

LC Paper No. CB(1)105/99-00  
(These minutes have been  
seen by the Administration)

Ref: CB1/BC/13/98/2

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

**Minutes of meeting held on  
Tuesday, 27 July 1999, 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 FUNG Chi-kin
- Members absent** : Hon Bernard CHAN  
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 Richard YIN  
Director of Intermediaries Supervision
- Mr Leo LEE  
Director of Licensing
- 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**  
(LC Paper No. CB(1)1764/98-99)

Follow-up on issues arising from previous meetings

At the Chairman's invitation, the Principal Assistant Secretary for Financial Services (PAS/FS) took members through the Administration's letter responding to the issues raised by members at previous meetings. He explained that the powers of the Securities and Futures Commission (SFC) as laid out in section 121AB were analogous to those provided under the existing sections 65D(1) and 95(1) of the Securities Ordinance (Cap 333) (SO) and the Bill did not seek to extend the scope of SFC's investigatory power over registered persons. He advised, however, that a comprehensive review of SFC's powers would be conducted in the context of the composite Securities and Futures Bill.

2. Noting the Administration's explanation that SFC's power to inspect all accounting and other records under section 121AB(4) included power to inspect the working papers of the auditors of the dealers, the Chairman expressed doubt

SFC on the interpretation of the provision since as far as he understood, from the auditor's perspective, the working papers belonged to the auditors, not the clients. While admitting that there could be ambiguity and uncertainty in the provision, the Executive Director of Intermediaries and Investment Products, Securities and Futures Commission, (EDII/SFC) advised that a similar provision under section 33(4) of the Securities and Futures Commission Ordinance (Cap 24) (SFCO) was considered broad enough to include auditor's working papers. He suggested that examples of SFC exercising its power in respect of obtaining auditor's working papers for the purposes of ascertaining compliance with the financial resources rules be provided for members' reference.

3. At the invitation of the Chairman, the Assistant Legal Adviser reported on a comparison between Division 6 (clause 3) of the Bill and the parallel provisions in SO. He pointed out that new sections 121AL to 121AQ of the Bill corresponded to sections 84 to 86 of SO. There were, however, some drafting differences between the following sections:

<u>The Bill</u>	<u>Securities Ordinance</u>
121AR	84(6)(a), (b) and (c)
121AS	84(7)(a)
121AP(1)	85(1)
121AP(2)	85(2)

The meeting did not raise any queries on these sections.

SFC 4. In view of the various restrictions imposed on registered financiers such as those provided under new section 121AP that money held in trust was not available to meet financier's own debts, the Chairman raised again his concern about the anomaly between the position of unregistered financiers and registered financiers. EDII/SFC stated that provisions to impose restrictions on unregistered financiers would be of no practical utility because if these financiers did not bother to become registered, it was unlikely that they would abide by these provisions. However, he agreed to explore the feasibility of introducing a provision under which amounts paid in respect of dealings with an unregistered financier would be deemed to be held in trust in order to give better protection to bona fide dealers with unregistered financiers in cases of competing claims over money of the unregistered financier.

5. As to Mr Albert HO's indication at the last meeting that he intended to submit a proposal with respect to 'pooling' arrangements to the Bills Committee for consideration, members noted that the proposal would be made available by the next meeting.

### Clause-by-clause examination of the Bill

#### *Clause 3 - Division 9*

(Supplementary provisions relating to auditing)

6. The Bills Committee went on to examine Clause 3, Division 9 of the Bill. Members noted that parallel provisions of the new section 121BE in the Division were in section 96 of SO.

SFC 7. When examining new sections 121BE and 121BF, the Chairman reiterated his concern about the lack of control over unregistered margin financiers and inadequate protection of clients' assets. In response to the question on control over unregistered margin financiers, EDII/SFC advised that apart from relying on provisions under section 121C, SFC could also close down the business and wind up the company concerned as provided under section 45 and 46 of SFCO. Protection of clients' assets had to be provided through insolvency provisions. Noting members' concern that penalties on dealings of unregistered financiers seemed rather light, he reiterated that the SFC and the Administration would review the penalty provisions in this respect.

#### *Clause 3 - Division 10*

(Miscellaneous provisions)

8. EDII/SFC informed members that it would be beneficial to study section 121BG in conjunction with section 146(3) in order to have an overall view of waiver/modification provisions in respect of requirements set down in the Ordinance. In response to the Chairman's inquiry, he confirmed that an unincorporated company could not apply to conduct securities margin financing business except in the case of the sole proprietor being already a registered dealer. He stressed that SFC's objective was to maintain an appropriate balance between business facilitation and investor protection when considering granting of waiver/modification.

SFC 9. The Chairman considered the threshold for granting of waiver/modification too high as section 121BG(3)(b) was worded in such a way that in considering such application, SFC would have regard to whether the exercise of the power in the particular case would result in undue risk to the investing public. His interpretation of the provision was that while 'undue risk to the investing public' was considered unacceptable, some risk to the investing public might still be considered acceptable. After deliberation, EDII/SFC agreed to consider the suggestion of lowering the threshold for SFC to refuse application for waiver/modification under section 121BG, by amending subsection 121BG(3)(b) to 'whether the exercise of the power in the particular case would result in undue risk to clients or prospective clients of the applicant', and by adding a subsection 121BG(3)(c) to bring in the public interest

Admin perspective. The Administration agreed to amend the section to provide that SFC would give the reasons for refusing an application.

10. In respect of the prescribed provisions listed under section 121BG(7)(a), the requirements under which could be waived or modified by SFC, the Chairman enquired about actual examples of waiver/modification that could be granted under the prescribed provision of section 121C. As section 121C stipulated the registration requirement for securities margin financiers, he pointed out that any waiver/modification granted under section 121C would impact on section 121D, which disallowed an unregistered person to act as representative of a registered financier. The Director of Licensing/SFC responded that on receipt of applications for registration, SFC might consider an applicant having met the conditions which would render him eligible for exemption from the registration requirement. SFC would only have the specific details of such cases when they arose. The Chairman requested the Administration to reconsider the prescribed provisions in subsection 121BG(7)(a), particularly with regard to giving examples of waiver that could be granted under section 121C and including 121D as part of the prescribed provisions.

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11. Mr Albert HO expressed concern that there did not seem to be any checks and balances on the power of SFC in imposing an order as provided under section 121BH(3). He opined that the applicant should be allowed to be heard or make representations in case of grievances. EDII/SFC pointed out the parallel provisions in section 39 of the SFCO and advised that under both sets of provisions, SFC was subject to the general rule of procedural fairness under which the applicant could seek a judicial review. On not stating explicitly the right to be heard in the legislation, he said that there might be circumstances under which the restriction order should be imposed with immediate effect so as to protect the interests of the clients. He further advised that such restriction orders served by SFC pursuant to Section 39 of SFCO were usually temporary and withdrawn or varied after certain conditions were met or upon further requests made by registrants concerned.

12. Citing the example of long-delayed approval of applications for registration under the Leveraged Foreign Exchange Trading Ordinance (Cap 451) for some cases, Mr FUNG Chi-kin expressed concern about the lack of a time limit on SFC for approving applications for registration as securities margin financiers, who might be allowed to carry on business pending registration as provided under section 121BH. To address concerns about fairness to the applicants and protection to the investing public in this regard, the Chairman suggested the Secretary for Financial Services to consider giving the assurance at the resumption of Second Reading debate that such applications would be processed by SFC within a reasonable time limit, notwithstanding the possibility of a longer processing time for some exceptional cases.

13. The Chairman concluded the discussion stating that the Bills Committee would resume scrutiny of the Bill from Clause 4 at the next meeting.

**II Any other business**

14. Members agreed to hold the next two meetings on 17 September 1999, from 4:30 pm to 6:30 pm and 27 September 1999, from 8:30 am to 12:30 pm.

15. The meeting ended at 10:15 am.

Legislative Council Secretariat

12 October 1999