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**Subcommittee on
Securities and Futures Bill**

**Minutes of meeting
held on Friday, 14 April 2000, at 3:30 pm
in Conference Room A of the Legislative Council Building**

- Members present** : Hon Albert HO Chun-yan (Deputy Chairman)
Hon Eric LI Ka-cheung, JP
Hon SIN Chung-kai
Hon Jasper TSANG Yok-sing, JP
Hon Ambrose LAU Hon-chuen, JP
Hon FUNG Chi-kin
- Members absent** : Hon Ronald ARCULLI, JP (Chairman)
Hon James TO Kun-sun
Dr Hon Philip WONG Yu-hong
- Public officers attending** : Miss AU King-chi, JP
Deputy Secretary for Financial Services

Miss Emmy WONG
Assistant Secretary for Financial Services
- Attendance by invitation** : Mr Andrew PROCTER
Executive Director of Intermediaries and Investment
Products, Securities and Futures Commission

Mr Paul BAILEY
Executive Director of Enforcement, Securities and
Futures Commission

Mr Stephen TISDALL
Legal Consultant, Securities and Futures
Commission

Mrs Alexa LAM
Chief 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

I Meeting with the Administration

Introduction on Parts V, VI, VII, IX and XI of the Securities and Futures Bill (the Bill)

The Deputy Secretary for Financial Services (DS/FS) gave a brief introduction on the parts of the Bill to be covered at this meeting. She said that Parts V to VII of the Bill consisted of provisions relating to the new licensing regime. The principal objectives of the proposals under the new licensing regime were to establish a streamlined framework that minimized costs for intermediaries; to set appropriate standards for intermediaries to meet the challenges of the competitive international financial market; and to provide equal and fair access to all suitably qualified applicants for a licence. In order to facilitate a smooth transition to the new licensing regime, a two years' transitional period would be allowed for the existing registrants to complete their applications under the new regime. Amongst the new proposals under the new regime, DS/FS drew members' attention to the proposed regulatory regime for exempt authorized financial institutions (AIs). To minimize regulatory overlap, it was intended that the Hong Kong Monetary Authority (HKMA) would remain to be the frontline regulator in respect of the activities regulated by the SFC ("regulated activities") of the AIs. The Securities and Futures Commission (SFC) and HKMA would maintain close liaison and update the present Memorandum of Understanding (MOU) in the light of the new regulatory framework. This arrangement would provide investor protection through effective regulation of AIs, and at the same time level the playing field between AIs and corporations licensed by the SFC.

2. DS/FS went on to introduce members to Parts IX and XI of the Bill, which covered disciplinary sanctions against improper conduct by intermediaries and the proposal of establishing a Securities and Futures Appeals Tribunal (SFAT) respectively. She said that Part IX empowered the

SFC to impose disciplinary sanctions on intermediaries in a more proportionate and flexible manner. Part XI provided for the establishment of the SFAT as part of the mechanism of checks and balances to hear appeals against a wide range of the SFC's decisions.

Parts V to VII of the Bill - the new licensing regime

3. The Executive Director of Intermediaries and Investment Products/Securities and Futures Commission (ED/I&IP) briefed members on the proposals for the new licensing regime. He highlighted the main features in the proposals as follows-

- (i) A single licence system was introduced in the Bill. Under the new regime, market intermediaries would only need one single licence to engage in "regulated activities" instead of the present requirement of separate registrations for undertaking different activities in different products. Essentially, two types of licences would be granted to corporations and their representatives in the form of corporate licences and representative licences. Individuals, sole-proprietorships and partnerships would not be granted corporate licences to carry out "regulated activities" under the new regime. However, transitional arrangements would be made for the existing registrants who were not corporations to comply with the requirements of the new regime. The SFC would maintain a register of licensed persons and exempt persons with information such as their names and addresses and conditions of the licences and exemptions. The register would be made available for public inspection (clause 131).
- (ii) As regards exemptions, clause 118 of the Bill empowered the SFC to exempt AIs from the licensing requirement. This exemption proposal would build on the existing arrangements, whereby HKMA should remain the frontline regulator for all AIs. The Bill would provide HKMA with the power for the day-to-day supervision of the "regulated activities" conducted by exempted AIs. Where necessary, amendments to the Banking Ordinance would be proposed to enhance HKMA's supervision over AIs. The new framework would be underpinned by a revised MOU to be drawn up between SFC and HKMA. The Bill also proposed revised arrangements for exemptions and exclusions for trustee companies. Trustee companies would only be excluded from the licensing requirement if the advisory activities which they carried out were wholly incidental to their overall trustee business. As for other exempt dealers under current legislation, the Bill no longer rendered them eligible to apply for such exempt status.

- (iii) A "management responsibility" concept was introduced in the Bill for enhancing investor protection. By this proposal, each intermediary had to nominate at least two "responsible officers" for approval by the SFC. The "responsible officers" as well as the corporation itself were liable for breaches by the corporation of certain fundamental regulatory requirements.
- (iv) There were new provisions in the Bill empowering the SFC to grant temporary and provisional licences to applicants. Temporary licences would be granted to facilitate overseas corporations and their employees that were licensed by competent overseas regulatory authority in working in Hong Kong on short or temporary assignments. Provisional licences would be issued to an applicant in the event that nothing adverse about him was known to the SFC and he could satisfy the SFC's education and experience requirements.

Discussion with members on Parts V to VII of the Bill

Administrative arrangements in licensing

4. Mr SIN Chung-kai opined that the requirement of publishing names of licensed persons and exempt persons in the Gazette stipulated in clause 132 was out-dated. He urged the SFC to consider making a statutory requirement to publicize this information through the Internet. ED/I&IP responded that the SFC shared Mr SIN's concern of making good use of modern technology to provide an up-to-date register for public scrutiny. As a matter of fact, the SFC was publishing the register on its web site and would maintain this practice under the new licensing regime. Nevertheless, it was a formal requirement to publish the information in the Gazette under the current law. Given the fast-changing technology advancement, it would not be appropriate to include in the legislation provisions requiring disclosure of information by means of present technological devices as the provisions would become too rigid and would be unable to accommodate new changes.

5. In response to Mr Eric LI's enquiry on the estimated level of licence fee under the new regime, DS/FS said that the estimated fee level was not available at this stage of consultation. However, with the streamlining of the licensing regime, it was anticipated that the regulatory system would be more cost-effective and the applicants should be able to benefit with a lower cost. ED/I&IP added that the single licence concept under the new regime would enable registrants to engage in a number of different "regulated activities" through one corporate vehicle. As a result, costs and administrative burdens would be reduced for both the intermediaries and the regulator. Moreover,

this resulting benefit did not come at the expense of compromising the protection for the investors.

Requirements on registrants

6. Referring to paragraphs 5.16 to 5.18 of the Consultation Document on the entry criteria to be met by an applicant for a licence, Mr Eric LI doubted whether these criteria would be more restrictive than the present ones. He expressed concern about whether the new criteria would pose any difficulties to existing intermediaries in continuing their work in the industry.

7. DS/FS responded that it was of the utmost importance that the standard of intermediaries in Hong Kong could be maintained at a high level in order to compete with other major markets. With advances in information technology and communications, geographical distances had become insignificant. Instead, the competency of intermediaries was increasingly vital to the growth and development of the local market and, ultimately, to its competitiveness in the international arena. ED/I&IP added that there was no additional competence requirement under the new regime. The requirements under the Bill were actually those implied in the present law and they were only being spelt out explicitly in the Bill. The basic test of "fitness and properness" remained unchanged. The licensing provisions in the Bill would not make it more difficult for an applicant to get a licence.

8. Mr FUNG Chi-kin expressed concern over the "management responsibility" concept and the requirement for continuous training under the Bill. He opined that people might be unwilling to accept the appointment as "responsible officers" of an intermediary because of the liability for breaches of regulatory requirements by the corporation. As to the requirement for continuous training, he sought information on the practical arrangements such as courses to be offered by the SFC and expressed concern about the possibility for existing licensed intermediaries to have their licences revoked if they fail to meet this requirement.

9. DS/FS explained that the "management responsibility" concept was introduced because it would be inadequate for the SFC to rely solely on its day-to-day supervision of intermediaries to promote compliance at all times. As in other jurisdictions, the regulator also had to rely upon the senior personnel of the intermediaries to ensure compliance. There were defence provisions in clause 367 of the Bill for a "responsible officer" to prove that he honestly and reasonably believed that the corporation was in compliance, and he acted promptly in notifying the SFC of the relevant breach once it became known to him. As regards continuous training, ED/I&IP said that a flexible approach would be adopted by the SFC. Instead of setting standard requirements for all registrants, the SFC would take into consideration the need and circumstances of different corporations and individuals concerned. The SFC would provide guidance to the registrants on the requirements of continuous training and

would not impose tough sanctions like revocation of licence in the event of failure to comply with the requirements.

Registered persons and regulated activities

10. Mr FUNG Chi-kin said that market participants supported streamlining of the licensing regime in general but were concerned about the exact category of employees required to be licensed and the role of the Hong Kong Exchanges and Clearing Limited (HKEx) in overseeing the activities of the intermediaries. He further cited the example of a terminal operator in a securities company who was responsible for inputting transaction details and asked whether such terminal operator would need a licence under the new regime.

11. Regarding persons required to be licensed, ED/I&IP said that there were essentially two types of licence proposed in the Bill, namely, the corporate licence and the representative licence. An individual who performed or took part in any act which constituted a "regulated activity" was required to obtain a representative licence. A terminal operator in a securities company undertaking inputting duties would not be required to get a licence. He was not required to be licensed under the current law and would not be so required in the Bill. ED/I&IP stressed that there would not be any additional licensing requirements imposed under the new regime. The proposals in the Bill merely aimed at simplifying the licensing regime to relieve the administrative burden on both the registrants and the regulator. Nevertheless, the terminal operators had to seek relevant approval from the HKEx in accordance with the exchange rules. The SFC and HKEx would work together to facilitate the streamlining of licensing procedures.

12. With reference to "advising on securities " in point (d) under Part 1 of Schedule 6, Mr SIN Chung-kai asked whether those giving comments on stocks performance through the media or press would be considered as "advising on securities" and the requirement on disclosure of their interest in these stocks. ED/I&IP said that intermediaries giving advice on stocks through the press or media would be covered by the regulatory regime. There were provisions in clauses 159 and 160 of the Bill empowering the SFC to make Business Conduct Rules for compliance of intermediaries and their representatives when carrying on the "regulated activities". These Business Conduct Rules would spell out clearly the requirement for an intermediary or its representatives on the disclosure of their interests in the stocks which they were giving advice on.

13. The Deputy Chairman sought information on the measures adopted by the SFC in detecting improper conduct by the intermediaries and asked whether trading in commodities futures would be categorized as "regulated activity". ED/I&IP said that the intermediaries would be expected to comply with the rules and codes of the SFC. Non-compliance of these rules and

codes would be detected either through the reports from the public via the SFC hotline or the unusual dealing pattern that aroused the attention of the SFC during its course of supervision. As to the coverage of "regulated activities", he said that there were two kinds of regulated activities in relation to the trading of futures contracts, namely, advising on and dealing in futures contracts. Commodities futures were covered by the definitions of these two activities. Trading in foreign exchange was also one type of "regulated activities" under "trading in leveraged foreign exchange contracts" in Part 1 point (c) of Schedule 6.

Proposed regulatory regime for exempt AIs

14. In response to Mr FUNG Chi-kin's enquiry on the standard and qualification requirements of persons engaging in securities business in AIs, DS/FS said that in developing the new framework, the guiding principles of providing adequate investors protection, minimizing regulatory overlap and levelling the playing field had been followed. To ensure that the individuals within exempt AIs who dealt with securities transactions were fit and proper, the Administration was planning to amend the Banking Ordinance with a view to requiring exempt AIs to accredit employees to act on their behalf, to maintain records of such employees and to notify their names and addresses to the HKMA. The primary responsibilities would rest with the senior management of exempt AIs to ensure the fitness and properness of their employees. The HKMA would maintain a register of such employees and would make the register available for public inspection.

15. The Deputy Chairman doubted whether it was appropriate for the HKMA, instead of the SFC, to be the frontline regulator of the "regulated activities" of AIs. He expressed concern about the expertise of the HKMA in supervising such activities and whether HKMA would place its focus on the core business of the AIs with less attention paid to operations of their securities divisions. He agreed that there should be proper division of labour between the HKMA and the SFC to avoid regulatory overlap. Nevertheless, he opined that the SFC should remain the major regulator in securities and futures related field. He queried whether the HKMA was empowered to impose similar disciplinary sanctions as the SFC. Moreover, the different appeal systems under the two regulatory regimes might lead to confusion and unfairness.

16. DS/FS responded that in preparation for the proposed regulatory framework, the HKMA had planned to establish three supervisory teams for the securities divisions of exempt AIs. The Administration would also put forward relevant amendments to the Banking Ordinance with a view to maintaining consistent standards that were applicable to both exempt AIs and persons licensed by the SFC. As regards the co-ordination between the HKMA and the SFC, the HKMA would be required to make available its supervisory findings to the SFC in accordance with the MOU between them. While the HKMA would be responsible for the day-to-day supervision of the

securities divisions of AIs, the SFC would retain the statutory power of inquiry and exemption.

17. Mr FUNG Chi-kin supported the proposal of having a single regulator, i.e. the HKMA, for AIs conducting "regulated activities". He opined that from his past experience in the securities and banking sectors, banks generally had developed more formalized and stricter internal control systems in securities dealings compared with most of the smaller scale securities companies and investment houses under the regulation of the SFC. As far as he knew, the officers of the banks involving in securities dealings did obtain relevant qualifications to ensure their standard of services despite that they were not subject to licensing requirements. He said that the HKMA should have adequate expertise to take up the day-to-day supervision work and this would be a desirable arrangement for avoidance of regulatory overlap provided that the same regulatory standard would be adopted by the HKMA and the SFC.

18. Mr Eric LI concurred with Mr FUNG that the HKMA had the necessary expertise to supervise the securities business of exempt AIs. He opined that the HKMA had been maintaining close supervision over banks. While declaring his interest as the director and the chairman of the audit committee of a bank, he supported the proposal of a single regulator for AIs engaging in "regulated activities". He pointed out that this arrangement would reduce cost and time required for compliance by AIs. He sought clarification on whether the AIs would be exempted from the listing rules of the Stock Exchange of Hong Kong (SEHK) and measures to ensure consistent regulatory standards between the SFC and the HKMA.

19. DS/FS said that the exemption granted to AIs was only limited to the requirement for obtaining licences from the SFC. All listed companies, including exempt AIs listed on the SEHK, would have to adhere to the listing rules of the SEHK. As to the issue of maintaining consistency in regulatory standards between different regulators, she said that this would be achieved through their MOU, the Business Conduct Rules and the legislation. ED/I&IP added that the exempt AIs would still have to be subject to some statutory requirements relating to "regulated activities". For example, they would be subject to the requirements relating to the handling of clients' securities, the preparation of contract notes, receipts and statements of accounts, the keeping of accounts and records, as well as the Business Conduct Rules set out in Parts VI and VII of the Bill. However, they were not subject to those requirements under the Bill that related to the maintenance of financial resources, the handling of client money and auditing, as these were adequately covered under the Banking Ordinance.

Parts IX and XI of the Bill - discipline and Securities and Futures Appeals Tribunal

20. The Executive Director of Enforcement/ Securities and Futures Commission (ED/E) briefed members on Part IX of the Bill in relation to the disciplinary powers of the SFC. The principal objective of granting the SFC such disciplinary powers was to enhance investor protection by ensuring proper conduct of licensed intermediaries. In delineating the ambit of the SFC's disciplinary powers, consideration had been given to providing adequate safeguards to ensure that the SFC's disciplinary powers would be exercised fairly, transparently and consistently. To this end, Part IX built upon the SFC's existing disciplinary powers and introduced changes which aimed at enabling the SFC to discharge its regulatory functions more effectively without compromising high standards of procedural fairness. He highlighted the following proposals in the Bill for members' consideration:

- (i) A broader range of sanctions was made available to the SFC under clause 180 of the Bill. The SFC was empowered to impose fines on licensed persons and corporations with a maximum level of \$10 million or three times the profit made or loss avoided as a result of the misconduct. It was also empowered to impose partial suspension or partial revocation of licence, prohibition orders and revocation of exempt status.
- (ii) In order to fill the existing disciplinary gaps, two further powers were conferred on the SFC under clauses 186 and 187. Clause 186 gave the SFC the explicit power to enter into negotiated settlements with persons proposed to be disciplined. Clause 187 empowered the SFC to issue incidental directions to require persons concerned to transfer to their clients such records relating to client assets or other affairs as the SFC might reasonably specified. These powers enabled the SFC to discharge its disciplinary functions more effectively.
- (iii) To provide for adequate checks and balances on the disciplinary powers of the SFC, the Bill provided for a fair and transparent disciplinary decision-making process, based on the process in the existing legislation. The proposed independent Process Review Panel would also provide an additional safeguard in this regard.

21. The Chief Counsel of Securities and Futures Commission (CC/SFC) said that Part XI of the Bill proposed to establish a statutory Securities and Futures Appeals Tribunal (SFAT) which would have the jurisdiction to review a wide range of the SFC decisions that might affect a person's rights or interests. Apart from preserving the existing checks and balances on the SFC's use of its

powers in the current system, under the proposed SFAT, the scope of merits review would be broadened. It would be headed by a full-time judge, assisted by two lay members selected on account of their expertise in relevant fields. The jurisdictions of the SFAT would be expanded beyond that of the existing Securities and Futures Appeals Panel (SFAP). Schedule 7 of the Bill set out a list of SFC decisions appealable to the SFAT. In response to the comments received during the July 1999 public consultation, the proposals in Part XI had been improved. First, the appeal period had been extended from 14 days to 21 days. Second, a person who was the subject of a SFC decision could apply to the SFAT for a stay of execution of that decision pending determination of an appeal.

22. Mr Eric LI said that at present, the SFC appeared to be more reserved in imposing severe sanctions, such as revocation of licence, on large size intermediary corporations than on those smaller size ones. Although it was understandable that the SFC had to take into consideration the market and public impact in revoking the licence of large size corporations, he raised doubts on the effectiveness of SFC's disciplinary sanctions on large size corporations and sought information on the possible measures to reduce the impact of revoking the licences of the corporations concerned on innocent third parties.

23. DS/FS said that the review of the existing disciplinary powers had suggested the need for making available a wider range of disciplinary sanctions. The Bill therefore proposed to provide more proportionate sanctions under the new regulatory regime. For example, the provision for partial suspension or revocation of an intermediary's licence in respect of part of its business was a less drastic sanction than a full suspension or revocation. It would allow the intermediaries concerned to continue with part of its business. The new sanctions under the Bill would be applicable to both large and small size intermediaries and the SFC would ensure fairness in disciplinary sanctions imposed on intermediaries regardless of their sizes. ED/E said that the SFC was mindful of the impact of revoking the licences of the corporations. The Securities (Margin Financing) (Amendment) Ordinance had already included measures like orderly winding down or temporary taking over of business of the intermediaries in order to reduce harm to innocent third parties.

24. In response to the Deputy Chairman's question about the appeal channel for exempt AIs, CC/SFC said that a list of excluded decisions of the SFC was given under Part 3 of Schedule 7 of the Bill. Most of the decisions on the list were related to exempt AIs and for these excluded decisions, the AIs concerned would have to appeal to the Executive Council instead of to the SFAT. However, the SFC was responsible for inquiry and investigation of misconduct of exempt AIs despite that the day-to-day supervision would be done by the HKMA.

25. While supporting the establishment of the SFAT with extended jurisdiction on a wider range of SFC decisions, Mr Eric LI suggested that the legislation should stipulate the time limit for the SFAT to conduct the first hearing upon receipt of an appeal. He pointed out that delays in commencement of hearings would be unfair to the appellant. He said that the practice of setting time limit on commencement of hearings was found in other tribunals. If this could not be provided for in the legislation, it should be stated at least in the form of performance pledge. Mr FUNG Chi-kin shared his view and opined that given the volatile nature of securities and futures products, any delay in the processing of appeal cases might involve high financial risks or losses on the part of the appellants. Therefore, appeal cases should be handled by the SFAT urgently.

26. CC/SFC agreed that appeal cases should be handled urgently without delay. She said that the existing SFAP, manned by part-time judges as chairman and deputy chairman, did not have adequate resources to handle a large caseload and hence resulted in a long time gap between the lodge of an appeal and the commencement of the hearing. The establishment of the SFAT headed by a full-time judge and provided with its own registry was proposed to address this problem and to improve efficiency of the appeal mechanism. While it would be inflexible to have the time limit for the commencement of hearing stipulated in the legislation, it was considered more important to put in place a mechanism that would allow the SFAT to speed up the process of appeal. The provision of the SFAT's power to conduct preliminary hearings and to serve preliminary orders in the Bill would help to achieve efficiency of the appeal mechanism in general. DS/ES said that the Administration would make reference to the practices in other appeal tribunals and consider suitable measures in setting target for commencement of hearing in appeal cases.

II Any other business

Date of future meetings

27. Members agreed that subject to consultation with the Chairman, the meetings scheduled for 2 and 3 May 2000 would be cancelled to avoid clash with the workshops on the Bill organized by the SFC for market participants. Members agreed to continue scrutiny of the major proposals of the Bill in accordance with the proposed work schedule (LC Paper No CB(1)1346/99-00(01)) at the meetings scheduled for 27 and 28 April 2000. Further meetings would be scheduled for around mid June 2000 to consider market responses to the Consultation Document.

(Post-meeting note: With the Chairman's agreement, the meetings scheduled for 2 and 3 May 2000 were cancelled.)

28. The next meeting would be held on Thursday, 27 April 2000, at 8:30am.
29. There being no other business, the meeting adjourned at 5:45pm.

Legislative Council Secretariat
25 September 2000