

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 Tuesday, 28 September 1999, at 2:30 pm
in Conference Room B of the Legislative Council Building**

- Members present** : Hon Ronald ARCULLI, JP (Chairman)
Hon Albert HO Chun-yan (Deputy Chairman)
Hon Eric LI Ka-cheung, JP
Hon Christine LOH
Hon SIN Chung-kai
Hon Jasper TSANG Yok-sing, JP
Hon Ambrose LAU Hon-chuen, JP
Hon FUNG Chi-kin
- Member absent** : Hon James TO Kun-sun
Hon Ambrose CHEUNG Wing-sum, JP
Dr Hon Philip WONG Yu-hong
- Public officers attending** : Miss AU King-chi, JP
Deputy Secretary for Financial Services
- Mr Mark DICKENS
Executive Director of Supervision of Markets
Securities and Futures Commission
- Mr Andrew PROCTER
Executive Director of Intermediaries and Investment Products
Securities and Futures Commission

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Mrs Alexa LAM
Chief Counsel of Securities and Futures Commission

Mr James CHAN Yum-min
Principal 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 Briefing by the Administration

Enhancing Inquiry Powers into Listed Companies
(LC Paper No. CB(1) 1867/98-99(05))

Executive Director of Supervision of Markets/Securities and Futures Commission (EDSM/SFC) briefed members on the information paper which outlined the proposed changes to Section 29A of the Securities and Futures Commission Ordinance (SFCO) in enhancing the power of the Securities and Futures Commission (SFC). Under the proposed changes, SFC was empowered :

- (i) to ask for an explanation as to the circumstances, reasons and instructions for making an entry in the books and records of a listed company;
- (ii) to inquire with parties that have a contractual relationship with the listed company under inquiry to confirm and verify entries in that company's books and records;
- (iii) to seek access to an auditor's working papers but subject to an additional certification that the SFC has imposed a requirement on the listed company to produce its books and records; and
- (iv) to gain access to bank records of a listed company subject to the same certification as in (iii) above.

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2. Members noted that while enhancing the power of SFC in inquiry of listed companies, the Administration would ensure that SFC's power would be complemented with adequate checks and balances. The conduct of an inquiry must be within the provisions of the law. Parties under investigation could seek judicial review by the Court of Appeal. Moreover, the SFC's decision-making process would be subject to scrutiny by the Process Review Panel. Members also noted the public responses to the proposals and the Administration's feedbacks to these responses.

Establishment of a Market Misconduct Tribunal
(LC Paper No. CB(1) 1867/98-99(04))

3. EDSM/SFC went on to introduce to members the proposal of establishing a Market Misconduct Tribunal (MMT). The MMT would be established to replace the Insider Dealing Tribunal with an enlarged ambit to tackle market misconduct through civil proceedings. It would be chaired by a current or a former High Court judge who would be assisted by two market experts. There would be a clear definition of market misconduct in the legislation. Penalties that could be imposed by the MMT included disqualifying a person from acting as a director or an officer of a corporation for five years and ordering a person to pay the greater of \$10 million or three times of the profits made or losses avoided. Members were also briefed on the market responses collected during the public consultation and the Administration's feedback.

Discussion with members

4. With reference to the examples of situations under which SFC was unable to seek an explanation on a transaction from counterparties of listed companies, the Chairman enquired how these unusual transactions came into light. EDSM/SFC responded that these transactions were detected during the course of SFC's investigation under Section 29A. However, the transactions could not be verified or confirmed as the SFC was not empowered to seek an explanation from the transaction counterparties under existing legislation.

5. Mr Eric LI expressed grave concern on behalf of the Hong Kong Society of Accountants (HKSA) over the proposal of empowering the SFC to seek access to an auditor's working papers. He informed members that the HKSA had submitted its comments in this respect to the Administration during the public consultation. The HKSA was preparing further submissions and was seeking arrangements for a meeting with the Administration to discuss the proposal in greater detail. He commented that the proposal would destroy the mutual understanding of information confidentiality between the auditors and their client companies. To avoid any abuse of this power of inquiry, he urged the Administration to ensure standard threshold for exercising the power for access to auditors' working papers. He suggested that in seeking access to auditors' working papers, the SFC should be required to apply for a

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court order instead of simply giving a certification that the SFC had imposed a requirement on the listed company to produce its books and records. Moreover, he opined that the SFC should specify the object and area of investigation so that the auditors could respond to specific area of misconduct under investigation instead of providing all their working papers.

6. Deputy Secretary for Financial Services (DS/FS) responded that the Administration had received submissions from the HKSA and their comments would be considered when drafting the Bill. She assured that the Administration would continue to engage the HKSA to further discuss the proposal. Furthermore, she explained that the proposed power to gain access to auditors' papers without recourse to a court order under Section 29A was similar to the power provided to the Independent Corporation Against Corruption (ICAC) and the Inland Revenue Department (IRD) of Hong Kong, as well as other regulatory bodies overseas. Therefore, the auditors should be familiar with their role in providing working papers in the course of investigation and this should not affect their relationship with client companies. She stressed that the SFC's inquiry was aimed at protecting the interest of shareholders, who were relying on the company's audited accounts, and were also the auditors' clients. The enhanced inquiry power would not be abused as the Administration had set statutory threshold for the SFC to exercise the power and that the internal procedure of the SFC would be subject to review by the proposed Process Review Panel. She added that the SFC would have to obtain a court order in case auditors refused to comply with SFC's requests to produce their working papers.

7. Miss Christine LOH proposed that the Administration should try its best to discuss with market participants and incorporate their views in the draft Bill at this stage so that the future Bills Committee could save much time in hearing and considering diverse views from different groups of market participants. DS/FS explained that the Administration was open to public views and was actively involved in consulting relevant interest groups in the market. However, these groups might still wish to make their submissions to the Bills Committee, which was an open channel for them to raise their concerns. The Chairman opined that while the Bills Committee welcomed any public submissions, interest groups were encouraged to forward their views to the Administration for consideration.

8. In reply to Mr Albert HO's enquiry on the requirements for other professionals e.g. solicitors to provide their working papers, EDSM/SFC said that the SFC's inquiry into a listed company was mainly on its financial position. Therefore, working papers of other professionals would not be required unless a full scale investigation by the ICAC or Police was justified subsequent to the findings of the preliminary investigation.

9. As regards Mr Albert HO's query on the inquiry power in case of market misconduct, EDSM/SFC explained that Section 29A would not be applicable to investigation into the securities and futures market. However, SFC could initiate an

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investigation into any forms of market misconduct under Section 33.

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10. Mr Eric LI requested that the definition of “working papers” be clearly stated in the draft Bill so that the auditors could have information on the type of documents that the SFC requested to gain access to. EDSM/SFC replied that auditors’ working papers would be obtained for the purpose of verifying the accounts and records of the company concerned and he undertook to consider members’ views, in particular, on the definition of “working papers”.

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11. Upon the Chairman’s request, the Administration undertook to provide information on the power of the Hong Kong Monetary Authority (HKMA) in seeking access to auditors’ working papers for a comparison with the proposed power of the SFC. Some members however remarked that since different regulatory bodies had different objectives, it would not be appropriate to draw a direct parallel in the comparison.

12. On confidentiality of information gained during the inquiry, DS/ES explained that Section 59 of SFCO set out the confidentiality requirements for the SFC to follow and these requirements would be incorporated in the draft Bill. She added that the inquiry power under Section 29A was very specific and only limited to inquiry of listed companies.

13. With regard to the proposal of providing immunity to auditors in reporting suspected fraud or misconduct in a listed company’s accounting to relevant regulatory authorities, Mr Eric LI suggested that immunity should also be provided to other professionals. Otherwise, there might be a misconception that auditors were held responsible for the investigation of listed companies. In addition, he said that it should be clearly stated in the legislation that the immunity provided to auditors would not constitute a legal responsibility for them to report.

14. DS/ES responded that provision of immunity to auditors would not imply that auditors would have legal responsibilities to report fraud to the relevant regulatory authorities. She said that the provision of immunity to other company officers or professionals would be considered later under the review of the Companies Ordinance. This, however, should not delay the provision of immunity to auditors in view of their unique position in relation to a listed company and the fact that the proposal had been a subject of consultation since 1996. Concerning the suggestion of providing an express provision in the Bill to state that auditors had no legal responsibilities to report fraud or misconduct, she responded that according to government legal advice, this might give the unintended legal interpretation that auditors would have the legal responsibilities to perform other relevant functions under the draft Bill. The Law Draftsman had already advised that such a provision was not necessary.

15. Mr SIN Chung-kai opined that it would be appropriate to provide immunity to auditors yet he had reservation on the extension of the immunity to other professionals. He felt that the extension should be considered carefully taking into

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account the special characteristics and circumstances of each profession. He said that provision of immunity should in no case be extended to the executive or non-executive directors, and paid executives of the listed companies.

16. Mr Albert HO suggested and Mr SIN Chung-kai concurred that the Administration should take a step further and follow the practice of other overseas jurisdictions which stated in the legislation the legal responsibilities of auditors to report fraud or misconduct. They considered that the auditor, appointed by the company to oversee its accounts, should be responsible to all the shareholders of the company and therefore they should assume the responsibility of reporting fraud for the protection of investors' interest. When this responsibility was not specified in the legislation, the auditors would be put in a difficult position to make their own decisions on whether to report the fraud or not.

17. Mr Eric LI commented that in overseas jurisdictions where auditors had the legal responsibilities to report fraud, the circumstances which constituted fraud were clearly defined in the legislation. He said that subject to the provision of a clear and specific definition, the HKSA would consider the above suggestion in detail.

18. DS/FS responded that the Administration had studied the practice in overseas jurisdictions. For instance, the US obliged the auditors to report fraud as part of their legal responsibilities, a breach of which might result in disqualification. Yet the Administration considered that this might not be acceptable in Hong Kong. The Administration's current proposal of providing immunity to auditors had been discussed for a few years. A consensus had emerged in the course of market consultation despite reservation from the accountancy profession. The Administration had to strike a balance on all the views heard so as to achieve a solution that would be acceptable to the majority of the market participants.

19. In response to Mr FUNG Chi-kin's concern about the abuse of inquiry power, DS/FS reiterated that the Administration was mindful of the need for adequate checks and balances against possible abuse, and assured that these would be included in the Bill. She informed members that since 1994, the SFC had exercised the inquiry power under Section 29A on only 9 occasions. The Bill would preserve the same threshold for inquiry and there would be built-in checks and balances e.g. the Process Review Panel to monitor the internal procedures of the SFC.

20. As regards Mr FUNG Chi-kin's worry about penalizing small scale listed companies, DS/FS assured that the legislation would not be prejudicial against such companies and that all companies would be treated fairly irrespective of their size.

Disclosure of Interests in Securities
(LC Paper No. CB(1) 1950/98-99(02))

21. EDSM/SFC highlighted salient points in the paper for members' information.

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He said that the proposed amendments to the Securities (Disclosure of Interest) Ordinance included reducing substantial shareholding disclosure threshold from 10% to 5% and shortening notification period from 5 to 3 business days. There were also proposed requirements on the disclosure of various types of information for the improvement of market transparency. The proposed amendments, at the same time, included some changes to reduce compliance burden on substantial shareholders in the disclosure of interest. Concerning the dissemination of information, more user-friendly disclosure forms would be designed and the disclosed information would be made available on the Exchange Website and in Exchange publications. EDSM/SFC also briefed members on public responses to the proposals. He informed members that the Administration had incorporated some of the market views and revised the proposal accordingly.

Statutory Backing for Listing Rules and Liability for Misstatements
(LC Paper No. CB(1) 1950/98-99(01))

22. EDSM/SFC briefed members on the proposal of providing statutory backing for Listing Rules and Takeovers Code. The proposal comprised two main areas :

- (i) specific civil right of action for omission and misstatement in statements made under the Listing Rules or the Takeovers Code and failure to proceed with a takeover offer once it had been announced without the consent of the Takeovers Executive or Takeovers Panel. The judicial process of an injured person seeking for redress would also be simplified.
- (ii) court orders to be made upon application of the SFC to compel compliance with the Listing Rules or to disqualify a person from being a director of any listed company for a period of time. In order to ensure that the rules and code were market-oriented with flexibility to allow for market growth and innovation, the non-statutory nature of the Listing Rules and Takeovers Code would not be altered.

Discussion with members

23. While supporting the objective of the proposal in increasing market transparency, Mr SIN Chung-kai suggested that there should be a requirement in the legislation for an on-line database similar to EDGAR in the U.S., from which investors from all over the world could gain access to first hand information of the listed companies without any time gap.

24. EDSM/SFC responded that the SFC and the Exchange would always try their best to improve the dissemination of information for investors' interest by making full use of new technology they could employ. He commented that it would not be necessary to make this a legal requirement since the Exchange would treat this with

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high priority for commercial interest. The Chairman concurred and added that given the rapid advancement in technology, there would be frequent revision of the legislation if the system of on-line database on dissemination of information of listed company was made a legal requirement. Mr FUNG Chi-kin supported the Chairman by saying that under existing market operations, investors had adequate means to access to information on listed companies and at present there had been no practical difficulties in this respect.

25. In response to Mr Eric LI's concern over the definition of "settlor" of a discretionary trust, EDSM/SFC explained to members that the definition had been released for public consultation and no adverse comments had been received so far. The Chairman shared Mr LI's concern and considered that under the proposed definition, the requirement for the disclosure of a "settlor" might put the interest of the controller or the beneficiary of the trust under a unfavourable situation.

26. Concerning Mr Albert HO's enquiry on the disclosure requirement of foreign custodians, EDSM/FSC advised that from past experience, foreign custodians were very cooperative in complying with the disclosure requirement.

27. Mr Eric LI expressed concern over the proposal of providing statutory backing for Listing Rules, while at the same time, preserving the non-statutory nature of the rules. He was concerned about the appropriate body to draft the rules; the checks and balances to ensure fairness, and the penalties that would be imposed in case of non-compliance. In addition, he suggested that the rules be made by legislation and submitted to the LegCo for negative vetting.

28. DS/FS reiterated that the Listing Rules were technical and complex, and had to be flexible and market-oriented in order to respond timely to market changes. Therefore, it would be undesirable to transform the rules into legislation which would require statutory procedures when making amendments. She informed members that during the public consultation, the market supported the provision of statutory backing for Listing Rules and commented that the rules should not be made as part of the legislation. She added that penalty for non-compliance to the Listing Rules would be decided by the court.

29. The Chairman opined that with the development of precedent court cases, certain Listing Rules would eventually evolve into a form of legislation. He nevertheless expressed concern over the implication of creating civil liability for omissions and misstatements in statements made under the Listing Rules on directors who were not directly responsible for the misdeed. DS/FS undertook to look into the need for equitable defence for directors.

30. EDSM/SFC supplemented that the Listing Rules would be drafted by the Exchange and approved by the SFC. He explained that the main objective of the statutory backing was to strengthen the protection for investors by imposing stricter

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control on the listed companies. He said that in achieving this objective, the SFC had tried its best to strike a balance between the interests of the listed companies and the investors.

II. Any other business

Date of next meeting

31. The next meeting would be held on Wednesday, 29 September 1999 at 10:45 am.

32. There being no other business, the meeting was adjourned at 6:30 pm.

Legislative Council Secretariat

7 March 2000