

立法會
Legislative Council

LC Paper No. CB(2)2526/99-00
(These minutes have been seen by
the Administration and cleared
with the Chairman)

Ref : CB2/BC/7/99

**Bills Committee on
Securities (Amendment) Bill 1999**

**Minutes of Meeting
held on Tuesday, 21 March 2000 at 2:30 pm
in Conference Room A of the Legislative Council Building**

Members Present : Hon Ronald ARCULLI, JP (Chairman)
Hon Eric LI Ka-cheung, JP
Hon NG Leung-sing
Hon CHAN Yuen-han
Hon SIN Chung-kai
Dr Hon Philip WONG Yu-hong
Hon Jasper TSANG Yok-sing, JP
Hon FUNG Chi-kin

Non-Bills Committee Member

Hon David CHU Yu-lin

Member Absent : Dr Hon David LI Kwok-po, JP
Hon Christine LOH

Public Officers Attending : Mr Bryan CHAN
Principal Assistant Secretary for Financial Services

Miss Hanny LAM
Assistant Secretary for Financial Services

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Ms Stella LEUNG
Director of Supervision of Markets
Securities and Futures Commission

Ms Stella CHAN
Government Counsel, Department of Justice

Attendance by Invitation : Group of 14 financial institutions and the Hong Kong Securities Industry Group and Pan Asia Securities Lending Association

Ms Pauline Ashall

Ms Pamela Root

Mr Roger Dunphy

Mr Dominick Falco

Clerk in Attendance : Mrs Constance LI
Chief Assistant Secretary (2) 2

Staff in Attendance : Mr KAU Kin-wah
Assistant Legal Adviser 6

Miss Betty MA
Senior Assistant Secretary (2) 1

I. Meeting with deputation and the Administration

[Paper Nos. CB(2)1437/99-00(01) and (02), CB(2)1447/99-00(01) and (02)]

The group of 14 financial institutions and Pan Asia Securities Lending Association (PASLA)

At the invitation of the Chairman, Ms Pauline ASHALL representing the Group of 14 financial institutions and PASLA briefed members on their comments on the Administration's proposed amendments (version as at 20 March 2000) [Paper No. CB(2)1437/99-00(02)]. The Group expressed appreciation that the Administration had made significant amendments to the Bill

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having regard to the concerns raised by the industry. The Group had the following comments -

- (a) although the Administration proposed to add a defence clause under section 80B, the onus of proof was placed on the defendant. The Group considered that the prosecutor should prove that the broker acted knowingly or recklessly for an offence under section 80B;
- (b) there would be practical difficulties to meet the documentary assurance requirement, for example, the brokers would need to confirm with sellers at the time of placing the order that the sellers actually owned the securities or had arranged for the delivery of the securities. The Group had reservations about keeping the tape record and suggested instead that a "hold" notice provided by the stock lenders after the transaction would be sufficient for the purpose of the Bill; and
- (c) the proposal to empower Securities and Futures Commission (SFC) to impose reporting requirements on short selling could create substantial administrative burden on the industry.

Scope of "short selling order"

2. Responding to Dr Philip WONG, Principal Assistant Secretary for Financial Services (PAS(FS)) said that while the Administration did not encourage or discourage day trading, the amended definition of short selling order had no impact on such activities as long as the seller had purchased the securities before they placed a sale order.

Rule making power of Securities and Futures Commission

3. With regard to the Group's concerns on the rule making power of SFC, the Chairman explained that the rules to be made by SFC were subsidiary legislation subject to the negative vetting procedure of Legislative Council (LegCo). He believed that SFC would widely consult the affected parties before making such rules.

Documentary assurance

4. PAS(FS) explained the rationale of the proposed defence provision under section 80B. He said that the Administration had agreed in principle that the market intermediaries should not be subject to strict liability for breaches of requirements under section 80B, and that an offence would only be committed if a person acted knowingly or recklessly. However, the Department of Justice had

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subsequently advised that it would be difficult, if not impossible, to prove that a person acted knowingly or recklessly. It would therefore be more practical from the enforcement angle if the onus of proof was on the defendant. However, the enforcement agency would first satisfy itself that there was prima facie evidence for a prosecution.

5. Ms Pauline ASHALL was of the view that although it would be easier to take prosecution if the onus of proof was on the defendant, it would be extremely difficult for the stockbrokers to prove after a transaction that he did not know that the transaction was a short sale.

6. The Chairman explained that an offence would only be committed under section 80C if the intermediary was aware that it was a short sale but did not pass on the information. The burden of proof would be on the prosecution. He was therefore only concerned about the inadvertent mistakes made by intermediaries. However, he noted a difference in the drafting of the defence provisions in the amended section 80B(7) and 80C(3) with regard to the onus of proof, as the latter expressly stated that only a person who "knowingly or recklessly" contravened section 80C(1) would commit an offence.

7. PAS(FS) responded that according to records maintained by SFC, there were not many cases of inadvertent input errors in relation to short selling. However, in view of the concerns expressed by the industry about the criminalization of inadvertent mistakes, the Administration had agreed to amend the defence clause in section 80C(3) to cover such situations and the burden of proof would be on the prosecution.

8. On record keeping, Ms Pamela ROOT, representative of the Group, commented that the proposed record keeping requirement had extended the criminal liability to all participants in a transaction. She reiterated that the industry was concerned about the strict liability in respect of the documentary assurance requirements as different types of records were being maintained by financial institutions and some of these records were not kept for seven years. It would be difficult for an intermediary to prove that he was innocent if part of the records was destroyed or lost.

9. PAS(FS) clarified that market intermediaries were only required to keep such records for one year under section 80B(4)(a). He added that market intermediaries were already required under the Securities Ordinance to keep relevant records for seven years, and the proposed requirement under the Bill did not go beyond the current requirements. As regards accidental loss or damage of records, PAS(FS) said that as far as he was aware, no prosecution had ever been instituted for such cases. Nevertheless, he would seek further clarification from the Department of Justice about the prosecution policy on cases involving damages caused by factors beyond control. To allay the industry's concern,

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PAS(FS) suggested that the Secretary for Financial Services could clarify the policy intent in delivering his speech during resumption of the Second Reading debate of the Bill.

Timing for providing documentary assurance

10. The Chairman noted that the Group had suggested that in order not to delay transactions, the stock lenders would record the time of issuing a "hold" and provide the "hold" notice after the transaction but before the close of the trading day. The Chairman considered the proposal feasible and asked whether the Administration saw any practical difficulties in implementing the proposal.

11. PAS(FS) stressed that the Bill sought to require a market intermediary to ascertain with his principal, at the time of placing a covered short sale order, that arrangements had been made to deliver the securities to which the short sale order related. Under the original proposal, if securities were to be arranged for the transaction, securities borrowing and lending agreement or a "hold" confirmation from the stock lenders was required. However, to address the industry's concerns, the Administration had agreed to accept verbal assurance at the time of placing an order, as long as the industry would maintain an internal record showing the time and reference number of "hold" notices issued, the name of clients and the amount of securities involved. PAS(FS) stressed that the assurance must be provided at the time when placing an order, so as to avoid over-promises by a holder of securities as this could inflate the volume of short selling orders. The purpose of obtaining the confirmation at the time of placing a short selling order was to ensure that the transaction was not a naked short sale.

12. PAS(FS) added that the proposal had been drawn up after consultation with PASLA. According to PASLA, an internal record of a "hold" notice already included a time stamp, the client's name and the number of securities involved. The record would enable tracing of a short sale by making reference to the time at which the "hold" notice was given.

13. Mr Roger DUNPHY said that it was the golden rule in the stock lending market that a time stamp would be put on a "hold" notice when an assurance of lending was given. Communication between the stock lenders and sellers would take place before the sellers sold the securities.

14. The Chairman reminded the Administration to allow a reasonably short time for the production of paper records with regard to the time differences in overseas markets.

15. Mr SIN Chung-kai expressed support for the proposal of allowing the market intermediaries to provide the required documents by the close of the

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trading day, provided that the intermediaries had obtained verbal assurance from their clients at the time of placing an order.

16. Dr Philip WONG was of the view that if the intermediaries were satisfied that the clients could cover the short sale position within the same trading day, such transactions should not be subject to the Bill, since naked short selling was already in contravention with the Securities Ordinance.

17. Referring to section 80B(1)(b), PAS(FS) clarified that a verbal assurance (such as the "hold" number) at the time of placing an order would suffice and supplementary information could be provided after the transaction within the trading day. As regards any further information required by SFC under the section, it would be promulgated by subsidiary legislation subject to the negative vetting procedure of LegCo.

18. Responding to Miss CHAN Yuen-han, PAS(FS) said that the Administration had made improvements to the Bill as far as practicable to address the industry's concerns. The Administration considered that the documentary assurance (such as verbal confirmation) should be provided at the time when placing a short selling order. He said that the Administration had already accepted the industry's proposal that if a time-stamp was applied on the "hold" notices, the "hold" number would not be required at the time of placing an order.

19. Mr Eric LI asked about the types of admissible evidence and whether the Administration would allow sufficient time for the industry to locate the documentary records as evidence of the short sale order. He considered that a proper internal control system in a financial institution coupled with good recording system or on-line computer system would provide useful evidence.

20. PAS(FS) said that assurance from the seller could be provided verbally or recorded in the form of tape or other documentary records. Under section 80B(5), information and evidence from the sellers, agents and principals would be admissible in a court proceeding.

II. Clause-by-clause examination

[Paper Nos. CB(2)1059/99-00(01) and CB(2)1437/99-00(02)]

21. The Chairman then invited members to examine the Bill clause by clause, with reference to the draft amendments proposed by the Administration as set out in Paper No. CB(2)1437/99-00(02).

Clauses 1 to 3

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22. Members raised no questions on clauses 1 to 3.

Clause 4

Section 80A - Definition of "short selling order"

23. Ms Pauline ASHALL representing the Group said that the proposed amendment to the definition of short selling order was satisfactory, except that she hoped the Administration would further consider improving the drafting of "irrevocable instructions". She pointed out that although under normal circumstances, a seller would not revoke his sales order, it was theoretically possible for him to do so particularly when there was such contractual provision. The Group therefore had reservation about the word "irrevocable".

24. The Chairman said that the Administration's proposal was only to ensure the availability of securities when an order of short sale was placed. As "irrevocable" instructions normally referred to an instruction given by a seller who should not revoke his instruction, the Chairman suggested the Administration might consider improving the drafting.

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25. PAS(FS) responded that the wording of the amendment was the same as that currently used in Schedule 11 to the Rules of the Stock Exchange of Hong Kong. Nevertheless, he agreed to reconsider whether the drafting in respect of irrevocable instructions could be improved.

Section 80B - Obligation to confirm short selling order

26. The Chairman pointed out that under the proposed paragraphs (a) and (b) in sections 80B(1), (2) and (3), a person should be prohibited from conveying a short selling order if he failed to provide supplementary information as required under paragraph (b). The drafting had not reflected the intention that paragraph (b) was to allow sufficient time for the seller to provide supplementary information after the transaction. The Chairman therefore suggested separating paragraph (a) from paragraph (b).

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27. PAS(FS) agreed with the Chairman and undertook to consider separating paragraphs (a) and (b) under section 80B(1), (2) and (3).

28. Assistant Legal Adviser 6 (ALA6) pointed out that the proposed new subsection (2A) was to clarify that a trustee or fund manager acting under discretionary authority would be regarded as acting as a principal. To spell out clearly that a trustee or fund manager acting under discretionary authority would not be regarded as acting as an agent under subsection (3), ALA6 suggested that the drafting could be improved by adding "only" at the end of subsection (2A).

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29. The Chairman agreed with ALA6 and pointed out that the proposed subsection (2A) might give rise to practical difficulties that the intermediaries would have to ascertain with the fund manager or trustee on each occasion as to whether the latter acted under discretionary authority.

30. Representatives of the Group expressed concern that the drafting of subsection (2A) had not adequately reflected the intention that stockbrokers needed only to obtain assurance from fund managers on the availability of securities when a short selling order was placed. They pointed out that a fund manager or trustee could also act as an agent in securities transactions. They expressed concern about the practical difficulties for an intermediary to ascertain that a fund manager or trustee did have securities in hand when a "hold" was given.

31. ALA6 suggested that the Administration might consider amending subsection (2A) to expressly exclude a fund manager or trustee, when selling securities under any discretionary authority, from the requirements of sections 80B(1) and (2), to the effect that the fund manager or trustee would be regarded as selling as a principal if he acted on his own initiatives and was not at the direction of another person.

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32. PAS(FS) undertook to consider the suggestion.

Clause 5 - Regulations

Admin

33. ALA6 pointed out that as a result of the enactment of the Securities (Margin Financing) (Amendment) Ordinance 2000, paragraph (ra) as mentioned in paragraph (a) of clause 5 had been deleted. PAS(FS) agreed to follow up.

III. Any other business

34. The Chairman said that the next meeting would be held on 27 March 2000 at 2:30 pm to discuss the Administration's proposed amendments.

(Post-meeting note : The meeting was subsequently re-scheduled for 10 April 2000.)

35. There being no other business, the meeting ended at 4:35 pm.

Legislative Council Secretariat

26 July 2000