

**立法會**  
**Legislative Council**

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(These minutes have been seen  
by the Administration and  
cleared by the Chairman)

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**Subcommittee on  
Securities and Futures Bill**

**Minutes of meeting  
held on Tuesday, 11 April 2000, at 2:30 pm  
in Conference Room A of the Legislative Council Building**

- Members present** : Hon Ronald ARCULLI, JP (Chairman)  
Hon Eric LI Ka-cheung, JP  
Dr Hon Philip WONG Yu-hong  
Hon Jasper TSANG Yok-sing, JP  
Hon Ambrose LAU Hon-chuen, JP
- Members absent** : Hon Albert HO Chun-yan (Deputy Chairman)  
Hon James TO Kun-sun  
Hon SIN Chung-kai  
Hon FUNG Chi-kin
- Public officers attending** : Miss AU King-chi, JP  
Deputy Secretary for Financial Services  
  
Mr CHAN Yum-min, James  
Principal Assistant Secretary for Financial Services  
  
Miss Emmy WONG  
Assistant Secretary for Financial Services
- Attendance by invitation** : Mr Mark DICKENS  
Executive Director, Securities and Futures  
Commission

Mrs Alexa LAM  
Chief Counsel, Securities and Futures Commission

Mr Anthony WOOD  
Senior Counsel, Securities and Futures Commission

**Clerk in attendance :** Ms LEUNG Siu-kum, Chief Assistant Secretary (1)4

**Staff in attendance :** Mr KAU Kin-wah, Assistant Legal Adviser 6  
Ms Rosalind MA, Senior Assistant Secretary (1)6

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## **I Meeting with the Administration**

The Deputy Secretary for Financial Services (DS/FS) drew members' attention to the proposed work schedule for the Subcommittee (LC Paper No CB(1)1346/99-00(01)) and sought members' views on the Administration's proposal of covering the major issues in the Consultation Document in four meetings. Members agreed that the Subcommittee would follow the proposed work schedule for discussion at the coming meetings. However, in view of the complexity of the Securities and Futures White Bill (the Bill), members opined that more time would be required for a thorough study on the Bill. At this stage members could only give their initial comments on the proposals.

### Briefing on Parts I to III and XII of the Bill - preliminary, Securities and Futures Commission, market operators and investor compensation

2. DS/FS said that Part I of the Bill provided for definitions and Part II provided for the operations of the Securities and Futures Commission (SFC) and its constitutional framework. She highlighted the following three changes in Part II of the Bill for members' reference -

- (i) a new clause 4 setting out the regulatory objectives of the SFC;
- (ii) a new provision in clause 6 setting out the general duties of the SFC; and
- (iii) clause 10 dealing with the delegation and sub-delegation of SFC's functions. This clause essentially re-enacted section 9 of the Securities and Futures Commission Ordinance. Part 2 of Schedule 2 to the Bill specified the non-delegable powers and functions of SFC. The list of non-delegable functions had been greatly expanded so as to encompass matters of broad market

impact and any functions which involved consultation with the Financial Secretary.

3. DS/FS went on to brief members on Part III of the Bill which dealt with market operators who provided exchange and/or clearing functions for transactions in securities and futures contracts. The proposals in the Bill largely retained the features of the existing regulatory framework, with new elements in extending its coverage to Automated Trading Services (ATS) and setting up a framework for new investor compensation arrangements through investor compensation companies (ICCs). She drew members' attention to the key features of the proposed regulatory framework as set out in paragraph 3.3 of the Consultation Document. These included the recognition of an exchange company, a clearing house or an ICC by SFC; the statutory duty and immunity of the recognized companies; the rule-making powers of the SFC for regulation of the recognized companies in discharging their functions; the transfer of regulatory functions from the SFC to recognized exchange companies or ICCs with the approval of the Chief Executive in Council (CE in Council); the authorization of ATS as well as a number of safeguards which allowed the SFC to ensure proper regulation of the recognized companies. For regulation of ATS, DS/FS said that the Bill adopted a flexible and pragmatic approach to cater for different kinds of ATS operations. Providers of ATS would either be licensed as an intermediary under Part V or authorized like other recognized companies operating in the market under Part III of the Bill.

4. As regards Part XII of the Bill which covered investor compensation, the Executive Director of Supervision of Markets/Securities and Futures Commission (ED/SM) advised that the main objectives of the new compensation proposals were to provide a "per investor level" of compensation; to make compensation arrangements through a new and independent entity representing the interest of the industry and public; and to protect as well as leverage existing compensation fund assets. DS/FS also advised that a new investor compensation fund would be established. She highlighted salient points regarding the new compensation proposals as follows -

- (i) On sources of funds for compensation, the remaining funds in existing compensation funds, namely, the Unified Exchange Compensation Fund (UECF) for the Stock Exchange of Hong Kong (SEHK) and the Commodity Exchange Compensation Fund (CECF) for the Hong Kong Futures Exchange (HKFE) would be transferred to the new investor compensation fund. The Administration would explore the possibility of introducing an insurance policy to increase protection for investors regarding the excess risk beyond the coverage of the new compensation fund. The proposed framework also allowed for the establishment of a back-up credit facility that might be repaid by the institution through a market levy.

- (ii) On the scope of compensation, the SFC in consultation with the Financial Secretary would make rules to prescribe the various circumstances under which investor compensation would be available.
- (iii) On the level of compensation, a "per investor" compensation limit would be prescribed by the CE in Council in place of the existing arrangement of a "per broker" compensation limit.

5. ED/SM supplemented that at present, the balance of UECF and CECF was \$290 million and \$90 million respectively. They would be transferred to the new investor compensation fund after satisfying outstanding claims. Part of this new fund might be used to pay for the premiums of an insurance policy to be introduced to cover the excess risk. The SFC had already initiated discussions with the Hong Kong Exchange and Clearings Limited (HKEx) on the new investor compensation proposals, given the need to reach suitable arrangements with the underwriters and exchange participants in time for the proposals to be implemented as soon as possible after the Bill was enacted.

6. On the regulation of ATS, ED/SM said that the Bill provided a flexible framework to cope with the fact that individual ATS could operate very differently, depending on factors like accessibility, target investor group, product range, etc. The SFC was in the process of developing draft guidelines for discussion with the industry on the regulation of ATS. The SFC would take into account market comments in past consultation exercises and experience of overseas regulators in the course of drafting the guidelines.

#### Discussion with members

##### *Effectiveness and transparency of the proposed regulatory regime*

7. Mr Eric LI said that there was an international trend for regulators to simplify the licensing and regulatory regime so as to reduce compliance cost and increase their competitiveness in the global market. However, the proposed reform of the regulatory regime in the Bill was only moving a small step towards this direction. He sought information on how the proposals would help the securities and futures industry in Hong Kong to compete with its counterparts in overseas markets and whether the proposed regime could achieve cost-effectiveness by simplifying the regulatory framework and reducing regulatory overlap. The Chairman shared his concern over the cost-reducing capability of the new proposals and asked whether the Administration had received comments from the industry in this respect.

8. DS/FS responded that the Administration did make reference to the practice in overseas jurisdictions in drafting the proposals in the Bill. Nevertheless, taking into consideration the different market structures and the

unique circumstances in Hong Kong, it would not be advisable to apply the overseas regulatory framework directly to Hong Kong. To achieve cost-effectiveness in regulation, the Bill had proposed a single licence system which would relieve the administrative burden of both the intermediaries and the regulator. She advised that this reform of streamlining the licensing regime was welcomed by market participants. Besides reducing operating cost and administrative burden of the intermediaries, the new licensing regime would also enable them to provide one-stop service to their clients for different investment products more readily. To further increase the competitiveness of Hong Kong in the international market, the notion of continuous training was introduced in the Bill. This served to upgrade the standard of services provided by the licensed persons and was important to the competitiveness of Hong Kong in the international financial market.

9. On minimizing regulatory overlap, DS/FS pointed out that the Bill provided for an exemption mechanism whereby authorized financial institutions (AIs) would be exempted from the need to be licensed. The exemption was intended to minimize regulatory overlap given that exempt AIs would be subject to closer supervision by the Hong Kong Monetary Authority (HKMA). Consistency in regulatory standards would be maintained through revised Memorandum of Understanding (MOU) between the SFC and HKMA. In addition, the Bill provided for the SFC to transfer its regulatory functions to recognized exchange companies or ICCs with the approval of the CE in Council. This transfer mechanism also aimed at minimizing regulatory overlap between the SFC and these recognized companies.

10. Mr Eric LI commented that given the complexity of the reform proposals, the SFC should improve its transparency and communication with the industry. He suggested that this should be done through revising the composition of the existing advisory bodies. He pointed out that as members of the advisory bodies under the SFC were all appointed in their personal capacity, they were not able to solicit views from the industry formally and the communication between the market participants and the SFC had been inadequate. He requested the Administration to make reference to the practice in overseas jurisdictions and to establish a consultative committee of market intermediaries made up of members elected from the industry. The Chairman concurred that advisory committee members appointed in personal capacity might not be ready to criticize the regulator.

11. DS/FS advised that the SFC had frequent and regular communications with the various organizations in the securities and futures industry, as well as market participants at different levels. It was also the SFC's practice to consult the market whenever new policies or guidelines were proposed. To enhance better communication with the industry, ED/SM undertook to consider members' suggestion.

*Investor Compensation*

12. The Chairman sought information on the operation of the ICC and the reason for having the provisions in clause 78 which empowered the SFC to transfer its investor compensation functions to one or more ICCs. He asked whether more than one ICC would be required for the management of the compensation fund under the proposed compensation framework.

13. ED/SM said that Part III of the Bill provided that the SFC might, after consultation with the Financial Secretary, recognize one or more ICCs to facilitate the management and administration of the new compensation fund. The SFC might request the CE in Council to transfer part of its investor compensation functions to one or more ICCs. The transferable functions included maintenance of the fund covering both payments to and out of it, keeping of accounts, etc. The SFC, however, might resume responsibility over any function so transferred under certain specified circumstances. The ICCs might promulgate rules and operational procedures that would be subject to the SFC's approval before implementation. As to the number of ICCs to be recognized, he said that the legal provisions in this regard aimed at providing a broad framework which would allow for the management of the compensation fund by one or more companies depending on operational needs. He explained that the compensation scheme might operate with one ICC managing compensation arrangements for the whole industry with different sub-accounts for different types of products. It might be possible as well for recognition of different ICCs in different parts of the industry, thus requiring the recognition of more than one ICCs. The number of ICC required would depend on the needs of the market rather than any preference on the part of the regulator.

14. On the merging of the two existing investor compensation funds, i.e. the UECF and the CECF, the Chairman enquired whether it would be more appropriate to consider this after the newly established HKEx had operated for a longer period of time. ED/SM replied that the matter was being considered by the HKEx at its senior management level but no decision had been made at this stage. The Bill provided for flexibility to enable the continued operation of the two funds separately while preserving the possibility of merging them eventually.

15. The Chairman further enquired whether the provisions in the Bill could accommodate all the possible changes in the structure of the HKEx, the number of compensation funds and the number of recognized ICCs. ED/SM said that the framework provided for in the Bill was flexible enough to accommodate the existence of one or more recognized exchange companies, compensation funds and recognized ICCs.

16. The Chairman sought information on the proposed introduction of an insurance policy covering the excess risk. He asked whether the SFC, the

HKEx or the recognized ICCs would be responsible for deciding on the need for an insurance policy and the level of insurance coverage required. ED/SM explained that an outline for the investor compensation proposal was given in the Consultation Document. There would be a "per investor" compensation limit set for the scheme and calculation would be based on the likelihood of the excess risk requiring payment of claims beyond the capacity of the existing compensation funds. The excess risk would be covered by an insurance policy with premiums funded by the monies in the new investor compensation fund. An introduction of a back-up credit facility that might be repaid by the institution of a market levy would also be considered. As to the decision on the need for the insurance policy and the suitable level to be introduced, he said that the SFC was in the process of consulting the HKEx on the compensation arrangements with a view to arriving at a mutually agreeable decision. With the establishment and recognition of the ICCs, the decision on insurance and compensation arrangements would be left to the ICCs in consultation with the SFC.

17. In response to the Chairman's enquiry on the linkage between the proposed insurance policy and the depositor insurance fund for the banking industry, ED/SM said that these were two different schemes covering the risks of investors of the securities and futures industry and depositors of banks respectively. For exempt AIs, only the business within their securities and futures division would be considered under the proposed investor compensation scheme.

18. The Chairman suggested that the compensation framework should allow for the provision of a voluntary insurance layer on top of the statutory layer as this would help to provide a level playing field for intermediaries with different scales of business. ED/SM said that the SFC would try to achieve the provision of voluntary insurance packages at more favorable terms through its negotiation with underwriters. However, this would merely be a commercial arrangement between the intermediaries and the insurance companies and would not be a requirement in the legislation.

#### *Transfer of regulatory functions and exemption of AIs*

19. Mr Eric LI sought information on the operation of the exemption mechanism applicable to AIs and the transfer of regulatory functions to recognized exchange companies or ICCs stipulated in paragraphs 2.19 and 3.3(d) of the Consultation Document respectively. He expressed concern over the adequacy of legal backing for the taking over of supervision on exempt AIs by the HKMA as well as for the transfer of SFC's regulatory functions to recognized companies.

20. DS/ES said that both the exemption and the transfer of regulatory functions arrangements aimed at reducing regulatory overlap. As to the

regulatory regime for exempt AIs, she informed members that a more detailed briefing would be given at the next Subcommittee meeting scheduled for 14 April 2000. In brief, clause 5 of the Bill provided for the reliance by the SFC in whole or in part on the supervision of exempt AIs by the HKMA. The HKMA would continue to take up the day-to-day supervision of the securities divisions of exempt AIs from the SFC for avoidance of regulatory overlap. In relation to the transfer of SFC's regulatory functions to recognized exchange companies and ICCs, she referred members to clauses 26 and 78 of the Bill. The clauses empowered the SFC to request the CE in Council to transfer certain regulatory functions of the SFC to recognized exchange companies or ICCs through transfer orders, if the SFC was satisfied that the designated companies were willing and able to perform the functions. The transfer orders would be laid before the Legislative Council and such transferred functions could be resumed by the SFC through orders by the CE in Council.

21. Mr Eric LI expressed concern about the transparency and accountability of those recognized companies which had assumed the functions transferred by the SFC. He suggested that the transfer orders be made in the form of subsidiary legislation so as to ensure that market participants and the public would have prior knowledge of the transfer and channels to express their views. Moreover, he proposed that amendments to clauses 26 and 78 could be made to the effect that public consultation would be required before the transfer of SFC's functions to any recognized company. The Chairman commented that it was rather uncommon to stipulate the requirement for public consultation in the legislation. He also opined that the transfer of regulatory functions to the ICCs would be rather straightforward since the functions of the ICCs focused only on investor compensation.

22. ED/SM informed members that the SFC had transferred its regulatory functions to a recognized exchange company only on one occasion, i.e. the transfer of the regulatory functions on listed companies to the SEHK. The SFC had conducted adequate public consultation to collect market views on the transfer despite the absence of any legal requirement for public consultation. Moreover, the MOU signed between the SFC and the SEHK enabled the former to monitor the standard of supervision by the latter, with power to resume the regulatory functions if the latter failed to meet the set standard. In response to Mr LI, DS/ES undertook to clarify that the transfer orders under clauses 26 and 78 would be made in the form of subsidiary legislation. She said that the Administration would conduct public consultation on issues of widespread concern to the market even there was no legal requirement in this respect. In response to the Chairman's comment on the transfer of functions to the ICCs, she agreed that the transfer should not be a complicated matter. Moreover, the SFC retained the power to make rules which the ICCs had to act in accordance with.



*Automated Trading Services (ATS)*

23. The Chairman sought information on the proposed regulation of ATS under the Bill. He pointed out that it would be difficult for the regulator to take enforcement actions against offshore providers of ATS who traded Hong Kong stocks through the internet. ED/SM explained that clauses 94 to 99 of the Bill specifically dealt with the regulation of ATS. The proposed legal framework should be wide enough to cover transactions or activities conducted through different media, including electronic media. The legislation would also extend to all activities which was targeted at Hong Kong investors, regardless of whether these were conducted locally or in overseas jurisdictions.

24. On the enforcement of legislation in relation to offshore ATS, ED/SM said that the SFC had entered into MOUs with over 40 overseas regulators. In the event of market misconduct or manipulation carried out offshore which affected the Hong Kong stock market, the SFC could seek assistance from its counterpart in the country concerned in accordance with the MOU signed between them. The overseas regulator would gather evidence on behalf of SFC and SFC would carry out prosecution or take appropriate disciplinary actions. For those offshore ATS providers who were licensed by their local regulators, the SFC could inform its counterpart of the breach of Hong Kong law by the providers and the regulators concerned would be able to take actions in accordance with the licensing conditions which required the licensed persons to be "fit and proper". However, if there was no MOU between the SFC and the regulator of the relevant jurisdiction, it would be difficult for the SFC to pursue any enforcement actions against the abusive conducts of ATS providers. This was a common problem all regulators around the world were facing and it was not the objective of this Bill to provide a solution to this problem. Noting the practical difficulties in the enforcement against offshore ATS providers, Mr Eric LI and the Chairman opined that to enhance investor protection, the Administration should strengthen the education programmes for investors on the risks involved in trading through ATS.

25. In response to the Chairman's enquiry on the definition of "fit and proper" in the Bill, DS/FS said that clause 126 provided the criteria for "fit and proper". ED/SM supplemented that the licence applicant was required to declare in the application form whether he had committed an offence or was subject to any disciplinary actions by regulators in and outside Hong Kong.

26. As the SFC could authorize ATS providers to operate a stock market as an exchange, the Chairman doubted how the monopoly of the HKEx would be preserved. ED/SM explained that the provisions regarding the statutory monopoly of the HKEx under the existing legislation would be preserved and reproduced in the Bill. Any person who wished to provide ATS which operated as an exchange would be required to operate in the office of an exchange participant of the HKEx. DS/FS added that clause 20 stipulated the

monopoly of the HKEx while the authorization of ATS and the requirement for an ATS provider to operate in the office of an exchange participant of the HKEx before operating as an exchange were set out in clauses 94 and 117. She said that the Administration had promised to preserve the monopoly of the HKEx in the course of consulting the industry on the proposal of merging the two exchange companies and three clearing houses. This statutory monopoly would be important for the newly established HKEx to strengthen its position in competing in the international financial market.

27. The Chairman sought information on the existence of similar monopoly in other overseas jurisdictions and the way the HKEx would monitor ATS providers as its exchange participants. ED/SM said that similar monopoly usually existed in smaller markets. There was no market monopoly in the United Kingdom, United States and Australia. The HKEx could monitor its exchange participants in a number of possible ways such as requesting them to provide transaction reports. It would be a matter of commercial arrangements between them.

28. Responding to the Chairman's enquiry on ATS providers operating other than as a stock exchange, ED/SM said that there were various kinds of ATS operations. For example, some ATS would operate in the form of bulletin boards. The definition of ATS was wide enough to cover different types of services including dealings in derivative products. These ATS providers would not be required to operate in the office of an exchange participant as the HKEx only had monopoly on the operation of stock market in Hong Kong but not futures market.

## **II Any other business**

### Dates of future meetings

29. Members agreed to schedule four more meetings for discussion of the Bill as follows-

Thursday, 27 April 2000 at 8:30 am;  
Friday, 28 April 2000 at 8:30 am;  
Tuesday, 2 May 2000 at 4:30 pm; and  
Wednesday, 3 May 2000 at 8:30 am.

*(Post-meeting note: To avoid clash with the workshops on the Bill organized by the SFC for market participants, members agreed to cancel the meetings scheduled for 2 and 3 May 2000. Another meeting would be held on Tuesday, 20 June 2000 at 10:45 am to receive oral presentation from deputations.)*

30. There being no other business, the meeting was adjourned at 4:30 pm.

Legislative Council Secretariat  
3 October 2000