

**立法會**  
***Legislative Council***

LC Paper No. CB(1) 1986/99-00  
(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  
Friday, 21 January 2000, at 10:45 am  
in Conference Room A of the Legislative Council Building**

- Members present** : Hon Ronald ARCULLI, JP (Chairman)  
Hon Albert HO Chun-yan  
Hon FUNG Chi-kin
- Members absent** : Hon Bernard CHAN  
Hon SIN Chung-kai  
Hon Jasper TSANG Yok-sing, JP
- 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 Confirmation of minutes of previous meetings**  
(LC Paper Nos. CB(1) 842 and 843/99-00)

The minutes of meetings held on 1 and 2 June 1999 were confirmed.

**II Meeting with the Administration**

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

2. The Bills Committee continued to study the list of outstanding items provided by the Administration.

*Item 72 - Schedule 1 item 43*  
*section 146 of the Securities Ordinance (SO)*  
*(Cap.333)*

3. Members noted that section 146 of the existing SO empowered the Securities and Futures Commission (SFC) to make rules for regulation of registered persons and their activities. Rules of SFC were subsidiary legislation under SO. During previous discussions of the Bills Committee, members requested the Administration to consider amending the rule-making power of SFC

such that SFC rules would be subject to the positive vetting of the Legislative Council (LegCo).

4. The Principal Assistant Secretary for Financial Services (PAS/FS) said that after considering the Bills Committee's proposal, the Administration was of the view that as the current regime of making SFC's rules by negative vetting had been working well, there was no strong reason to change the approach.

5. The Chairman reiterated members' concern that due to the complexity of the rules and their significant impact on the market, it would be advisable to allow a longer scrutiny period for the rules. He requested the Administration to explore the feasibility of providing in the Bill the option which would enable the Administration to, after assessing the urgency of the situation and complexity of the proposed rules, elect whether the rules should be subject to positive or negative vetting by the LegCo.

FSB

6. PAS/FS responded that to facilitate scrutiny of subsidiary legislation, such as SFC's rules which were envisaged to be complex and have far-reaching impacts on the market, the Administration would as a matter of practice arrange them to be discussed by the Financial Affairs Panel before submitting them to the LegCo. The Chairman's proposal would be a fundamental change from the existing approach and would involve complex legal issues. He agreed to follow up the matter and to consult the Department of Justice and the Director of Administration on the issue.

*Item 74 - Schedule 3 item 3  
section 15(2) of the Stock Exchanges Unification  
Ordinance (Cap. 361)*

7. Members noted the Administration's explanation for not accepting the Assistant Legal Adviser (ALA)'s suggestion to repeal the word "any" after "section 65B and" in section 15(2) of the Stock Exchanges Unification Ordinance (Cap. 361).

*Item 76 - Schedule 4 item 1*

8. PAS/FS said the Administration would move a Committee Stage Amendment (CSA) to delete section 1 in Schedule 4 of the Bill which provided the Chief Executive-in-Council with the power to make regulations of a saving or transitional nature consequent to the enactment of the Amendment Ordinance. He explained that on reflection such reserved power would be unnecessary as provisions in the Bill had provided SFC with sufficient flexibility to deal with events of transitional nature.

*Item 77 - Schedule 4 item 3*

9. PAS/FS explained that the proposed CSA in item 3 of Schedule 4 was to provide securities dealers a three-month transitional period to obtain new authorization from their existing clients for the purpose of complying with the new section 81A of SO after commencement of the Amendment Ordinance. During the period, clients' authority made under the existing section 81 of SO would remain in force, provided that the authorization had not expired.

10. The Executive Director of Intermediaries and Investment Products, SFC (ED/IIP(SFC)) added that according to the existing sections 81(3), (4) and (5) of SO, clients' written authority to dealers regarding the disposition of securities was subject to renewal every 12 months. In the event that the dealers were unable to obtain new authority from clients during the transitional period SFC could, after the consequential amendment to section 55A(1) of the Securities and Futures Commission Ordinance (Cap. 24) under the Bill, consider modifying the requirements of the relevant sections of SO applicable to dealers where justified.

*Item 78 - unregistered dealing and margin financing activities*

11. On the Bills Committee's concern that the Bill had not provided SFC with adequate power to deal with unregistered dealing and margin financing cases, PAS/FS said that the matter would be reviewed in the context of the composite Securities and Futures Bill. The Administration noted the suggestions made by the Bills Committee which included providing SFC with power to suspend the operation of suspected unregistered dealers pending the application for court injunctions to wind up the firms and subject such power to proper checks and balances. The suggestion would be referred to the relevant team working on the composite Securities and Futures Bill for consideration.

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Proposed amendments to Division 4 of the Bill

12. Members noted that the Administration was finalizing the provisions for the revised Division 4 of the Bill. The Bills Committee had already agreed to hold a meeting on 22 January 2000 to discuss the draft provisions.

13. ED/IIP(SFC) explained that the original proposal in Division 4 which provided a client with the right to rescind a contract entered into with an unregistered SMF was mainly derived from the Australian Corporations Law. Although the concept of rescission also appeared in different forms in existing ordinances, there were inherent weaknesses including the difficulty in protecting bona fide third party right. The revised Division 4 would be modeled on the UK Financial Services and Market Bill. Under the proposal, the contract entered into between the client and an unregistered SMF would be unenforceable by SMF against the client. In the event that the client had completed his obligation under the contract, he could be regarded as the victim and be entitled to compensation for any loss he had suffered. The amount of compensation could be agreed between

the client and the unregistered SMF, or on the application of either party, be determined by the Court. The Court could also allow a contract which would otherwise be unenforceable to be enforced against the client where it took the view that it would be "just and equitable" to do so. The negotiation for compensation between the client and the unregistered SMF would not affect the right of the bona fide third party.

14. The Chairman expressed concern that the new Division 4 might protect the interest of clients who were not genuine victims, i.e. those fully aware that a SMF was unregistered and still entered into contract with it. ED/IIP(SFC) remarked that such a situation would be most unlikely. He explained that a client should not get windfall benefits. Apart from that the client would be running the risk of having the contract unfulfilled, the unregistered SMF could, in the event that the client did not perform the contract, apply to the Court requiring the client to return any property or money he received under the contract. The client would also be liable to criminal charge of being accessory to the offence of unregistered dealing.

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15. Since the revised Division 4 involved complicated legal issues, the Administration undertook to provide a paper to facilitate members' understanding of the proposed provisions therein.

16. The Chairman enquired whether clients of a suspended SMF would fall under Division 4. He expressed concern about the position of the clients when a registered SMF had his licence revoked or suspended.

17. PAS/FS said that the Administration would move CSAs to delete the proposed section 121C(3) which stipulated that a SMF would be taken as unregistered when his registration was suspended and to add a new section 121WA to enable SFC to suspend the whole or part of the registration of a SMF and make an order specifying the manner in which the existing business could be continued to be carried on. ED/IIP(SFC) remarked that revocation or suspension of registration of a SMF would not affect the contractual right of clients in respect of agreements entered into before the said suspension or revocation. Even after the registration was suspended or revoked, SMF would be allowed to operate in limited scope in order to serve the interest of existing clients.

Admin

18. For the sake of clarity, the Chairman suggested the Administration to review the drafting of section 121X(1) on the effect of revoking or suspending registration of SMFs.

#### The Administration's proposal on pooling of clients' assets

19. PAS/FS informed the Bills Committee that the Administration was awaiting the formal feedback of the Hong Kong Association of Banks (HKAB) on the proposal. He remarked that HKAB had no objection in principle to the Administration's revised proposal to incorporate in the Code of Conduct the limit

of the amount of credits SMFs could obtain from banks with clients' securities collateral at any time to 120% of the aggregate outstanding loans owed by clients but suggested that there should be provisions in the Code to ensure banks' right to dispose of the securities collateral in case of default of SMFs. In the connection, the Chairman suggested that banks could include a provision in the loan agreement with SMFs stating that the Code should not affect their collateral right. ED/IIP(SFC) said that the standards set in the Code for dealers and SMFs by the regulator were non-statutory and did not have legal effect on agreements between SMFs and the banks.

#### Examination of the draft CSAs

(LC Paper Nos. CB(1) 774/99-00(01) - sixth draft CSAs dated 30 December 1999, CB(1) 865/99-00(01) - marked-up copy of the Blue Bill)

#### *Section 121B*

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SFC 20. On the need of the new section 121B(3), ED/IIP(SFC) explained that subsection (3) clarified that when a person carried on a securities margin financing business in addition to any of the exempted business listed in the new Schedule 4, the whole range of business would be subject to the regulatory regime of SMFs. He accepted the Chairman's suggestion and agreed to consider replacing the word "business" in subsections (2) and (3) by "activities" or "transactions".

Admin 21. The Administration also undertook to consider ALA's suggestion to re-draft subsection (4) to provide that SFC, by notice in the Gazette, could modify any of the provisions in Schedule 4. The proposed amendment would enable SFC to amend the exempted list under the Schedule so that the public needed not look at the Commission Rules to find out what amendment to Schedule 4 had been made.

#### *Section 121C*

Admin 22. The Administration agreed to consider ALA's suggestion of putting the words "in Hong Kong" after "must not" in the beginning of subsection (1) so as to clarify that a person carried on a margin financing business outside Hong Kong would not be caught by the Amendment Ordinance.

Admin 23. The Administration also accepted the Chairman's suggestion to add "Subject to section 121B(2)" at the beginning of subsection (1).

24. Some members expressed concern that the new subsection (2A) might be abused and would require a high threshold for SFC to take action against suspected unregistered SMFs. They suggested the Administration should review the provision to ensure that the present drafting would achieve the purpose of the section.

25. In response, ED/IIP(SFC) explained that subsection (2A) was a defence provision for non-SMFs when their clients used the loans obtained for purchase of securities without their knowledge. The provision stated that if a person who provided financial accommodation and had a reasonable belief that it was not used to facilitate acquisition or the continued holding of securities, the person would not be taken as contravening section 121C of carrying on securities margin financing business without registration.

*The new section 121WA*

Admin 26. The Administration took note of members' suggestion of reviewing the drafting of section 121WA(3). The provision which stipulated the penalty levels for contravening the order of SFC specifying the manner in which a suspended SMF or a SMF representative could continue to operate should be comparable to those prescribed for unregistered SMFs or SMF's representatives under sections 121C and D.

*Section 121Y*

Admin 27. Members noted that the Administration would formulate CSAs incorporating members' suggestions made in previous meetings in respect of sections 121Y(1)(d) and (4).

*Section 121AA*

Admin 28. The Administration undertook to prepare new CSAs for sections 121AA(1), (3) and (4) taking into consideration members' comments made at previous meetings.

29. On section 121AA(5), ED/IIP(SFC) explained that it was analogous to the proposed section 81A(6) of the SO which provided that clients' authorization in respect of the disposal of securities deposited with securities dealers was subject to renewal every 12 months. The provision was modeled on the existing sections 81(3) , (4) and (5) of SO which had been operating well. Moreover, there had been no adverse comments from the industry against retaining such a requirement during the consultation of the Bill. PAS/FS stressed that the provision was an important means to protect clients' assets and therefore should not be relaxed.

**III Any other business**

30. The Chairman reminded members that the next meeting had been scheduled for 22 January 2000, at 10:30 a.m. to examine draft CSAs for the revised Division 4 of the Bill.

31. The Administration agreed to provide the finalized draft CSAs for members' consideration as soon as possible. Subject to the completion of the scrutiny of the proposed CSAs, the Bills Committee aimed at reporting to the House Committee on 18 February 2000 and would recommend resumption of the Second Reading debate on 3 March 2000. If the target schedule could not be met, the Bills Committee would report to the House Committee on 3 March 2000 and recommend resumption of the Second Reading debate on 15 March 2000.

32. There being no other business, the meeting ended at 1:00 p.m.

Legislative Council Secretariat  
2 August 2000