

立法會
Legislative Council

LC Paper No. CB(1) 994/99-00
(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
Monday, 28 June 1999, at 2:30 pm
in Conference Room A of the Legislative Council Building**

- Members present** : Hon Ronald ARCULLI, JP (Chairman)
Hon Albert HO Chun-yan
Hon Bernard CHAN
Hon SIN Chung-kai
Hon Jasper TSANG Yok-sing, JP
Hon FUNG Chi-kin
- 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 Leo LEE
Director of Licensing
- Mrs Yvonne MOK
Associate Director of Intermediaries supervision
- Ms Judith YUEN
Senior Manager 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

Members noted the Administration's written responses (LC Paper No. CB(1)1599/98-99) to the submissions provided by Mr Leo CHIU and the Hong Kong Association of Banks (LC Paper No. CB(1)1508/98-99), and the further submission provided by the Law Society of Hong Kong (LSHK) (LC Paper No. CB(1)1533/98-99).

Submission from Mr Leo CHIU

2. On the Administration's response to Mr Leo CHIU's submission, members noted that the Administration had accepted some of the suggestions made in respect of provisions on "right to be heard", "statement of account" and "rescission" (i.e. paragraphs 4, 7 and 8 of the Administration's response.) The Administration would review relevant provisions in the Bill and make

amendments as appropriate.

3. Regarding the suggestion on the item "right to be heard", the Executive Director for Intermediaries and Investment Product, Securities and Futures Commission (ED/IIP(SFC)) clarified that although the right for a registered margin financier (SMF) or its representatives to be heard before the imposition of a penalty of suspension had not been expressly provided in sections 121 R(5) and 121T(5) of the Bill, registrants would be entitled to such right as a matter of procedural fairness. The same applied to registered dealers or its representatives under the existing Securities Ordinance (SO) (Cap. 333). Aggrieved parties had the right to appeal to the Securities and Futures Appeals Panel which dealt with appeals of SFC's decisions concerning licensing or disciplinary matters. The Panel comprised of lay members of the public.

4. ED/IIP(SFC) disagreed with Mr CHIU's comment that the wide scope of the definition of "misconduct" as provided in Sections 121S(5) and 121U(5) of the Bill would be tantamount to giving "unrestricted investigation powers" to SFC, and stressed that the term "misconduct", for the purpose of the Bill, should be wide enough to cover all conduct that was "prejudicial to the interest of members of the investing public". Indeed, a similar provision already existed in the present SO and had not given rise to any particular problem so far. He assured members that as a matter of fair administrative practice, SFC had to have proper grounds for its belief before it would exercise the powers vested under section 33 of the Securities and Futures Commission Ordinance (SFCO) (Cap. 24) and any conduct of SFC was subject to judicial review.

Exemptions suggested by the Law Society of Hong Kong

5. The Principal Assistant Secretary for Financial Services (PAS/FS) stressed that, as a general principle, any exemption granted under the Bill should be consistent with and should not undermine the policy objective of the Bill, which was to provide better protection to investors engaged in securities margin financing activities and to prevent such activities from creating systemic risk in the market. To these ends, the list of activities which were clearly not intended to be covered by the present regime would be put under a Schedule under the Ordinance to be amended by SFC subject to "negative vetting" of the Legislative Council, as suggested by members at a previous meeting. On the other hand, SFC would retain the flexibility in granting class exemption to specific types of persons by way of Commission rules as provided for in section 146(3) of the Bill. SFC would also be empowered to waive or modify certain specific provisions under the Bill on a case-by-case basis upon application by SMFs. ED/IIP(SFC) supplemented that SFC saw the merit of having an extensive exemption list to provide the industry with certainty and predictability. He clarified that while a company carrying on the exempted business only would not be required to register as a SMF, once the company was registered as a SMF, all relevant

Action

activities carried on by it including the exempted business, i.e. its entire business portfolio, would be subject to the regulatory regime and be covered by the relevant requirements under the law. In considering class exemptions, SFC would expect applicants to describe its nature of business in considerable details and provide any other explanation necessary for SFC to assess whether such kind of business should be regulated.

Admin/
SFC

6. Among the six suggested exemptions made by LSHK which were found agreeable by the Administration, the Chairman expressed grave concern about giving exemption to the provision of financial accommodation to a company with paid up share capital of \$1 million or foreign currency equivalent or to a listed company or the subsidiary of a listed company. Notwithstanding the Administration's explanation that exemption for this type of business was justified on the grounds that such lending activity was not intended to be covered by the present regime as its clients were sophisticated institutional investors rather than the ordinary investing public and that it was unlikely that a financier would run an exclusive business on providing this type of financial accommodation in order to avoid registration, the Chairman pointed out that it would be possible for a financier to restructure its business into such activities so as to circumvent the legislation. Mr FUNG Chi-kin cautioned that providing exemptions to large well capitalised firms serving "big investors" would be against the principle of maintaining a level playing field for all business operators and would disadvantage small firms. After deliberation the Administration and SFC took note of members' concern and undertook to re-consider LSHK's suggestion in this respect.

7. As to the suggestion of exempting the provision of financial accommodation to facilitate the acquisition of 5% or more of the issued share capital of a listed company, the Chairman remarked that since a prospective purchaser would often require some time to acquire a stake of 5% or more in any listed company, a financier providing the necessary funding to this purchaser would not be exempted from registration until such time as the accumulated stake reached 5%. Hence, it might be necessary for the financier to consult SFC on whether registration for the business was required when he was first approached by the prospective purchaser. ED/IIP(SFC) said that SFC would consider whether registration was required under such circumstances on a case-by-case basis.

Clause-by-clause examination on the Bill

Clause 2 - Interpretation

8. On the need to provide a definition for "audit" in section 2(1) of SO, members noted the Administration's explanation that since the meaning of "audit" in the Ordinance would be expanded to include examining records of

Action

registered financiers in relation to SFC exercising its general inquiry power, a definition for the word would be necessary.

Admin/
SFC

9. As to the Chairman's concern about the need for a definition on "agent", ED/IIP(SFC) explained that the word would pick up the meaning of the expression "a person acting for or by arrangement with another", which was commonly found in the Ordinance where the intention was to refer to the term "representative". Adoption of the word "agent" would obviate the need to repeat the phrase at various places in the Bill. In this connection, the Senior Assistant Law Draftsman cited sections 121AB(4)(a) and 121BB(1)(a) as examples. However, in view of the Chairman's concern about the loose definition and the inclusion of an independent contractor in its meaning, ED/IIP(SFC) undertook to review the provision with a view to expanding the definition of a representative instead of expanding the meaning of "agent".

10. From the definition of "securities margin financing", members noted that the financial accommodation provided by a SMF was for the acquisition of securities "listed on a stock exchange". It was expressly provided in section 121B(1) (in clause 3) that "a stock exchange" could be located in Hong Kong or elsewhere.

*Clause 3 - Division 1
(Preliminary)*

11. Members noted from section 121B(2) that registered securities dealers or exempt dealers and authorised financial institutions (as defined under the Banking Ordinance (Cap. 155)) would be exempted from the application of Part XA. Registered securities dealers would not be required to apply for an additional licence for carrying on securities margin financing business but would be subject to the same financial regulation, requirements on protection of clients' assets and Code of Conduct applicable to registered financiers through consequential amendments to relevant ordinances.

Admin/
SFC

12. The Chairman pointed out that without a proper definition in the Ordinance, the use of the word "prospectus" in section 121B(2)(g) might be inappropriate as it had a local meaning, which was inconsistent with the inclusion of overseas securities in the meaning of "securities margin financing". He urged the Administration to clarify the meaning of the word.

*Clause 3 - Division 2
(Registration of securities margin financier)*

13. The Chairman had reservation over the drafting of the provisions under section 121C(3) and 121D(3) where it was provided that a financier or its representatives would be regarded as unregistered when their registration was

Admin/
SFC

suspended. He was concerned that the provisions would have the effect of precluding a financier or its representatives, when under suspension, from engaging in activities which served to maintain the business and protect the interests of their existing clients, such as unwinding positions in loan portfolios. The Director of Licensing, Securities and Futures Commission clarified that the financier or its representatives, when under suspension, would be prohibited from providing new financial accommodations to clients. They could carry on activities to maintain their business, such as effecting security for settlement of clients' obligations and liabilities. Such acts would not be regarded as contravention to sections 121C(1) and 121D(1). As regards the situation where an existing financier or its representatives were in the process of applying to SFC for registration, section 121BH provided that they could continue to carry on the business, subject to conditions imposed by SFC, pending the determination of the application, or within 14 days after notification of refusal to the application, or any period as permitted by SFC. They would not be regarded to be contravening sections 121C(1) and 121D(1). Noting the Chairman's concern and his suggestion of giving SFC the power to give directives as to how a suspended registrant could carry on the business during the concerned period instead of deeming the person unregistered, ED/IIP(SFC) undertook to review the provisions in the two sections with a view to clarifying the policy intention. The Administration would also give consideration to how a third party could exercise its rights against a suspended registrant under the circumstances.

II Any other business

Date of next meeting

14. Members noted that the next meeting would be held on 29 June 1999, at 4:30 pm.
15. There being no other business, the meeting ended at 4:15 pm.

Legislative Council Secretariat

16 February 2000