

**立法會**  
**Legislative Council**

LC Paper No. CB(1) 2054/99-00  
(These minutes have been seen  
by the Administration and  
cleared by the Chairman)

Ref: CB1/BC/2/99/2

**Bills Committee on  
Exchanges and Clearing Houses (Merger) Bill**

**Minutes of meeting  
held on Thursday, 6 January 2000, at 2:30 pm  
in the Chamber of the Legislative Council Building**

- Members present** : Hon Ronald ARCULLI, JP (Chairman)  
Hon NG Leung-sing  
Hon SIN Chung-kai  
Dr Hon Philip WONG Yu-hong  
Hon Jasper TSANG Yok-sing, JP  
Hon FUNG Chi-kin
- Members absent** : Hon LEE Kai-ming, SBS, JP  
Hon CHAN Kam-lam
- Public officers attending** : Mr Bryan P K CHAN  
Principal Assistant Secretary for Financial Services
- Ms Doris HO  
Principal Assistant Secretary (Constitutional  
Affairs)
- Ms Gloria LO  
Assistant Secretary for Financial Services
- Ms Mabel CHEUNG  
Government Counsel  
Department of Justice

- Attendance by invitation** : Mr David STANNARD  
Executive Director, Corporate Finance  
Securities and Futures Commission
- Mr Gerald D GREINER  
Senior Director of Supervision of Markets  
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 Connie SEZTO  
Senior Assistant Secretary (1)1
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## **I Meeting with the Administration**

### Re-delineation of the financial services functional constituency (LC Paper No. CB(1) 747/99-00(01))

Some members re-iterated their concern about whether the 21 non-trading active members of the Stock Exchange of Hong Kong (SEHK) would be eligible to become electors subsequent to the proposed re-delineation of the Financial Services Functional Constituency (FSFC). Dr Philip WONG expressed objection to depriving non-trading members of SEHK of their right to vote in the Legislative Council election.

2. In response, the Principal Assistant Secretary for Financial Services (PAS/FS) explained the rationale for re-delineating FSFC upon the merger reform. He said that the composition of FSFC was provided in section 20U of the Legislative Council Ordinance (Cap. 542). At present, FSFC included, inter alia, members of SEHK and the Hong Kong Futures Exchange (HKFE) who were entitled to vote at their respective general meetings. Given the separation of the shareholding of the two exchanges from the right to trade on and through the respective exchanges following the merger reform, FSFC needed to be re-delineated. Each member would be issued a "trading right" for each share held in the respective exchanges. Existing members of the exchanges would be deemed to be exchange participants under clause 23 of the Bill and be allowed to continue to trade on or through the exchanges provided

that they satisfied the requirements imposed by the Hong Kong Exchanges and Clearing Limited (HKEC) and registered with the Securities and Futures Commission (SFC) as dealers. The Administration considered that the concept of "traders of the exchanges" which was central to the current delineation of FSFC should continue to apply after the merger. Hence, the proposed replacement of "members" by "exchange participants" which was in line with the general policy and the existing delineation of FSFC should be adopted. In other words, "exchange participants" of SEHK and HKFE would be eligible to register as electors of FSFC.

3. As regards the concern about the status of the 21 non-trading active members of SEHK, PAS/FS advised that the constitution of SEHK provided that members who were not bankrupt and whose membership remained "active" (i.e. not suspended) were entitled to vote at general meetings and therefore eligible to become electors of FSFC. Hence, non-trading status would not affect members' eligibility to vote at general meetings and to become electors of FSFC. The 21 non-trading members would be deemed to be "exchange participants" as other SEHK members and thus would become eligible as electors for FSFC, unless their registration with SFC was suspended or revoked. As such, PAS/FS stressed that the proposed re-delineation of FSFC would not disadvantage the 21 members by making them ineligible for elector registration of FSFC. Even under the current delineation, whenever the membership of a SEHK member was suspended, which might be due to disciplinary actions by SFC, or failure to pay dues to SEHK, he would become ineligible to vote at SEHK general meetings. PAS/FS also informed the Bills Committee that according to SEHK, as at January 2000, two out of these 21 members had already had their registration suspended. Mr Gerald GREINER, Senior Director of Market Supervision, SFC supplemented that flexibility was provided for registered dealers to cease trading from time to time. Until SFC had confirmed that a registered dealer was permanently out of business, its registration would not be revoked indiscreetly.

4. Dr Philip WONG opined that it was the political right of exchanges members to register as electors of FSFC. Their voting right should not hinge upon their trading status nor their eligibility to vote at general meetings of respective exchanges. The Chairman remarked that this was outside the scope of the Bill and should be a matter for the Constitution Affairs Bureau to consider. It was the Administration's policy to allow relevant professional bodies of functional constituencies to decide their respective eligibility criteria for membership and hence eligibility for registration as electors.

#### Commencement dates of the Bill

(LC Paper No. CB(1) 725/99-00(01))

5. Members noted the Administration's paper explaining the commencement dates of the Bill. PAS/FS advised that clauses 22(1) and (2),

which provided the legal basis for the conversion of Hong Kong Securities and Clearing Company Limited (HKSCC) from a company limited by guarantee to a company limited by shares, would take effect before the rest of the Bill to enable the conversion to take place prior to the coming into effect of the merger. The Administration's intention was to announce commencement of the two clauses on the same date when the Bill was gazetted after enactment. The commencement date of the rest of the Bill would coincide with the effective date of the schemes of arrangement governing the merger.

SFC's regulatory function in respect of listing of HKEC  
(LC Paper No. CB(1) 747/99-00(03))

6. Mr David STANNARD, Executive Director, Corporate Finance, SFC briefed members on the information paper comparing the performance of the regulatory functions of SEHK and SFC in respect of listing matters before and after the merger. Mr STANNARD explained that at present, while SEHK was the front-line regulator of listed companies responsible for matters under the Listing Rules, SFC was in charge of policy matters concerning listing. The two parties had established memorandum of understanding (MOU) regarding the division of functions on the matter. The division of functions would remain substantially the same as at present after the merger. SFC was discussing with SEHK to modify the existing MOU to incorporate the necessary changes.

7. Mr STANNARD advised that as to remove possible conflict of interest which would arise when HKEC or its subsidiaries sought to be listed on SEHK, clause 13 of the Bill provided that HKEC had to satisfy SFC that adequate rules and arrangements were in place to deal with possible conflicts of interest to ensure market integrity and compliance with listing obligations before any of such listing was to be permitted. The provision was similar to that in the Australian laws governing the listing of the Australian Stock Exchange. Mr STANNARD added that notwithstanding that clause 14 of the Bill was not found in the Australian model, SFC considered it appropriate to provide the clause empowering SFC to give direction to HKEC or its subsidiaries to take steps to remedy any conflict of business interest whenever appeared. The provision would ensure a level playing field on the stock market between the HKEC group and other listed companies.

Levels of penalty under the Bill and other ordinances  
(LC Paper No. CB(1) 747/99-00(02))

8. Members noted the Administration's paper comparing the levels of penalty under the Bill with those under other relevant ordinances. They noted that penalties for offences committed by an exchange controller under the Bill were modelled on those imposed on an authorized institution under the Banking Ordinance (BO) (Cap.155). The Administration noted the

Chairman's view that it should ensure that the penalty provisions in BO were not out-dated.

Clause-by-clause examination on the Bill

*Clause 23*

9. Members noted that under clause 23 existing members of SEHK and HKFE would be deemed to be exchange participants after the merger. Discussion was underway between SFC and the two exchanges to review their respective rules in order to ensure that they would be applicable to exchange participants.

*Schedule 1*

10. Members noted that Schedule 1 contained provisions which would be applicable where a person had contravened a notice issued by SFC under clauses 3(6), 4(1) or 6(5) of the Bill. The Schedule was modelled on similar provisions in BO.

11. Members noted that SFC could, under clause 3(6), serve a notice on a person, who had become a controller of an exchange company or clearing house without the prior approval of SFC, directing him to take specified steps to cease to be such controller. The Chairman expressed concern about the absence of appeal channel to the court. PAS/FS responded that clause 3(9) provided the person concerned with access of appeal to the Chief Executive in Council. Moreover, all decisions made by SFC were subject to judicial review. There was also a proposal under the composite Securities and Futures Bill to introduce a new mechanism for review of a wide range of SFC decisions. Hence, there would be adequate checks on SFC's power in this respect. The Assistant Legal Adviser 6 said that SFC, in issuing the concerned notice under clause 3(6), had to act within the regulatory power it had been vested with under the Securities and Futures Commission Ordinance (Cap. 24).

12. Members noted that clause 6(5) empowered SFC to issue notice to a person directing him to take specified steps to cease to be a minority controller (i.e. a person holding 5% or more of the shares of the company, or exercising 5% or more of the voting power at any general meeting of the company) of an exchange company or a clearing house. Dr Philip WONG was of the view that the 5% shareholding limit might discourage investors from investing in HKEC and adversely affect the company's commercial viability in the long run. It was also unreasonable to criminalize a person for contravening the said notice. Dr WONG opined that the Administration should consider imposing other penalties, such as restricting the effective voting right of a minority controller to 5% regardless the amount of shares held by him.

13. In response, PAS/FS stressed that the 5% shareholding limit was to prevent control of HKEC or its subsidiary exchanges and clearing houses by any individual party or parties. On Dr WONG's proposal, PAS/FS remarked that there was no such provision in other jurisdictions.

Admin  
14. Some members pointed out that shareholders might inadvertently hold excessive shares of HKEC under some situations, such as after buying back of shares by the company, which were out of their control. They opined that these innocent shareholders should not be punished. In response, the Administration undertook to review the drafting of clause 6(5) to provide a chance for the person holding shares in excess of 5% limit to explain for the increase of his shares.

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15. Some members also raised queries on sections 1(7), (8), and (9) of Schedule 1. The Administration undertook to refer them to the Law Draftsman for clarification.

## **II Meeting with deputation**

(LC Papers No. CB(1) 713/99-00(01)-(04) -- Submissions from four organizations, CB(1) 713/99-00(05) -- Administration's response on the submissions)

16. The Chairman said that the Secretariat had placed advertisements in the South China Morning Post and Hong Kong Economic Times and had written to nine organizations to invite views on the Bill. So far, four organizations had provided submissions and the Hong Kong Stockbrokers Association Limited had expressed interest in meeting the Bills Committee.

17. Mr Paul FAN, Chairman of the Hong Kong Stockbrokers Association Limited (HKSbA) presented HKSbA's views on the Bill as detailed in its submission.

### Risk Management Committee

18. HKSbA expressed concern about the discrepancies between the Bill and the scheme of arrangement documents (Scheme Documents) of SEHK and HKFE circulated to members prior to their voting on the merger on the composition of and method for appointing members to the Risk Management Committee (RMC) to be established by HKEC under the merger reform. In response, PAS/FS said that the concept of RMC had been explained in detail in the Administration's policy paper entitled "Hong Kong Exchanges and Clearing Limited : Reinforcing Hong Kong's Position as a Global Financial Centre" (Policy Paper) which was issued in July 1999. The Policy Paper stated that RMC should be chaired by the Chairman of HKEC and comprise a majority of

external board members of HKEC, including representatives of market regulators, relevant market experts and public interest representatives. The RMC should be made up of three HKEC directors (including the chairman) and three to five external members (appointed by HKEC board). Subsequently in Appendix VI of the Scheme Documents, it was stated that members of RMC would be appointed by both the Financial Secretary (FS) and HKEC board. PAS/FS stressed that the current provision of the Bill broadly followed the proposal made under the Policy Paper and Scheme Documents. Given the important functions of RMC and the need to balance the commercial interests of HKEC vis-à-vis its risk management functions, the Administration considered that the proposed structure of RMC was appropriate.

Admin 19. As regards HKSbA's concern over the excessive power of RMC where its decisions would prevail unless overruled by a two-third majority of the members of HKEC board, PAS/FS remarked that the proposal was also included in the Scheme Documents. As the Bills Committee had also expressed the same concern, the Administration had undertaken to review relevant provisions in the Bill.

#### Board of directors of HKEC

20. On HKSbA's view that HKEC board directors to be appointed by FS should include market participants and shareholders with relevant experience in the securities industry in order to ensure adequate balance and representation in the board, PAS/FS said that the Policy Paper had stated that FS would appoint directors from, inter alia, market professionals and respectable members of the community who could represent public interest and the interest of the investing public.

#### Trading rights

21. HKSbA pointed out that although it was stated in the Scheme Documents that there would be a two-year moratorium on the issue of new trading rights in the two exchanges from the coming into effect of the merger, such moratorium would not be applied when HKEC or its subsidiary exchanges entered into alliances with other exchanges. HKSbA opined that it would be desirable to specify in the Bill the details of the arrangements in respect of the protection of the interest of existing members following the formation of alliances with other exchanges.

22. PAS/FS advised that the shareholding of the exchanges and the right to trade on and through them would be separated after the merger to increase market access in order to enhance global competitiveness of the exchanges. However, the Administration shared the concern of existing members of the exchanges about an abrupt opening of the market which might adversely affect their business. In order not to undermine their confidence in the merger

reform, the Administration had accepted to include proposals of imposing a moratorium on the issue of new trading rights and transferability conditions of such rights in the Scheme Documents. The Administration considered that issues related to the moratorium were essentially commercial matters for HKEC and were not intended to be dealt with by the Bill. As regards the granting of trading rights to members of foreign exchanges forming alliances with HKEC, PAS/FS said that the industry concurred that formation of strategic alliances with overseas exchanges would be essential to enhance the competitiveness of local markets in response to rapid development of globalization of financial markets. Hence, HKEC should be given the flexibility to grant new trading rights to members of overseas exchanges on appropriate terms to facilitate the formation of alliances. He believed that HKEC would make such decisions prudently and in consultation with SFC with consideration on the risk management implications and reciprocity in the proposed alliance arrangements.

#### Clause 14

23. The Administration noted HKSbA's suggestion of providing HKEC with a defence for failure to comply with the notice issued by SFC under clause 14. On the enquiry about the position of "individuals" committing the offence under clauses 14(3)(a) and (b), the Government Counsel clarified that the reference to an "individual" committing the offence referred to directors and other officers of the company who were individuals and guilty of the like offence by virtue of section 101E of the Criminal Procedure Ordinance (Cap.101).

### **III Any other business**

24. The Chairman reminded members that the next meeting would be held on 7 January 2000, at 8:30 am.

25. There being no other business, the meeting ended at 6:05 pm.

Legislative Council Secretariat

18 September 2000