

## Securities and Futures Market Reform Members' Concerns Co-ordinating Group

### Comments on the Exchanges and Clearing Houses (Merger) Bill

#### Trading Rights issue

We note that there is no provision in the Bill dealing with the trading rights issue, including their transferability, the moratorium period and the future admission fee as set out in the Scheme Document.

#### Clause 9 - Establishment and functions of Risk Management Committee

According to the information on the governing committees contained in the Scheme Document (copy of the relevant page is enclosed), the composition of members of the Committee should be made up of 3 HKEC directors (including 1 as chairman) and 3 to 5 external members including cross-market government experts and public interest representatives to be appointed by the HKEC Board. Yet, clause 9(2) is not consistent with the information contained therein in the way that HKEC can only appoint not more than 2 members and the appointment of the external members will be made by the Financial Secretary.

We also note that under clause 9(5), the policy recommended by the Risk Management Committee shall be adopted by the HKEC Board unless not less than 2/3 of the total membership of the Board pass a resolution declining to adopt and implement the policy. This appears that the Risk Management Committee will have even greater authority than the HKEC Board.

Clause 14 - Commission may give directions to recognized exchange controller where it is satisfied that conflict of interest exists etc.

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Under clause 14, no defence is available to HKEC when it fails to comply with the notice issued by the Securities and Futures Commission such as "due diligence" as provided in clauses 3 and 6. We consider it would be fair and consistent to include similar defence and where circumstance beyond the control of the HKEC to comply with the notice, it should not be convicted. We are also concerned whether the "individual" mentioned in clause 14 (3)(a) and (b) may be referred to any director of the Board of HKEC.

Clause 20 - Financial Secretary may appoint not more than 8 persons to board of directors of HKEC

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It is not mentioned in this clause the eligibility of persons to be appointed by the Financial Secretary to the HKEC Board except that the appointment would be in the public interest. Since the nomination process by HKEC of the 6 directors returned by shareholders is still unknown, we cannot be assured that persons from the broking community would be nominated and the interest of the broking community would be represented. We are concerned that in the absence of some concrete criteria for either appointment or nomination or both, there may not have a balanced representation on the Board of HKEC, especially when HKEC becomes a listed company with shareholder base no longer confined to existing Members of the two Exchanges.

Clause 71, Schedule 2 - Composition of the financial services functional constituency

We note that under this clause, the Exchange may provide a class of Exchange Participants in the rules of the Exchange to be excluded as Exchange Participants as eligible to register as electors of the financial services functional constituency. It is unknown as to which class of Exchange Participants would be excluded under this clause. We are of the view that after the merger, existing active but non-trading Members of the Exchange should remain eligible to be electors and should not be excluded.

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## LETTER FROM HKEC

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It is envisaged in the Position Paper that HKEC will also have the governance committees and consultative panels referred to in the table below, which committees and panels will include external members as indicated in the table:

<b>HKEC BOARD COMMITTEES AND PANELS</b>			
	<b>Committees</b>	<b>Key tasks</b>	<b>Composition</b>
<b>Governance committees:</b>	Audit	<ul style="list-style-type: none"> <li>• Review financial statements before HKEC Board</li> <li>• Nominate external auditors</li> <li>• Monitor the structure of internal controls</li> </ul>	<ul style="list-style-type: none"> <li>• 3 HKEC Directors (including 1 as chairman)</li> <li>• 3 to 5 external members (appointed by HKEC Board)</li> </ul>
	Risk management	<ul style="list-style-type: none"> <li>• Review risk management procedures</li> <li>• Assess changes in minimum capital reserve requirement, margining levels, counterparty risk limit</li> </ul>	<ul style="list-style-type: none"> <li>• 3 HKEC Directors (including 1 as chairman)</li> <li>• 3 to 5 external members including cross-market government experts and public interest representatives (appointed by the HKEC Board)</li> </ul>
	User appeal	<ul style="list-style-type: none"> <li>• Adjudicate disciplinary matters concerning participants and listed companies</li> </ul>	<ul style="list-style-type: none"> <li>• 1 HKEC Director</li> <li>• 5 to 6 external market professionals (e.g. lawyers, accountants)</li> <li>• 2 to 3 public interest representatives</li> </ul>
	Listing matters	<ul style="list-style-type: none"> <li>• Adjudicate appeals on listing decisions and other listing matters</li> </ul>	<ul style="list-style-type: none"> <li>• 1 HKEC Director</li> <li>• 5 to 6 external market professionals (e.g. lawyers, accountants)</li> <li>• 2 to 3 public interest representatives</li> </ul>
<b>Consultative panels:</b>	Cash market	<ul style="list-style-type: none"> <li>• Provide market expertise on :</li> </ul>	<ul style="list-style-type: none"> <li>• 10 members for each panel of which 2 are HKEC Directors</li> </ul>
	Derivatives market Clearing	<ul style="list-style-type: none"> <li>- International trends</li> <li>- Intermediary / issuer / investor needs</li> <li>- Technology challenges</li> <li>- New product opportunities</li> <li>• Act as sounding board for               <ul style="list-style-type: none"> <li>- Policy decisions</li> <li>- Strategic initiatives</li> <li>- Major investments</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Selected from representatives of market participants and industry experts</li> <li>• Selection process to be determined</li> </ul>

### (d) Shareholding limit

The HKEC Directors draw to the attention of Stock Exchange Shareholders that, in response to the proposals contained in the Position Paper, it is provided in the draft new Articles of Association of HKEC that no person will be permitted to have an interest in more than 5 per cent. of the votes that could be cast on any resolution at any general meeting of HKEC unless they fall within one of the categories of permitted person. Such categories of permitted person include a person who has obtained a waiver from the provisions of the new Articles of Association from the SFC in consultation with the Financial Secretary of Hong Kong. A summary of the relevant provisions of the draft new Articles of Association of HKEC is set out on pages 172 to 182 in appendix V to this document.