

立法會
Legislative Council

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by the Administration)

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**Subcommittee on
Securities and Futures Bill**

**Minutes of meeting
held on Friday, 10 September 1999, 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 (Deputy Chairman)
Hon James TO Kun-sun
Hon Ambrose CHEUNG Wing-sum, JP
Hon Christine LOH
Hon SIN Chung-kai
Dr Hon Philip WONG Yu-hong
Hon Jasper TSANG Yok-sing, JP
Hon Ambrose LAU Hon-chuen, JP
Hon FUNG Chi-kin

Members attending : Hon Mrs Sophie LEUNG LAU Yau-fun, JP

Member absent : Hon Eric LI Ka-cheung, JP

**Public officers
attending** : Miss AU King-chi, JP
Deputy Secretary for Financial Services

Mr Andrew PROCTER
Executive Director of Intermediaries and Investment Products
Securities and Futures Commission

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Mr Paul BAILEY
Executive Director of Enforcement
Securities and Futures Commission

Mrs Alexa LAM
Chief Counsel of Securities and Futures Commission

Miss Emmy WONG
Assistant Secretary for Financial Services

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

I Election of Chairman

Mr Ronald ARCULLI and Mr Albert HO Chun-yan were elected Chairman and Deputy Chairman of the subcommittee respectively.

II Meeting with the Administration

Review of Licensing Regime
(LC Paper No. CB(1) 1867/98-99(01))

2. The Executive Director of Intermediaries and Investment Products/Securities and Futures Commission (EDI&IP/SFC) briefed members on the major proposals in the "Consultation Paper on Review of Licensing Regime". He said that the Securities and Futures Commission (SFC) conducted a comprehensive review of the licensing regime in 1990 and many of the unimplemented review recommendations were incorporated in the draft Composite Securities and Futures Bill released for public consultation in 1996. In view of the changes in the financial markets, the SFC undertook a second review in 1998. In the course of the review, the SFC had adhered to the core objectives of securities regulation adopted by the International Organization of Securities Commission, namely, the protection of investors; ensuring that markets were fair, efficient and transparent; and the reduction of systemic risk.

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3. EDI&IP/SFC advised that under the reform, a single licence category would replace the existing licensing system under which there were six functional categories of licence in respect of dealers and their representatives (in securities and futures), advisers and their representatives (in securities and futures) and leveraged foreign exchange traders and their representatives. The new legislation would re-define the activities for which a licence would be required and the single licence would specify the scope of permitted business. A provisional licence could be issued to an applicant on a nothing-known-against basis pending full scale vetting. Moreover, licensing requirements would be extended to all persons in the senior management level (including all executive directors) who could exercise significant influence over the licensed entities. To ensure competence of licensed firms and individuals, the SFC would set new criteria for fitness and properness and the licence applicants had to satisfy the SFC that they were able to meet the criteria. The granting of exempt status to firms would be confined to Authorized Institutions.

4. EDI&IP/SFC further advised that there would be a two-year transitional period for the full implementation of the reform proposals. The proposed licensing regime had been released for a two-month public consultation on 30 June 1999. Responses received from various interested parties were generally supportive.

5. Following EDI&IP/SFC's presentation, the Chairman invited members' comments on the consultation paper.

Legislative timetable of the Securities and Futures Bill

6. While supporting the objectives of the reform proposals of the Securities and Futures Bills (the Bill) in general, members raised concern over the legislative timetable.

7. Mr Albert HO opined that in view of the complexity of the Bill and thus the lengthy process anticipated in vetting the wordings of the Bill in detail, he urged the Administration to speed up drafting of the Bill and suggested that different parts of the draft could be submitted to the subcommittee once available for members' initial vetting.

8. Mr James TO supported Mr HO's suggestion. Nevertheless, he expressed reservation on the urgency in enactment of the Bill. He opined that a Bill of such complicated nature and wide coverage should be given adequate time for scrutiny. Moreover, the reform proposals would likely be governing the market operations in the coming decade or more, it would be undesirable to enact the Bill in such a rush.

9. Miss Christine LOH echoed and elaborated that from past experience of vetting draft bills, the details and wordings of a bill could be crucial to the future implementation of the proposals. In this connection, she felt that more time would be required for members to consider the Bill in detail as well as to meet relevant

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interested groups to hear their views.

10. DS/FS responded that the reform proposal would be crucial for increasing protection for investors, improving transparency in market operations, and reducing possible systemic risks. As such, the enactment of the Bill should be treated as a matter of urgency so as to keep the regulatory mechanism in pace with the rapid development of the financial market. The proposals under the Bill were also important for maintaining Hong Kong's position as a leading financial centre and should be achieved as soon as possible. She added that market responses during the public consultation had indicated a wish for timely reform to improve market competitiveness. She also undertook to work with the Department of Justice for urgent completion of the draft Bill so that members could consider it in detail at the earliest possible date.

11. In reply to the enquiry about the way in which the reform proposals of the Bill would be related to the proposed merger of the two exchanges and three clearing houses. EDI&IP/SFC explained that these were two separate reforms though they were complementary and both aimed at, inter alia, improving market regulation to keep in pace with the rapid market development. He elaborated that when the two reform proposals were implemented, there would be a single exchange entity, a single licence category and single clearing and settlement system. These would enable more efficient risk management of the market.

12. Concerning possible disruption to market operations if the proposed merger and the reform proposals of the Bill were introduced at different timing, EDI&IP/SFC clarified that although the two concerned bills were complementary, they could be implemented separately without causing disruption to the market. He elaborated that, if, for example, the market merger was introduced before the single licence category proposal, the licensed firms or individuals could carry on their business with their original licences.

13. DS/FS supplemented that the proposed merger bill was comparatively concise and would likely be implemented before the enactment of the Bill. The draft Bill would then be updated to incorporate changes governing the new market structure.

Proposed Licensing Regime

14. Mr FUNG Chi-kin said that members of the industry were generally in support of the objectives of the Bill. In view of the rapid development of the market brought by globalization, computer usage, new products and services, as well as the impending merger of the securities and commodities markets, members of the industry felt that the enactment of the Bill was a matter of urgency. However, he expressed concern that upon the implementation of the reform proposals, SFC might be given excessive power and would become a super regulatory body embodying the authority to issue and revoke licences, as well as to take disciplinary actions against market misconducts.

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15. DS/FS responded that while the reform proposals of the Bill would extend the power of the SFC to take a wider range of disciplinary actions against misconduct, the SFC would be subject to additional checks and balances. An independent Process Review Panel would be established to review key aspects of the SFC's internal processes, including the disciplinary decision-making process. Moreover, it was proposed that a Securities and Futures Appeals Tribunal be set up to consider and review disciplinary decisions made by the SFC. These mechanisms would ensure that the SFC would exercise its disciplinary powers fairly, responsibly and consistently. These proposals would be further discussed at the coming subcommittee meetings under separate papers.

(Post-meeting notes: the proposals on establishment of a Securities and Futures Appeals Tribunal was discussed at the subcommittee meeting on 24 September 1999.)

16. Mr Albert HO requested the Administration to clarify the co-ordination among different regulatory bodies in the case of those business entities engaging in activities that fell within the regulatory ambit of more than one regulatory bodies, for example, Authorized Institutions (AIs) which were under the regulation of the Hong Kong Monetary Authority (HKMA) and engaged in securities brokering at the same time. He was concerned about the possible overlaps in regulation and confusion that might arise. He proposed that the Administration could study the model of the United Kingdom and consider combining the different regulatory bodies for finance, securities and commodities into one single body to avoid confusion or overlaps in the work of different regulators and at the same time to achieve consistency in the regulatory principles in different areas.

17. EDI&IP/SFC explained that AIs which participated in securities brokering might either choose to set up subsidiaries for this purpose or to carry out the brokering activities within the same business entity. In the former case, the subsidiaries would have to obtain licence from the SFC while in the latter case, the AIs could do their securities business under the exempted status granted by the SFC and would only be under the regulation of the HKMA. He advised that SFC and HKMA had been maintaining close coordination through the signing of "Memorandum of Understanding", regular meetings, and exchange of information to ensure consistency in the competence requirements of market participants. DS/FS supplemented that there was no plan at this stage to combine the different regulatory bodies in Hong Kong.

18. While appreciating the objectives of the Bill and the need for Hong Kong to improve its international competitiveness, Mr James TO expressed concern over the possible impact of the new criteria for fitness and properness of firms on the survival of those small scale firms in the market. He urged the SFC to strike a balance between setting appropriate criteria to ensure competence of the applicants and leaving

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survival space for those small scale firms to continue their business in the market.

19. EDI&IP/SFC assured that the SFC would adopt a pragmatic and flexible approach in the consideration of licence applications. Special circumstances and individual characteristics of every case would be examined carefully.

20. On professionals exemption, Mr James TO requested that clarifications be made on the following points mentioned in the “Consultation Paper on Review of Licensing Regime” :

- (i) the definition of “incidental advice” provided by professionals such as accountants and solicitors mentioned in paragraph 7.3.1; and
- (ii) the proposed requirements of submitting reports and complying with some parts of the Code of Conduct by persons engaged in professional dealings stated in paragraph 7.4.4.

21. In relation to point (i) above, EDI&IP/SFC explained that a practice note was being prepared for the definition of incidental advice and this, when ready, would be passed to members’ for information and comments. The practice note would also be a subject of public consultation. He added that SFC had no intention to make any alteration on the exclusion of professionals from registration requirements in this regard and the practice note would only aim at clarifying what constituted activities “wholly incidental to the practice of the professions”.

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22. Concerning point (ii) of paragraph 20, EDI&IP/SFC said that the existence of certain unregulated parts of the market at present e.g. the over-the-counter derivatives activities by registered firms, had created an information gap in respect of dealings by professionals. In light of recent experience, justification that “professional dealings” posed minimal risk to the investing public, especially unsophisticated retail investors, had become less compelling. With the recent development of the market in complexity, the problem and possible systemic risks posed by this information gap had become more acute. Therefore, the SFC considered it necessary to acquire more information on these parts of the market in order to decide on the appropriate level of regulation required. He informed members that the type of information required by the SFC would vary according to the circumstances and characteristics of the particular part of the market being considered.

23. Upon Mr James TO’s request, the Administration undertook to provide members with an information paper on the “over-the-counter derivative activities”.

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(Post-meeting notes: The information papers on “Report of the surveys on the over-the-counter derivatives activities by registered firms” and “Core operational and financial risk management controls for over-the-counter derivatives activities of registered persons” were circulated to members on

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15 September 1999.)

24. Mr James TO also raised concern over the proposals to put the automated trading systems (ATSs) e.g. the tradings through internet, under SFC's regulation. DS/FS informed members that related proposals would be discussed at a later meeting of the subcommittee under a separate paper. She added that the rapid technological development of the market and the growing popularity of the ATSs were pressing for a set of new regulations and thus making the implementation of the reform proposals in the Bill a matter of urgency.

(Post-meeting notes: the proposals on the regulation of ATSs were discussed at the subcommittee meeting on 29 September 1999.)

25. EDI&IP/SFC supplemented that market participants operating the ATSs would welcome the SFC's regulation of their business as it would help increase investors' confidence in their services. He informed members that a set of guidance notes had been prepared on the nature and type of services provided through the internet to be regulated and would be available for interested members' information.

26. Before concluding, the Administration undertook to provide a comparison of licensing regimes of overseas jurisdictions for members' information.

(Post-meeting notes : the information paper was circulated to members on 15.9.1999.)

III Any other business

Future Meetings

27. Members enquired about the topics to be covered and the major purpose of the coming subcommittee meetings. The Administration clarified that all the new reform proposals of the Bill would be presented under separate information papers for members' information and comments in the coming meetings. The major purpose of these meetings was to give members an overview of the Bill as well as to invite members' initial feedbacks on the reform proposals, in particular the objectives and the policy issues relating to the Bill.

28. In response to Mr Albert HO's request for a comprehensive presentation on the responses collected from members of the industry concerning the reform proposals, DS/FS undertook to provide in more detail the market responses received during the consultation exercise under the respective reform proposals in the coming subcommittee meetings.

29. In view of the lengthy discussion required for the proposals at this meeting, the

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Chairman proposed and members agreed that two additional sessions of the subcommittee meeting would be scheduled for 28 September 1999 (Tuesday) at 2:30 pm and 4:30 pm.

Date of Next Meeting

30. The next meeting would be held on 16 September 1999 (Thursday) at 2:30 pm.

(Post-meeting note: the meeting was cancelled due to the passage of a typhoon and the second meeting of the subcommittee was held on 24 September 1999.)

31. There being no other business, the meeting ended at 12:45 pm

Legislative Council Secretariat

14 December 1999