

立法會
Legislative Council

LC Paper No. CB(1) 1988/99-00
(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
Monday, 21 February 2000, at 10:45 am
in Conference Room A of the Legislative Council Building**

- Members present** : Hon Ronald ARCULLI, JP (Chairman)
Hon Bernard CHAN
Hon SIN Chung-kai
Hon Jasper TSANG Yok-sing, JP
Hon FUNG Chi-kin
- Member absent** : Hon Albert HO Chun-yan
- Public officers attending** : Mr Bryan CHAN
Principal Assistant Secretary for Financial Services
- Miss Hinny 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
- 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 previous meetings
(LC Paper Nos. CB(1) 993, 994, 995 and 996/99-00)

The minutes of the meetings held on 21, 28 and 29 June and 7 July 1999 were confirmed.

II Meeting with the Administration

The rule-making power of the Securities and Futures Commission

2. Referring to the Bills Committee's proposal of subjecting the rules made by the Securities and Futures Commission (SFC) under section 146 of the Securities Ordinance (SO) (Cap. 333) to "positive vetting" of the Legislative Council (LegCo), or providing an option for the Administration to submit the rules for negative or positive vetting by the LegCo, the Principal Assistant Secretary for Financial Services (PAS/FS) said that the Department of Justice and the Director of Administration had both been consulted and they were of the view that the proposal involved complex legal issues and had implications on the existing approach for the scrutiny of subsidiary legislation. PAS/FS undertook to refer the matter to the two departments with a view to considering if the time limit of the extension of negative vetting could be lengthened in order to provide more flexibility to LegCo in handling more complicated and lengthy subsidiary legislation.

3. The Chairman re-iterated that the proposal would provide LegCo with more time to scrutinize complicated rules and those with significant impact on the market. He concurred that the matter was beyond the scope of the Bill and should be reviewed in respect of all subsidiary legislation. He suggested that the matter be referred to the Panel on Constitutional Affairs for follow up with the Administration as appropriate.

Examination of the draft Committee Stage Amendments (CSAs) to Division 4 of the Bill

(LC Paper No. CB(1) 1401/99-00(01) - proposed CSAs (second draft dated 14 February 2000) for Division 4)

4. The Administration tabled the second draft CSAs to Division 4 together with comments from the Hong Kong Society of Accountants (HKSA), the Hong Kong Association of Banks (HKAB) and Mr Alan EWINS of the Law Society of Hong Kong at the meeting. The Executive Director of Intermediaries and Investment Products, Securities and Futures Commission (ED/IIP(SFC)) explained that the second draft had incorporated the Bills Committee's suggestions made at previous discussions including clarifying that the Court should determine the amount of compensation recoverable by the client, and whether the agreement should be enforced with appropriate modifications on the basis of just and equitable considerations.

5. Members noted that HKSA had made no comment on the draft. On HKAB's suggestion of stipulating a time frame within which a client should decide whether he would perform the agreement entered into with the unregistered securities margin financier (SMF), ED/IIP(SFC) said that it was not necessary to provide any time frame in this respect as the Court would be given discretion to allow the agreement to be enforced against the client based on just and equitable considerations. As regards HKAB's comment that the provisions had not addressed the concern about third party rights, ED/IIP(SFC) re-iterated that the matter should be left to the provisions of the general law. If a bone fide third party had lawfully taken securities collateral deposited by the client without knowing that the SMF was unregistered, its entitlement over the securities should not be affected by merely the fact that the SMF was unregistered. He added that the comments made by Mr EWINS were mainly about drafting issues which would be considered by the Law Draftsman.

6. PAS/FS explained that section 121AC set out the scope of Division 4. It covered agreements entered into with SMFs not registered under Division 2, or with their registration suspended but excluded those agreements made with SMFs which did not contravene section 121C because of the operation of sections 121WA(2), 121BH(1) or 121BI. Section 121WA(2) enabled SFC to make an order specifying the manner in which the business of a suspended SMF could be carried on for serving the interests of its existing clients. Section 121BH(1) was applicable to existing SMFs which had applied for registration under the Amendment Ordinance and were allowed to continue their business pending SFC's determination of their applications. Section 121BI enabled existing SMFs to

provide margin financing business to recover outstanding loans granted before the commencement of the Amendment Ordinance without requiring them to register under the Amendment Ordinance.

7. The Chairman re-iterated the anomaly in section 121C(3) where a registered SMF would be taken as unregistered when its registration was suspended. The provision would be inconsistent with section 121AC(2). He also pointed out that section 121X(1)(a) stipulated, inter alia, that revocation or suspension of the registration of a SMF could not affect an agreement entered into "before or after" the said revocation or suspension, while section 121AC(2) stated that an agreement made with a SMF after its registration was suspended would fall within Division 4. The difference in effects on agreements made with unregistered SMFs under the two sections would cause confusion. He suggested the Administration review the provisions to maintain consistency in drafting.

8. In response, PAS/FS said that the Administration would move CSAs to delete the proposed section 121C(3) upon the adding of the new section 121WA. As regards the relation between sections 121C and 121AC, PAS/FS stressed that as long as SMFs acted within SFC's directives issued in relation to sections 121WA(2), 121BH(1) or 121BI, they would not be taken as breaching section 121C nor regarded as unregistered. Hence, Division 4 would not apply to agreements entered into with these SMFs.

9. On concern about the drafting of section 121X(1)(a), ED/IIP(SFC) remarked that the section was consistent with the provisions in Division 4. Nonetheless, he undertook to re-examine the provisions therein.

SFC

10. Responding to the Chairman's enquiry about whether agreements made with a registered SMF when its business was partially suspended would fall under Division 4, ED/IIP(SFC) re-iterated that agreements entered into with registered SMFs only when their registration was suspended or revoked would fall under Division 4. He added that a suspension order should be distinguished from a restriction notice. While a SMF had to cease its operation completely under a suspension order, a restriction notice would usually be issued if SFC intended to stop or limit certain aspects of the business of the SMF. Under such circumstances, a SMF operated in accordance with a restriction notice would still be regarded as registered. Suspension of registration was a sanction in relation to serious misconduct of registered entities and such an order could only be made after the conduct of a disciplinary hearing on the case. Such sanction was usually used in respect of an individual registrant rather than a firm in view of possible adverse impact on the reputation of the firm and hence its commercial viability in the long run. For corporate registrants, SFC would usually issue public reprimand as punishment or revoke their registration in case of serious misconduct committed. PAS/FS supplemented that as far as he could recall, suspension imposed by SFC on SMFs in the past two years was all in relation to liquidation orders issued to the firms for their winding-up. In view of the uncommon penalty of suspension on SMFs, the concern about its possible effect on agreements entered into with suspended SMFs should be allayed.

Admin

11. As the consequences of suspension or revocation of the registration of a registered SMF on the agreement entered into after the suspension or revocation, as well as the effect of the SMFs breaching the restriction notice or suspension order had not been clearly spelt out, the Chairman requested the Administration to redraft the provisions in Division 4 for further deliberation of the Bills Committee.

12. The Chairman shared the concern raised by Mr EWINS over the meaning of section 121AD(3) which provided that the client of an unregistered SMF could be entitled to recover compensation for loss that was a "direct result" of the SMF being unregistered and within the "reasonable contemplation" of the parties. He opined that the drafting of the provision would narrow the scope of compensation available to the client thus over-protecting the unregistered SMF.

13. In response, ED/IIP(SFC) remarked that SFC considered it appropriate for the Court to make the judgement on whether the loss suffered by the client was a direct result of the SMF being unregistered. PAS/FS said that the Department of Justice was strongly of the view that compensation had to be confined to losses that were direct and within the reasonable contemplation of the parties only, otherwise it would leave the scope of the provision widely open and the client might get windfall benefits.

Admin

14. The Chairman did not agree with the Administration that extending the scope of compensation under section 121AD(3) would necessarily advantage the client, as in order to qualify for compensation, the client had to prove that he did not know that the SMF was unregistered and that he had suffered losses. The Chairman requested the Administration to provide details of the legal considerations behind the formulation of the proposed section to facilitate the Bills Committee's further deliberation on the matter.

Admin

15. The Chairman suggested that the definition of "agreement" for the purpose of Division 4 should be provided at the beginning of the Division. It should be clarified that whether the definition would only cover the master contract entered into between the client and the SMF when the margin account was opened or whether it would also include instructions on transactions, arrangements and activities relating to the account. Moreover, the time reference to section 121AD(3) would need to be specified so that matters relating to compensation for loss suffered by the client could be determined. He also opined that the term "the purchaser" which referred to a client of SMF was not appropriate. He requested the Administration to consider replacing the term with other more suitable words.

16. The Assistant Legal Adviser pointed out that section 121AE provided that the Court could allow an agreement, which would be otherwise unenforceable, to be enforced if it was satisfied that the enforcement conditions were met. In doing so, the Court might practically be permitting unregistered SMFs to continue to operate. ED/IIP(SFC) said that it was envisaged that the Court would not make any decision allowing for the continuation of illegal activities. The Court

would probably order for some transactions to be completed which it considered just and equitable and fair to both parties concerned.

17. Mr SIN Chung-kai opined that it would be more important to provide investors with up-to-date information on registered SMFs for better protection of their interests. The Chairman said that SFC was required to keep a register of registered SMFs which would be available for public inspection free of charge. ED/IIP(SFC) advised that SFC had been maintaining a register of registered entities which was accessible via the Internet. Moreover, all registered intermediaries were required to display their certificates of registration at their business premises. In this connection, the Chairman suggested that it might be useful to specify in the Code of Conduct requiring SMFs to provide the firms' registration numbers on the contract notes and statements of account for clients' information.

III Any other business

18. Members agreed to hold a meeting on 22 February 2000, at 10:45 am to examine the revised draft CSAs for Division 4.

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

Legislative Council Secretariat
2 August 2000