

**立法會**  
**Legislative Council**

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**Subcommittee on  
Securities and Futures Bill**

**Minutes of meeting  
held on Wednesday, 29 September 1999, at 10:45 am  
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 SIN Chung-kai  
Dr Hon Philip WONG Yu-hong  
Hon Ambrose LAU Hon-chuen, JP  
Hon FUNG Chi-kin
- Member absent** : Hon Ambrose CHEUNG Wing-sum, JP  
Hon Christine LOH  
Hon Jasper TSANG Yok-sing, JP  
Hon James TO Kun-sun
- 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 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

Mrs Alexa LAM  
Chief Counsel of Securities and Futures  
Commission

**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

Ms Rosalind MA  
Senior Assistant Secretary (1)9

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**I. Briefing by the Administration**

(LC Paper Nos. CB(1) 1867/98-99(07) and (08))

On alternate trading systems, the Executive Director of Supervision of Markets Securities and Futures Commission (ED(SM)/SFC) highlighted salient points in LC Paper No. CB(1) 1867/98-99(07) for members' consideration. He explained that alternative trading systems (ATSs) could take various forms including, bulletin boards, trade matching systems, broker-run proprietary ATS, exchange-run ATS, broker-client linkages, and Internet-based operations . It was the recent trend in both the United States and in Hong Kong that increasing number of securities and futures transactions were being done through Internet. In Hong Kong, 25% of the registered firms were providing or had proposed to provide services through Internet. In view of this new trend driven by modern technology, the existing legislation would be inadequate in providing regulation of these new market activities. A more tailor-made regulatory system would be required for the new trading systems.

2. ED/SFC said that in developing a regulatory framework for ATSs, the SFC upheld the principles of keeping it flexible enough to protect investors and market integrity without stifling innovation; catering for the individual characteristics of each ATS; and maintaining the existing Stock Exchange

monopoly as presently prescribed in the law. The proposed regulatory framework for ATs involved a three tier system, which included, licensed dealer, authorized ATS, and recognized overseas exchange. The SFC would develop guidelines, in consultation with the industry, on the conditions for applying the three tier regulatory framework, i.e. when an ATS should be licensed, authorized or recognized as an overseas exchange. Moreover, references would be made to the result of the Consultation on 1996 Composite Bill, the 1997 Working Group on Automated Trading Systems, and the experience in other overseas markets. ED(SM)/SFC also briefed members on the regulation of ATs in overseas markets such as the U.S. and the U.K., the responses from the public consultation as well as the Administration's initial feedback.

3. On statutory private right of action, the Chief Counsel of Securities and Futures Commission (CC/SFC) briefed members on the proposals outlined in the information paper LC Paper No. CB(1) 1867/98-99(08). She said that the proposed Securities and Futures Bill (the Bill) would create a statutory right of action for persons materially affected by another's regulatory violation(including market misconduct activities) to sue for injunction, damages and other orders by application to the Court of First Instance. The proposal had gained initial support from various sectors of the market. On powers of intervention in proceedings, she introduced to members that the Bill would empower SFC to intervene in third party civil proceedings. This proposal was made in the light of the present difficulties that the SFC had no means of becoming a party to address issues concerning questions of law relevant to its functions and responsibilities or involving larger public interest. As a result, litigating parties had no channel to benefit from the assistance of SFC's expert view on any particular issue. It was noted that in other jurisdictions like U.S. and Australia, the regulatory authorities were given similar power of intervention into private proceedings. The proposed power of intervention by SFC would be put under adequate checks and balances.

### **Discussion with members on Alternative Trading Systems**

#### Preserving the existing Stock Exchange monopoly

4. The Chairman doubted whether the monopoly of the Stock Exchange of Hong Kong (SEHK) could be preserved when it had to face competition from

ATs. While investors buying through the Stock Exchange were subject to charge of stamp duty and fixed commission, they would be attracted to invest through ATs which had a lower transaction cost. ED(SM)/SFC explained that the Administration aimed at preserving the legal monopoly of the SEHK. In other words, the existing legal status of the SEHK in the market would remain unchanged. ATs providing considerable scale of services to sellers and purchasers in Hong Kong would be required to become exchange participants and subject to the rules and regulations of the SEHK. Therefore, the transaction costs comprising stamp duty and commission would also apply to these ATs. Nevertheless, the preservation of the legal monopoly of the SEHK would not protect it from legitimate competition from other parties with integrity, liquidity and better services. It would have to review its business plans in response to its competitors. With increasing liquidity in the market, there would be lower market impact cost for the SEHK enhancing its comparative advantage over the ATs.

5. The Deputy Secretary for Financial Services (DS/FS) added that when the Administration proposed the merger of the two exchanges and three clearing houses, it had agreed that the existing statutory market status of the SEHK would be preserved. Whilst keeping the market status of the SEHK, the Administration would try not to hinder the development of ATs. In response to the Chairman's comment that the monopoly of the SEHK would unavoidably be affected by the ATs, DS/FS reiterated that those ATs which were operating in the form of exchanges would be required to become exchange participants of the new Hong Kong Exchanges and Clearing Limited.

#### Competition with offshore ATs

6. Mr SIN Chung-kai commented that it was a global trend for securities and futures transactions to be done through the internet and it was impossible for the Administration to stop people from engaging in these kind of transactions. DS/FS said that the Administration would not try to stop the development of ATs but aim at including ATs under the regulatory framework so that they would be on a level playing field with other trade members. It was anticipated that existing trade members would try to maintain their competitiveness by upgrading their facilities and providing services through electronic transaction systems. The Chairman echoed and commented that existing trade members should do this for their own commercial interest.

7. While supporting legislative amendments for the regulation of ATs, Mr FUNG Chi-kin expressed concern over the possible impact on local trade members when offshore ATs were granted an authorization or recognized as overseas exchange under the proposed regulatory framework. He asked whether the proposal would provide adequate monitoring of over the counter activities and transactions done through offshore ATs. ED(SM)/SFC said that although the Administration could not monitor the operations of those ATs which were purely offshore, it would aim at creating a system to bring offshore ATs under the regulatory regime of Hong Kong. DS/FS added that the over the counter activities and offshore ATs were already in existence and the purpose of the legislation was not to prevent the development of these trading systems. Instead, the Administration considered that there was a need to regulate the operations of these systems. By putting these systems under the regulatory framework, it would provide protection to investors, preserve market integrity, as well as a level playing field for both local trade members and operators of offshore ATs.

8. Mr Philip WONG opined that in terms of investor protection, the offshore ATs would be less competitive as investors would have more confidence in local trading systems which were under the regulatory regime of Hong Kong. He considered that the competition from offshore ATs should not have very strong impact on local exchange traders.

#### Difficulties in regulating ATs

9. In response to Mr FUNG Chi-kin's enquiry on the requirements on compliance of offshore ATs, ED(SM)/SFC explained that the Administration would not be able to regulate the activities of a purely offshore AT. However, if an AT engaged in transactions of Hong Kong stocks, it would be required to meet certain regulatory standards in respect of transparency of trading, fairness of trading rules, adequacy of audit trails and market surveillance. However, for those ATs which could not become a recognized exchange because they were unable to meet the required criteria, the brokers should have the responsibility to advise their clients of the possible risks in carrying out transactions under these ATs. In practice, most of the offshore ATs interested in engaging in trading of Hong Kong stocks would establish good relationship with local regulators. They often approached SFC for discussion of mutually agreeable

trading and clearing rules.

10. On the definition of the ATs under the regulatory framework, the Executive Director of Intermediaries and Investment Products/SFC (ED(I&R)/SFC) said that it would be difficult to have a single set of definitions or rules in this regard. Instead, individual characteristics and circumstances of every ATs would be assessed before deciding whether it involved transactions of Hong Kong stock and should be under regulation.

11. As regard Mr Philip WONG's concern over the handling of trade disputes and market manipulations involving offshore ATs, ED(SM)/SFC said that before granting the status of recognized overseas exchange to an ATs, it was required to satisfy certain criteria. The requirement served to ensure that only reputable exchanges with reasonable trading and clearing rules would become recognized exchanges in Hong Kong and in case of trade disputes, there would be adequate information available for a fair settlement. On the issue of cross market manipulation, ED(SM)/SFC said that the risk of market manipulation existed before the introduction of offshore ATs. To tackle the problem, memorandum of understanding (MOU) were signed between different jurisdictions to enhance investigation and exchange of cross market information. For example, if someone engaged in insider dealings of Hong Kong stocks in the New York market, the United States Securities and Exchanges Commission could carry out investigation and passed the information collected to the SFC for enforcement actions. Although in some cases the authorities in certain jurisdictions had limited power to investigate, the MOU enabled cooperation and information sharing among different jurisdictions in enforcement actions against market manipulations.

## **Discussion with members**

### Creation of statutory private right of actions

12. The Chairman opined that as legal proceedings would be costly and time-consuming, the creation of statutory private right of actions would not provide actual protection for small investors who had limited resources for taking their cases to the court. He doubted whether this additional channel for seeking compensation from regulatory violators would be meaningful to all investors or only to those big companies with adequate resources to take legal

proceedings. Mr Philip WONG shared his view.

13. CC/SFC agreed that there would be difficulties for small investors to make use of the statutory private right of actions in view of their limited resources. Nevertheless, the Administration was trying to provide an additional channel for those suffering loss as a result of other's market misconduct to claim compensation. DS/ES supplemented that the existence of this additional channel could serve to deter market misconduct as those intended to engage in misconduct would take into consideration the possible consequence of being liable for compensation. Moreover, similar channels provided overseas like Australia and the United States demonstrated that it had certain deterrent effect on improper market behaviors. Therefore, the Administration considered that the provision of this additional channel would serve a similar purpose in Hong Kong and would help to achieve more comprehensive market regulation. Though not against the creation of this additional channel, the Chairman commented that the situation in the United States might not apply to Hong Kong as the trading systems in the two jurisdictions were quite different.

14. While supporting the provision of an additional channel for those injured parties to seek recompense, Mr Albert HO proposed that a special fund should be set up to assist small investors to cover the legal cost in this regard. He said that the fund, similar to the Consumer Legal Action Fund, should be operated under strict scrutiny of the SFC. He considered that without the provision of a special fund, the statutory private right of action would not serve any meaningful purpose except for window dressing. In response, DS/ES explained that apart from the proposed creation of statutory right of actions, there were other means provided in the Bill for the assistance and protection to small investors. As consumer products and stock investments were of very different nature, the operation of a special fund for legal cost provision in the two situations could not be directly compared. The suggestion of setting up a special fund, though outside the scope of the Bill, could be further considered by the Administration under the current review of the Companies Ordinance.

#### Powers of intervention in proceedings

15. The Chairman raised concern about the circumstances under which the SFC would intervene in third party proceedings. He agreed that it would be

justified for the SFC to intervene when it was in the public interest to do so. However, he expressed reservation over the rationale behind intervening “in the interest of the just and equitable resolution of the proceedings” as mentioned in the presentation material. Mr Philip WONG echoed and said that he could not appreciate any other circumstances under which the SFC should intervene in third party proceedings except for public interest.

16. CC/SFC quoted the example of the CA Pacific case and explained that the SFC could not provide its expert views to the court for a just and equitable resolution of the proceedings in this case because there was no legal provisions for SFC to intervene at present. ED(I&IR)/SFC added that under the provisions of Section 59 of the Securities and Futures Commission Ordinance, the SFC could only disclose information in hand if it was a party to the proceedings. Therefore, if the SFC had certain information which, if not disclosed to the court, would lead to a miscarriage of justice, it would be justifiable for the SFC to intervene.

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17. The Chairman requested the Administration to further consider the circumstances under which the SFC would intervene in third party proceedings taking into account members' comments.

#### Future meetings and work of the subcommittee

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18. Concluding the discussion, the Chairman said that as the subcommittee had gone through all the major proposals of the Bill, its work would be temporary suspended until the Administration submitted the Bill. The subcommittee would then be transformed into a Bills Committee to consider the Bill in detail. Meanwhile, the subcommittee would prepare a report to the House Committee, summarizing members' comments expressed in these four meetings. He also requested the Administration to provide copies of the submissions collected during the public consultation for members' reference. Any further submissions or representations received by any member after the meeting could be passed to the Administration for consideration in the preparation of the Bill. DS/FS thanked members for their valuable comments expressed at the subcommittee meetings and said that the Administration would try to speed up the drafting of the Bill for members' early consideration.

*(Post-meeting note: copies of the representations from respondents during the public consultation were circulated for members' reference vide LC Paper No. CB(1) 109/99-00 dated 14 October 1999.)*



**II. Any other Business**

19. There being no other business, the meeting was adjourned at 12:45p.m.

Legislative Council Secretariat

29 March 2000