After considering the Bills Committee's suggestion of shortening the two-year period of which registered financiers were required to keep record of transaction statements, the Administration had agreed to amend section 121Z(3)(a) by repealing "2 years" and substituting "3 months".

- (c) After re-considering the Law Society of Hong Kong's suggestion of giving exemption to the provision of financial accommodation to facilitate the acquisition of 5% or more of the issued share capital of a listed company, the Administration had decided that, in view of practical difficulties as explained in page 3 of the response paper, such business would not be exempted from the Bill.

Clause-by-clause examination on the Bill

Clause 3 - Division 3

(Conduct of securities margin financing business)

2. Members noted from the Administration's paper (LC Paper No. CB(1)1731/98-99) comparing sections 81, 81A (under Clause 4) and 121AA (under Clause 3) in the Bill which sought to impose restrictions on disposition of clients' securities by securities dealers and securities margin financiers. Section 81 would apply to registered securities dealers when dealing with cash clients. Section 81A would apply to dealers who also provide securities margin financing service. Section 121AA would apply to registered financiers.

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3. Referring to item 6 of the paper, the Executive Director of Intermediaries and Investment Products, Securities and Futures Commission (ED/IIP(SFC)) said that amendments would be made to sections 81A and 121AA to allow client's securities to be registered in the name of the dealer's or financier's nominee with a view to providing better protection for dealers' or financiers' collateral interest. Another amendment would be made to the same two sections as described under item 10 of the paper to allow dealers or financiers to dispose of securities collateral in case of client default if clients had given the authority at the outset and such authority would not be subject to annual renewal.

4. Section 121AB was modelled on the provisions in sections 65C, 65D and 95 of the existing Securities Ordinance (SO) (Cap. 333). The section required a registered financier to notify SFC if it became "aware" that it could not comply with the financial resources rules (FRR). Subsection (2) stipulated that the financier was taken to be aware that it was unable to comply with FRR if "any director" of the financier, with the exercise of reasonable diligence, had become "aware" of the matter. The Chairman remarked that subsection (2) would have the effect of lowering the threshold for committing an offence under this section and putting a duty on "any director" (including the non-executive directors) of the financier to report on possible non-compliance of FRR by the financier. The financier's contravention of section 121AB would infer a liability on these directors.

5. In response, ED/IIP(SFC) said that section 121AB(2) was analogous to section 65C(3) of SO which should be read in conjunction with section 147 of SO concerning liability of directors of a corporation. When relating section 121AB(2) with section 147 of SO, the legal effect would be that if an offence committed by a corporation under SO was proved to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of any director etc., the corporation and the concerned person would be liable to be prosecuted for the offence. Hence, the concept of linking the offence committed by a corporation to the liability of directors found in section 121AB(2) was also present in section 147 of SO. However, as the responsibility to report failure in compliance with section 65C(3) of SO was limited to "any dealing director" vis-à-vis the extension to "any director" under section 121AB(2), he agreed with the Chairman's comment that section 121AB(2) did have the effect of boardening the liability of "directors" of a corporation. Notwithstanding that section 147 of SO was strict in a sense that an offence under SO could be attributed to "any neglect" on the part of the directors, he was not aware of any prosecution ever brought under section 147 solely on the ground of "any neglect" of directors. On the other hand, there were proposals under the composite Securities and Futures Bill providing defence provisions for directors which would clarify their responsibilities and the information or matters they were expected to have knowledge of in respect of the management of the corporation.

6. Mr Albert HO questioned the need to impose an independent duty, hence liability, on "officers, employees or agents" of the financier to produce records for SFC's inspection in ascertaining the financier's compliance with FRR under section 121AB(4)(a). The Chairman remarked that the accounting profession was very concerned about subsection 4(b) requiring the auditor of the financier to produce all records for SFC's inspection, which might include accountants' working papers. Pointing out the extensive power vested in SFC under subsection (4), the Chairman also re-iterated his concern about the Bill imposing stringent regulation over registered financiers vis-à-vis the apparent lack of control over unregistered operators.

7. In response, the Senior Assistant Law Draftsman (SALD) said that section 121AB(7) would provide a defence for "officers, employees or agents". ED/IIP(SFC) added that the concerned persons would not be taken as contravening the legal provisions about commercial secrecy in complying with the requirement under subsection (4)(a). On the concern about subsection (4)(b), ED/IIP(SFC) said that the subsection could be taken as an extension of section 65D of the existing SO which provided SFC with the power to inspect books, accounts and records of registered dealers. SFC in exercising its supervisory and investigative powers over registered entities provided under section 30 and 33 of the Securities and Futures Commission Ordinance (SFCO) (Cap.24) could also require "any other person" to produce any record which was relevant to the registrant's business.

8. The Chairman opined that SFC's inquiry power to be provided under section 121AB(4) should not be mixed with its supervisory and investigative powers under SFCO. The drafting of subsection (4) conveyed a predication of non-compliance of FRR and provided SFC with unrestricted investigative power.

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SFC 9. SALD remarked that section 121AB(4) should be read in conjunction with subsection (3) which provided that SFC should have reasonable belief that there was a breach of FRR before taking the action in subsection (4). ED/IIP(SFC) stressed that since FRR was regarded as the fundamental pillar of the investor protection regime, the whole of section 121AB was intended to draw out the importance of FRR, make clear SFC's inquiry and inspection powers in respect of FRR, as well as stipulate that non-compliance with FRR would be an offence. Nonetheless, he undertook to consider the proposal to provide for a better link between subsections (3) and (4).

Admin. 10. The Chairman remained concerned about section 121AB. He requested the Administration to provide further information on SFC's powers under existing legislation in respect of investigations and inquiries. He also
Admin. requested the Administration to review the relative severity of penalties under subsections (6) and (7).

*Division 4
(Contracts with unregistered financiers)*

11. This Division provided that if an unregistered financier entered into a securities margin financing contract with a client, the client would have a right to rescind the contract, unless the rescission of the contract would prejudice the rights of bona fide third parties. The policy intent of the Division was to render better protection for the interest of clients who had entered into contract with unregistered financiers. Members observed that there were drafting problems in the Division. These included the absence of an opportunity for the bona fide third party to apply to the Court for making consequential orders regarding the rescinded contract under section 121AE(1) if its rights had been unfairly prejudiced. The legal consequences of rescinding a contract and the third party rights had not been clearly spelt out in the provisions. For instance, what would be the legal positions of unregistered financiers and the clients under different scenarios, under which the market value of the securities collateral deposited with the financier could exceed the loan outstanding from the client or vice versa, or the collateral could have become valueless. The situation would be even more complicated when the collateral had been "pooled" and repledged to banks for credits.

Admin. 12. In view of members' grave concerns about Division 4, the Chairman requested the Administration to review the provisions therein and revert to the Bill Committee as soon as possible.

Division 5

(Accounting records of registered financiers)

13. Section 121AI was analogous to section 83 of SO. The Chairman remarked that it would facilitate future amendment if the details required to be shown in the accounting records as specified in subsection (4) was to be provided in a Schedule to the Ordinance. ED/IIP(SFC) advised that this would be the approach to be adopted in the composite Securities and Futures Bill.

14. Members noted that a registered financier which did not keep its accounting records in a bound book was required under section 121AI(10) to take reasonable precautions to guard against falsification of the records and to facilitate discovery of any such falsification. ED/IIP(SFC) said that to this end, the financier should put in place proper internal control systems ensuring matters, such as segregation of accounting responsibilities of officers, appropriate access of officers to accounting files and records etc.

15. On the concern about the low level of penalty prescribed under section 121AK(4) for the offence of a registered financier failing to lodge the annual financial statement with SFC, ED/IIP(SFC) said that the levels of penalties for offences under the Bill had largely reflected those in SO. There would be proposal under the composite Securities and Futures Bills to increase penalties prescribed for various offences under SO.

Division 6

(Registered financiers' trust accounts)

Admin. 16. ED/IIP(SFC) said that provisions in Division 6 were mainly modelled on those under sections 84 to 86 of the existing SO. He pointed out that the only difference would be the level of fines prescribed for contravention of any provision in the Division under section 121AS(2) which would be higher than that prescribed for offences under section 84(7)(b) of SO. In this connection, the Chairman suggested and the Administration agreed to review the entire Bill with regard to the appropriateness of the penalty levels for different offences.

ALA 6 17. The Chairman requested the Assistant Legal Adviser to compare Division 6 of the Bill with the parallel provisions in SO to see whether there was any material difference and report to the Bills Committee in due course.

(Post-meeting note: ALA reported to the Bills Committee at its meeting on 27 July 1999.)

Division 7

(Auditing of accounting and other records)

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SFC 18. Upon enquiry, ED/IIP(SFC) clarified that an "auditor" to be appointed by a registered financier for the purposes of Division 7 could be the same one appointed under the requirement of section 131 of the Companies Ordinance (CO) (Cap. 32). He agreed to add a new provision in Division 7 to put it beyond doubt that it was not necessary for a registered financier to appoint an auditor in addition to the one appointed under CO.

19. Members noted that the provisions in sections 121AW and 121 AX were similar to those under sections 89 and 89A of the existing SO.

Division 8

(Audits by auditors appointed by Commission)

20. Members noted that the "auditor" to be appointed by SFC under Division 8 was an auditor independent of the "auditor" appointed by the registered financier for the purposes of Division 7.

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SFC 21. Section 121AY was analogous to section 90 of the existing SO. Subsection (2) stipulated that SFC could make order to direct the financier to pay for the expenses of the appointed auditor. ED/IIP(SFC) advised that this provision was similar to that in section 90(2) of the existing SO. SFC so far had been able to enforce such order on registered dealers. There had been an occasion where SFC was requested to provide indemnity before the appointment of the auditor. Upon the Chairman's request, ED/IIP(SFC) agreed to make a technical amendment in subsection (2) to replace the word "section" by "division" to clarify that the expenses incurred by appointing an auditor upon request of a client would also be borne by the registered financier.

22. Members noted that sections 121AZ, 121BA, 121BB, 121BC and 121BD were analogous to sections 91, 92, 93, 94 and 95 of the existing SO respectively.

23. ED/IIP(SFC) advised that section 33 of SFCO (i.e. investigative powers of SFC) was the enabling provision for SFC's power under subsections 121BD(3) and (4) which required concerned persons to answer questions relating to the business of the financier. The Chairman expressed concern that subsections (3) and (4) seemed to provide SFC with unrestricted power. Pointing out that section 33 of SFCO was more specific in respect of SFC's investigative power and protection for concerned persons against self-incrimination, and that it was unclear whether the offence prescribed under

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Admin. subsection (6) would also be applicable to subsection (4), he requested the Administration to review subsections 121BD(3), (4) and (6) to make them more specific with reference to similar provisions under SFCO.

II Any other business

"Pooling arrangement" on margin clients' assets

24. Mr Albert HO said that for the sake of rendering better protection to clients' assets under "pooling arrangement" and recognising the industry's concern about outright banning of "pooling", the Democratic Party was preparing a proposal in respect of "pooling" based on the Singaporean model. Under the model, one of the rules was to limit the amount of bank credits that could be secured with clients' securities collateral to the amount of margin loan provided to clients. He would forward the proposal to the Bills Committee and the Administration for consideration in due course.

(Post-meeting note: The Democratic Party's proposal and the Administration's response were at Enclosure B of LC Paper No. CB(1)1959/98-99(01). The proposal was discussed by the Bills Committee at the meeting on 27 September 1999.)

Date of next meeting

25. Members agreed to hold the next meeting on 27 July 1999 at 8:30 am.
26. There being no other business, the meeting ended at 10:30 am.

Legislative Council Secretariat
5 May 2000