

立法會
Legislative Council

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by the Administration and
cleared by the Chairman)

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**Subcommittee on
Financial Resources Rules,
Commodities Trading (Accounts and Audit) (Amendment) Rules 2000 and
Securities (Margin Financing) (Amendment) Ordinance 2000 (20 of 2000)
(Commencement) Notice 2000**

**Minutes of meeting
held on Tuesday, 16 May 2000, at 10:45 am
in the Chamber of the Legislative Council Building**

- Members present** : Hon Ronald ARCULLI, JP (Chairman)
Hon Eric LI Ka-cheung, JP
Hon HUI Cheung-ching
Hon Jasper TSANG Yok-sing, JP
Hon Ambrose LAU Hon-chuen, JP
Hon FUNG Chi-kin
- Members absent** : Hon Albert HO Chun-yan
Hon SIN Chung-kai
- Public officers attending** : Mr Bryan CHAN
Principal Assistant Secretary for Financial Services

Mr Howard YAM
Assistant Secretary for Financial Services
- Attendance by invitation** : Securities and Futures Commission

Mr Stephen PO
Director of Intermediaries Supervision

Mr Leo LEE
Director of Licensing

Mrs Yvonne MOK
Associate Director of Intermediaries Supervision

Ms Helen H Y LEE
Consultant - Special Project

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 SZETO, Senior Assistant Secretary (1)1

I Meeting with the Administration
(LC Paper No. LS 119/99-00 , LegCo Brief Ref: 121/LG/1001/0200)

The Financial Resources Rules (FRR)

The Subcommittee continued to examine the new FRR starting from section 8.

Section 9 -- Capital requirement for dealers

2. Mr FUNG Chi-kin re-iterated the concern raised by some securities dealers who were sole proprietors about their difficulty in complying with the new capital requirement of \$5 million. He said that currently there was no minimum capital requirement for securities dealers. Sole proprietors were only required to fulfil liquid capital requirement of \$500,000 vis-à-vis that of \$3 million for corporate dealers. He said that sole proprietors would not have difficulty in meeting the new liquid capital requirement which would be increased to \$3 million to be on a par with the existing requirement for corporate dealers. However, as sole proprietors had usually pledged their own assets to obtain financial accommodation from banks for the daily operation of their business, there might be difficulty for them to make alternative financial arrangement to set aside an additional \$5 million to meet the minimum paid-up capital requirement before the new FRR came into force on 12 June 2000. Mr FUNG urged the Administration to consider extending the six-month grace period which was applicable to securities dealers providing securities margin financing for compliance with the new capital requirement to cover sole proprietors.

3. Mr Stephen PO, Director of Intermediaries Supervision, Securities and Futures Commission (SFC) said that when the industry was consulted on the new FRR in 1997, SFC did not receive any objection from sole proprietors in respect of this new capital requirement. Nevertheless, in anticipation of the possible impact of the new requirement on sole proprietors, SFC had explained to them the details of the new requirement during the seminars on the new FRR arranged for the industry in the past few months. No sole proprietors had raised particular problem so far. He added that individual sole proprietors could approach SFC for assistance if necessary. Where sole proprietors had genuine difficulty in meeting the new capital requirement, SFC could consider exempting them from compliance of the rule on a case by case basis and subject to conditions as SFC saw fit without undermining the protection to investors.

4. Mr Leo LEE, Director of Licensing, SFC added that section 9(2) of the new FRR only required sole proprietors, who did not provide securities margin financing, to maintain a minimum of \$5 million in the capital account. The capital could be in any form including cash, securities, fixed assets held in the name of the sole proprietors, etc.

Section 11 -- Calculation of liquid assets

5. Responding to the enquiry raised by the Assistant Legal Adviser 6 (ALA6) at the last meeting, Mr PO explained that in the case of an overseas securities company setting up a branch in Hong Kong, the assets of the entire company would be included in the calculation of liquid assets for compliance with the FRR by the Hong Kong branch.

6. Members expressed concern about the disparity in treatment between a securities company (or a securities margin financier (SMF)) registered in Hong Kong operating an overseas branch and an overseas company operating a Hong Kong branch. They noted that under section 11(2), assets used to satisfy the financial resources requirement of the overseas regulatory authority in relation to an overseas branch of an intermediary registered in Hong Kong could not be included in the calculation of the liquid assets of the parent company in Hong Kong for the purpose of complying with the liquid capital requirement under the FRR. In other words, assets of a Hong Kong intermediary were prohibited by the FRR to be double counted vis-à-vis its overseas branch's liabilities while a similar restriction did not apply to a Hong Kong branch of an overseas company. Members opined that such disparity in treatment was unfair to companies registered in Hong Kong and were concerned that it would encourage local companies to relocate overseas and to operate through a branch in Hong Kong to take advantage of the more favourable treatment. In order to fill such loophole in the regulatory regime, members suggested that the Administration consider regarding a branch of an

overseas company operating in Hong Kong as a separate entity and subjecting it to the same liquid capital requirement applicable to a Hong Kong company.

7. In response, Mr LEE advised that a company operating a branch in Hong Kong had to fulfil other requirements such as placing deposits in prescribed banks in Hong Kong and complying with the accounting and auditing standards of Hong Kong. Some of these requirements were more stringent than those imposed on Hong Kong registered companies. Due to the higher cost of compliance, most overseas companies would prefer to establish a subsidiary company instead of a branch in Hong Kong. Indeed, currently, there were only three overseas securities companies operating through a branch office in Hong Kong.

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8. Members remained concerned about the disparity in treatment of the two types of companies. In order to address members' concern, the Principal Assistant Secretary for Financial Services (PAS/FS) undertook to review in a separate exercise the disparity of treatment, and its implication on encouraging companies to relocate from Hong Kong.

Section 35 -- Dealers or securities margin financiers to lodge monthly returns

9. Noting that dealers or SMF were required under section 35 to submit various FRR returns on a monthly basis, the Chairman enquired about SFC's assistance in helping registrants in this respect. Mr Eric LI Ka-cheung also enquired about the feasibility for SFC to develop appropriate computer software to facilitate them in compiling FRR returns. He made reference to the practice of the Inland Revenue Department (IRD) which had developed its own software programmes to facilitate business enterprises to complete the tax returns.

10. On assistance provided to market participants and professionals, Mr PO advised that SFC had organized a series of seminars for the industry on the new FRR among which three were mainly about the compilation of FRR returns. Two seminars had been scheduled specifically for members of the Hong Kong Society of Accountants later this month. More seminars and workshops could be organized if necessary. SFC had also handled a lot of enquiries from market participants about detailed requirement of FRR returns in recent months.

11. As regards the production of computer software, Mr PO said that it might not be appropriate for SFC to give accreditation to individual software as a means of quality control. He advised that SFC had contacted some ten software vendors and briefed them on the requirements under the new FRR in order to make sure that the software they produced would facilitate market participants and professionals to complete the prescribed forms for monthly returns to SFC. In this connection, Mr LEE supplemented that SFC had been

working on a pilot scheme for market intermediaries to submit various returns and reports to SFC through computer network. The project was in good progress and a number of dealing companies including small ones had participated in the trial run.

Schedule 1 -- Haircut percentages for shares

12. Mr FUNG Chi-kin enquired about the haircut percentage applicable to the Tracker Fund (TF). The Chairman opined that as TF comprised constituent stocks of the Hang Seng Index (HSI), the same haircut of 15% as applied to HSI stocks should be applied to TF. In view that new investment products comprising constituents stocks of HSI were likely to be developed in the future, the Chairman further suggested amending section 1(a) of Schedule 1 by adding "or a combination there of" after "being a constituent stock of the Hang Seng Index" so that they would be subject to the 15% haircut percentage as for HSI constituents stocks. The Administration undertook to consider the Chairman's suggestion.

(Post-meeting note: The Administration advised in its reply dated 19 May 2000 that SFC, after reviewing the matter, had confirmed that TF, though listed on the Unified Exchange, was an index fund by nature. The haircut applicable for equity fund including index fund, as specified in Schedule 3 -- Haircut percentages for other securities and investments, was 20%. Hence, the proposed amendment suggested by the Chairman was not necessary.)

Schedule 2 -- Haircut percentages for qualifying and special debt securities

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13. ALA6 pointed out that the meaning of the category of "Any other bonds" in table 2 under Schedule 2 was unclear. The Administration undertook to move an amendment to clarify the meaning of the category and improve the format of the table.

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14. Mr FUNG Chi-kin opined that as the new FRR was much more stringent than the existing rules, he urged the Administration to undertake regular reviews on the rules in the light of actual implementation. The Chairman requested the Administration to report on the implementation of the new FRR to the LegCo Panel on Financial Affairs. He opined that the first report should be made in September/October 2000 which was sometime after the new FRR had been implemented. The second report should be made in early next year which was after the expiry of the six-month grace period.

Commodities Trading (Accounts and Audit) (Amendment) Rules 2000

15. The Subcommittee supported the amendments made to the captioned rules which were introduced to reflect changes made in the new FRR.

Securities (Margin Financing) (Amendment) Ordinance 2000 (20 of 2000)
(Commencement) Notice 2000

16. Members noted that the captioned Commencement Notice appointed 12 June 2000 as the commencement date of the Securities (Margin Financing) (Amendment) Ordinance 2000 except item 4 of Schedule 3. PAS/FS explained that item 4 of Schedule 3 to the Amendment Ordinance introduced a consequential amendment to the Stock Exchanges Unification Ordinance (SEUO) (Cap. 361) imposing a duty on the Exchange Company to ensure that its members complied with the FRR. Amendments to the same effect had been introduced to SEUO by the Exchanges and Clearing Houses (Merger) Ordinance (12 of 2000) which was enacted in February 2000. Accordingly, there was no need to bring into operation item 4 of Schedule 3 to the Amendment Ordinance. He added that the Administration would consider repealing the item under the composite Securities and Futures Bill.

17. The Subcommittee raised no objection to the Commencement Notice.

II Any other business

18. The Subcommittee completed the scrutiny of the three pieces of subsidiary legislation and agreed to report to the House Committee on 26 May 2000.

19. The meeting ended at 12:40 pm.

Legislative Council Secretariat
25 August 2000