LINKLATERS ON BEHALF OF A GROUP OF FINANCIAL INSTITUTIONS

Clause by clause summary of outstanding comments on the Bill/ amendments expected to be made by the Administration in the light of comments made.

7 June 2001

INTRODUCTION

This paper does not raise new issues, but is intended to summarise, on a clause by clause basis, the main comments made by the Group of nine financial institutions for which Linklaters is acting, and to indicate whether, in discussions with the Group and/or in its written response to public comments, the Administration has addressed those comments (and, if so, whether the Administration has indicated willingness to propose Committee Stage Amendments to the Bill).

As noted in this paper, we have had detailed discussions with the Administration and the SFC in a number of areas. We hope that these discussions will continue and that some, at least, of our remaining points will be addressed, for example by exemptions to be made by the SFC under powers to be conferred under the Bill.

PART IV - OFFERS OF INVESTMENTS

Provision	Group's comments	Administration's response
Clause 102 - issue of advertisements, invitations etc.	We suggested that there should be more clarification on when an invitation would be regarded as being made to the public and proposed some express safe harbours, such as for marketing to no more than 50 persons. We also noted that the exemption for marketing to "professional investors" is in some respects narrower than the exemption under the existing law (which permits marketing to anyone whose business involves buying, selling or holding securities). Finally, we note that the various exemptions in Clause 102 seem to be mutually exclusive - for example the exemption for marketing to professional investors is only available if the investments are being sold only to professional investors.	The Administration has stated (in Paper No 4/01 to the Bills Committee) that "the notion [of the public] is essentially a question of fact and should in case of dispute be decided by the court". We remain of the view that this may make it difficult to conduct business without a high degree of uncertainty. The Administration has stated that the definition of "professional investor" in the existing law is too uncertain. However in addition to the categories of person within the definition of "professional investor" in Schedule 1 to the Bill, the SFC has power to prescribe additional categories through making rules. A Working Group, including some members of the Group, has been set up with the SFC to discuss the types of persons who might be included in any such rules.
Clause 107 - civil liability for inducing others to invest money in certain cases	The version of Clause 107 in the White Bill made clear that a person was only liable to pay compensation for pecuniary losses that were within the reasonable contemplation of the parties at the time when the misrepresentation was made. However, this "reasonable contemplation" test was deleted in the Blue Bill.	The Administration, in Paper 4/01, did not accept our suggestion that Clause 107 be consolidated with other clauses in Parts X, XIII and XIV of the Bill which give rise to a civil cause of action. The Paper does not specifically address our other comments.

Provision	Group's comments	Administration's response
	While we do not object in principle to a right of action for misrepresentations, in our view Clause 107 goes considerably further than common law liability for misrepresentation. We proposed restricting compensation to cases where it was reasonable for the person to whom a misrepresentation was made to have relied on it, where the losses were within the reasonable contemplation of the parties and where compensation was fair, just and reasonable. We are also concerned about Clause 107(2), under which directors are liable for misrepresentations made by the company unless the director concerned can prove that he/she did not authorise the making of the misrepresentation. It is difficult to prove such as negative.	
Clause 108 - offers by intermediaries	This is based on Section 72 of the Securities Ordinance, the purpose of which seems unclear. We assume that it is meant to apply to the situation where a securities dealer/investment adviser is acting on behalf of an offeror, to facilitate a general offer to buy or sell securities. If so, it should, in our view, be significantly redrafted. Currently, it would seem to apply (subject to the defences in Clause 108(5)) to any situation where a securities dealer/investment adviser "invites" a customer to acquire or dispose of any securities, even if the transaction will simply be a normal secondary market transaction.	The Administration in Paper 4/01 referred to some additional exemptions to Clause 108 that were introduced in the Blue Bill as compared with the White Bill. While helpful, these exemptions do not address the specific comments we have raised.

Provision	Group's comments	Administration's response
	Unless Clause 108 is to be redrafted more narrowly, there should in our view be an exemption for offers relating to the purchase or sale of securities to take place on-exchange (whether or not the offer is made by an Exchange participant), and an exemption for communications with an existing client, whether or not the person has acted on at least three transactions for the client in the preceding 3 years.	
Clause 109 - offence to issue advertisements relating to carrying on of regulated activities etc.	We have made a number of points on the scope of Clause 109. In view of Clause 102 we see no particular reason for Clause 109 at all (and the fact that it is an expansion of an existing statutory provision, Section 5 of the Protection of Investors Ordinance, does not appear to be a valid reason for its inclusion in the Bill). If Clause 109 is to remain in the Bill, we propose that it should be expressly limited to advertisements in which an unregulated person holds himself out as being prepared to carry on in Hong Kong the regulated activity for which he is not licensed or exempt. Also, there should be an exemption for Type 1 intermediaries, who are not licensed to conduct investment advisory activities, and are not exempt persons, but who are permitted to engage in investment advisory activities if wholly incidental to a securities dealing business. Also, we consider that (for consistency with Clause 102) Clause 109 should be restricted to advertisements issued to the public.	There has been no specific response to date on these comments.

PART V - LICENSING AND EXEMPTION

Provision	Group's comments	Administration's response
Clause 114(6)	The definition of "securities margin financing" applies where financial accommodation is provided in order to facilitate the acquisition etc. of securities. Since the definition relates to the provider rather than the recipient, we believe that a licensing requirement should only be triggered if the provider of the financial accommodation was aware that the funding was to be used for this purpose. Therefore, the defence in Clause 114(6) of the Bill appears unnecessary, and may in fact be regarded as expanding the scope of the licensing requirement. The defence is only available if the provider reasonably believed that the funding was not to be used to facilitate the acquisition etc. of securities. If a person makes a loan, and the borrower is free to use the loan for any purpose, this defence would not seem to be available. If the borrower happened to use the loan to buy listed securities, there is a risk that the lender would therefore be regarded as having engaged in securities margin financing (even though the loan was not made in order to finance the acquisition of securities). We suggested that the defence should be available to a lender unless he had reasonable grounds to believe that the funding would be used to acquire listed securities.	The SFC has written to the Group indicating that it sees no need to amend Clause 114(6). This has also been stated in the Administration's response to comments on Part V of the Bill (Paper 5D/01).
Clause 115(7)	Clause 115(7) prohibits a licensed corporation, when carrying on regulated activities, from using a name other than the name specified in its licence. We are concerned as to whether this will prohibit the use (in conjunction with the licensed name) of trade names, brand names etc.	No specific comments.

PART VI - CAPITAL REQUIREMENTS, CLIENT ASSETS ETC.

Provision	Group's comments	Administration response
Clause 141 - financial resources	This clause gives the SFC extensive rule-making powers. We believe that the Bill should provide for public consultation before such rules are made. The same comment applies to the other rule-making powers in Parts VI and VII of the Bill.	From discussions with the SFC, the Group understands that they are considering providing that all rules (like any rules to be made under Clause 384(2)) required prior public consultation. They thought that if this change were to be made, a carve out would be needed because the public interest might require rules to be made quickly and without prior consultation.
Clause 142 - failure to comply with financial resources rules	By Clause 142(14), the financial resources rules may provide that a breach of those rules, without reasonable excuse, is a criminal offence. The SFC will have, under the Bill, extensive powers to take disciplinary action against intermediaries (including the power to impose civil fines of up to HK$10 million). It seems unnecessary, and contrary to principle, for the SFC to have power to create criminal offences as well, punishable with imprisonment and a fine. The same comment applies to the other rule-making powers in Parts VI and VII of the Bill.	In Paper 6A/01 to the Bills Committee the Administration notes that breaches of rules will only be criminal if committed without reasonable excuse and that the rules would be subject to negative vetting by Legco.

PART VII - BUSINESS CONDUCT, ETC.

Provision	Group's comments	Administration's response
Clause 163 - business conduct of intermediaries and their representatives	Same comments on SFC not being required to issue rules in draft for public consultation, and on ability of SFC to make rules a breach of which is a criminal offence.	As above.
Clause 164 - codes for business conduct of intermediaries and their representatives	There should be a requirement for public consultation before codes of conduct are issued.	The Administration commented in Paper 6B/01 to the Bills Committee that it is standard practice for the SFC to consult with the market on proposed codes and guidelines.
Clause 168 - requirements for options trading	The reason for the inclusion of Clause 168 (option trading) as a separate section is unclear. Any rule-making power is, in our view, more appropriately included in Clause 163.	The Administration has stated in Paper 6B/01 that in their view options trading is a discrete matter better dealt with in a separate clause.
Clause 169 - cold calling	The rationale for prohibitions on cold calling is to prevent high-pressure sales techniques. We consider that the definition of "call" in Clause 169(7) is unduly wide and the prohibition in Clause 169 should only apply in respect of personal visits or telephone calls. As drafted, Clause 169 would appear to be wide enough to cover television advertising, banner advertising on websites etc. as well as mailshots. The exemption for calls on persons whose business involves the acquisition, disposal or holding of securities has been replaced by an exemption for calls on professional investors. The definition of professional investor in the Bill is in some respects narrower than the current exemption.	The SFC has indicated that it does not wish to amend the wide definition of "call" in the Bill but is willing to consider introducing rules to exempt certain types of "calls" from the prohibition. A Working Group, including industry representatives, has been established to consider this issue and proposals for exemptions are awaited from the SFC. We hope that the SFC will agree to make rules to treat additional categories of persons as professional investors - a Working Group has also been established to discuss this issue

Provision	Group's comments	Administration's response
	We commented that Clause 169(6) (right of rescission) is too widely drafted. A person who receives an unsolicited call will be aware of this from the time the call is made. If a person wishes to avoid a contract which has turned out to be unprofitable, there is a significant risk that he will argue that he has only just realised that he has a right of rescission, and seek to set the contract aside a long time after it was entered into.	*The Administration has agreed to introduce a CSA to limit the right of rescission to 28 days from the date of the contract.*

PART IX - DISCIPLINE, ETC.

Provision	Group's comments	Administrator's response
Clause 188 - other circumstances for disciplinary actions in respect of licensed persons, etc.	We expressed concern that Clause 188(1)(d) would allow the SFC to revoke or suspend existing licences if it changed its licensing standards for new applicants, and existing licence holders did not meet those standards.	*The Administration has agreed to introduce a CSA to delete Clause 188(1)(d)*.

PART X - POWERS OF INTERVENTION AND PROCEEDINGS

Provision	Group's comments	Administration's response
Clause 208 - civil liability for false or misleading public communications concerning securities and futures contracts.	While we do not object in principle to civil rights of action being created in respect of negligent misrepresentations, Clause 208 as currently drafted is too broad in scope. Potentially, it seems that any communication made available to more than one person could be treated as a communication to the public. If Clause 208 is to remain in the Bill, we consider that it should be limited to announcements made to the public at large e.g. through public media such as newspapers, TV and financial portals, and to communications to holders of securities in a listed corporation. If a communication is issued, the range of persons who can be liable under Clause 208 for any inaccuracy in that communication is very wide. A person is treated as "responsible" for a communication if he issued it, caused or authorised the material to be issued, or in any material manner participated in, or approved, the making or issuing of it. This creates a risk of multiple liability and of a person being sued for misstatements contained in communications with which he had limited involvement. In order to attract liability for negligent misrepresentation under Clause 208, it is only necessary that the representation "concerns" securities or futures contracts, or "may affect" the price of securities or futures contracts. This is very wide, and it would be better if it was limited to a situation where the person making the communication was aware that it was likely to have a material effect on the price of specific securities.	In its response to comments (Paper 9A/01), the Administration did not accept the comments of the Group and other commentators on Clause 208, arguing that the introduction of the specific cause of action to make investors explicitly aware of their rights is justified, and that Clause 208 indicates with sufficient clarity the criteria which have to be satisfied if liability is to attach.

Provision	Group's comments	Administration's response
	Liability under Clause 208 arises either if this is "fair, just and reasonable" or if the person has "assumed a responsibility" with respect to the claimant in connection with the relevant communication. It is not at all clear when there would be such an assumption of responsibility, and even if there is, there should be no obligation to compensate unless this would be "fair, just and reasonable". It would be better if it was necessary for the claimant to show both an assumption of responsibility and that compensation is fair, just and reasonable.	

PARTS XIII AND XIV - (MARKET MISCONDUCT)

Provision	Group's comments	Administration's response
Clause 237 - interpretation of Part XIII	"Listed securities" - as compared with the definition in the Securities (Insider Dealing) Ordinance, the definition is extended to include: "…securities which, at the time of any insider dealing…have not been issued by the corporation and are not listed but which, at that time, it is reasonably foreseeable will be and which, in fact, are subsequently so issued and listed." This will create difficulties for pre-IPO marketing and underwriting, since at the time of marketing or arranging underwriting, the investment bank concerned will have price-sensitive information about the issuer. Same comment applies in respect of Clause 277 - Interpretation of Part XIV.	The Administration's response in Paper No.12A/01, referring to equality of information distribution in light of the U.S. SEC's Regulation FD, does not specifically address the concern raised. If the definition is to be extended to cover unlisted and unissued securities, we believe there should be a safe harbour for pre-IPO marketing and underwriting.

Provision	Group's comments	Administration's response
Clause 240 - possession of relevant information in a privileged capacity (insider dealing)	The Securities (Insider Dealing) Ordinance was extended last year to treat an Exchange participant which receives price-sensitive information about a listed corporation as "connected" with that corporation, therefore preventing the Exchange participant from dealing in that corporation's securities. This change to the law was not well publicised and many industry participants are unaware of it. We are concerned that it would prevent an Exchange participant who, for example, receives an order from a substantial shareholder who is increasing his stake, from executing that order. The Bill would extend liability to officers and employees of the Exchange participant as well. The law in other countries (United Kingdom, Singapore, Australia) creates a safe harbour so that a person who has knowledge of a proposed transaction is not precluded from executing that transaction because of his knowledge. Same comment applies in respect of Clause 280 in Part XIV of the Bill.	The Administration has indicated in Paper 12A/01 its view that there is no need for a safe harbour. The Group submitted a further paper to the Bills Committee in May 2001, copied to the Administration, responding to Paper 12A/01 but has not as yet had any feedback on this. Generally, we would urge the SFC to exercise its powers under Clause 273 and 297 of the Bill to make rules creating a number of "safe harbours" from Parts XIII and XIV of the Bill, and would welcome the opportunity for more discussions with the SFC on this subject.

Provision	Group's comments	Administration's response
Clause 242 - interest in securities and beneficial ownership etc. (market misconduct other than insider dealing)	Clause 242(7) provides that for the purposes of the provisions of the Bill on false trading etc. a transaction is deemed to be a "wash trade" (and therefore illegal unless a defence can be shown) if, after the transaction, an associate of a person who had an interest in the securities before the transaction is interested in the securities. This provision seems unduly wide, and may make large numbers of legitimate transaction potentially criminal (e.g. one company in a group is selling securities on-market to hedge a derivatives transaction at the same time that the fund management company in the group is buying such securities for its clients portfolios). Same comment applies in respect of Clause 282 in Part XIV of the Bill.	In Paper 12A/01 the Administration repeated its view that the provisions on such trades only apply to "common blatantly manipulative forms of conduct which have few legitimate excuses". We responded to this in our further submission to the Bills Committee of May 2001, on which we have not as yet received any feedback.
Clause 265 - false trading	Although Clause 265(1) and (2) require that the person acted intentionally or recklessly, we are concerned that if a person intentionally does something that, in the view of the Tribunal or court, had the result of misleading the market, he would be guilty of false trading even though he did not intend and was not reckless as to whether, his conduct created a false or misleading appearance. We had proposed a minor drafting change to clarify that intention or recklessness must relate to all the elements of the offence.	The Administration's response in Paper 12/01 does not specifically comment on this issue.

Provision	Group's comments	Administration's response
	Clause 265(5) deems certain types of transactions to constitute "false trading", subject to the possibility of the person who engaged in the activity establishing a defence that his purpose was not to create a false or misleading appearance in the market. We understand that Clause 265(5) is intended to prohibit "wash trades" and "matched orders", and we agree that these are abusive transactions that should be prohibited. However, Clause 265(5) would also appear to be drafted widely enough to catch many legitimate transactions: • as noted above, by Clause 242(7), a sale or purchase is treated as not involving a change in beneficial ownership if one person had an interest in the securities before the sale or purchase, and an associate of that person has an interest after the sale or purchase. • read literally, the clause would prohibit off-market transfers of securities from a company to an associated company, which occur very regularly and have no market impact whatsoever. • even in relation to market transactions, it may be very likely that one company will be selling securities (for example, for the purposes of an index arbitrage transaction, and an associated company, or a different division of the same company, (for example, a fund manager acting for its clients) will be purchasing the securities in the market). As a result of Chinese Walls, each party will be unaware of the other's involvement in the market.	

Provision	Group's comments	Administration's response
	In summary, we do not agree with the Administration's comment that the only types of transactions falling within Clause 265(5) are "common blatantly manipulative forms of conduct which have few legitimate excuses". Nor do we believe that it would make it unduly difficult to prosecute blatantly abusive conduct if the onus of proof was on the prosecution. Furthermore, we consider that Clause 265(5) and Clause 242(7) should be more narrowly drafted so as not to deem transactions between associated companies to be illegal. Same comments apply in respect of Clause 287 in Part XIV of the Bill.	
Clause 266 - price rigging	We remain of the view that a separate market misconduct category of price rigging is unnecessary. The Administration states in its comments that it would be circular, confusing and unnecessary to expand the defence in Clause 266(4) to all the various categories of offence set out in Clause 266. If it were clear that the offences in Clause 266(1)(b) and (2)(b) require proof of intention or recklessness as to all the elements of the offence (including artificiality) we would agree with this. However, we consider that as drafted, these categories do not necessarily require proof of wrongdoing. Our preferred solution would be to repeal or redraft Clause 266(1)(b) and (2)(b). However, if this is not done, we consider that a defence should be available for a person whose purpose was not to rig the market. Same comments apply in respect of Clause 288 in Part XIV of the Bill.	The Administration in its response repeats its view that, notwithstanding the considerable duplication between Clauses 265 and 266, both should be included in the Bill.

Provision	Group's comments	Administration's response
Clause 268 - false or misleading information	We are concerned that Clause 268, which applies to anyone who is "concerned in" the dissemination of false or misleading information which is "likely" to affect market prices or induce transactions, is too widely drafted. See our comments on Clause 290, below.	The Administration, in Paper 12A/01 states that it does not anticipate that Clause 268 will have a "chilling" effect on the dissemination of reliable information. However, we remain concerned about the scope of this provision.
Clause 272 - civil liability for market misconduct	While we do not object in principle to statutory rights of action for negligent misrepresentations, we consider that the scope of the right of action should be further qualified, so that the action should only arise in favour of persons to whom the relevant representation was addressed, and where it was reasonable for the person to rely on the representation, and where the loss was within the reasonable contemplation of the parties at the time when the misrepresentation was made.	In Paper 12A/01 the Administration says that it does not anticipate a floodgate of unmeritorious claims.
Clause 273 - transactions not to constitute market misconduct	In relation to insider dealing, we believe that, in line with the law in other markets, a number of safe harbours for legitimate transactions such as stake-building, underwriting, pre-IPO marketing and stabilisation activities should be introduced, so as not to impede the conduct of the Hong Kong market.	The SFC has indicated willingness to make rules introducing a safe harbour for stabilisation but not for other activities. We would welcome the opportunity for further discussions with the SFC in this area.
Clause 277 - interpretation of Part XIV	See comments on Clause 237 above.	See above.
Clause 280 - possession of relevant information in a privileged capacity - insider dealing	See comments on Clause 240.	See above.

Provision	Group's comments	Administration's response
Clause 282 - interest in securities and beneficial ownership etc. (market misconduct offences other than insider dealing)	See comments on Clause 242 above.	See above.
Clause 287 - offence of false trading	See comments on Clause 265 above.	See above.
Clause 288 - offence of price rigging	See comments on Clause 266 above.	See above.

Provision	Group's comments	Administration's response
Clause 290 - false or misleading information	We note the Administration's comments on Clause 290, but remain unconvinced that it is appropriate for the Bill to criminalise the negligent dissemination of false or misleading information. The offence is a very serious one, carrying a maximum penalty of 10 years imprisonment and a fine of HK$10 million. We believe that criminal liability should be limited to mis-statements made knowingly or recklessly.	In Paper 12A/01, the Administration notes that existing HK law already imposes criminal liability for negligent dissemination of information, and that Australian, Singaporean and Malaysian law does too.
	Also, Clause 290, like Clause 268, is very widely drafted, and may apply to anyone who is "concerned in" the dissemination of false or misleading information if that information is regarded as "likely" to affect market prices or induce transactions. The width of the drafting raises the potential for multiple liability, and for civil lawsuits to be brought, under Clauses 272 and 296, not just against the person with direct responsibility for the mis-statement. For example, where a listed company has issued an announcement, actions might be brought against all the professional advisers to the company who were in any way involved. Furthermore, these provisions may apply not just to formal documents such company circulars, but also to informal comments or correspondence. For example, an off-the-cuff remark to the press by a director of a listed company may be likely to affect market prices, and it seems very harsh that the director would be exposed to the risk of criminal and civil liability if the remark was, through carelessness, inaccurate.	The Administration states in Paper 12A/01 that the present requirement in Clause 290 that the information be likely to induce investment decisions is appropriate.

Provision	Group's comments	Administration's response
Clause 294 - falsely representing dealings in futures contracts	We proposed a minor amendment to ensure that, if a futures contract was being executed on a futures exchange, and the broker mistakenly confirmed that the order had already been executed when it had not, he would have the ability to establish a defence. This has been rejected by the Administration, which means that the offence is one of strict liability, and could criminalize mistakes made by legitimate futures brokers who are not "bucket shops".	In Paper 12A/01 the Administration states that there is no need for such a defence, and that it is a simple matter for a broker to check whether an on-exchange contract has in fact been executed.
Clause 296 - civil liability for market misconduct	Same comments as on Clause 272 - see above.	

PART XV - (DISCLOSURE OF INTERESTS)

Provision	Group's comments	Administration's response
Clause 299 - interpretation of Part XV	As a general comment, the Group, as well as the International Swaps and Derivatives Association ("ISDA"), is concerned about expanding the scope of the disclosure regime to cover: • interests in unissued share capital • interests in cash-settled equity derivatives • short positions • disclosure of changes in the nature of an interest If the existing law were to be amended in the above respects, the drafting of Part XV could be considerably simplified, and many of the definitions in Clause 299, such as "cash-settled equity derivatives" could be deleted.	Detailed comments on the policy underlying the legislation have been set out in the Administration's Paper 13/01 and 13A/01. The Administration is only willing to consider relaxations in respect of stock lending and borrowing activities, and proposes that provisions should be included in the Bill giving the SFC power to create exemptions from the disclosure regime for such activities. While we would prefer wider redrafting of Part XV in relation to stocklending and borrowing, we support this proposed change to the Bill.

Provision	Group's comments	Administration's response
	If disclosure of interests in unissued share capital is not to be required, the definition of "relevant share capital" should, in our view be amended by deleting para. (b) of the definition. If the law is to be extended to require disclosure of interests in unissued shares, we have the following comment. In relation to issued share capital, if there are shares of more than one class, disclosure obligations apply separately in respect of each class. However, in relation to unissued shares, the definition refers to issued shares of <u>any</u> class. Clause 299(2) also confirms that disclosure obligations are computed on a class-by-class basis in relation to <u>issued</u> share capital, but does not refer to unissued share capital. This could mean that the holding of shares in Class A would need to be aggregated with a holding of convertible bonds convertible into shares of Class B for disclosure purposes, which would not make sense. See also our comments on Clause 305.	The Administration, in its response to comments (Paper No. 13A/01) has said that "the principle is that relevant share capital (issued or unissued) should only be aggregated with shares of the same class. We will consider whether this point needs to be further clarified."
	Clause 299(6) is intended to clarify whether a derivative relating to a number of different underlying shares creates a discloseable interest in all or any of those shares. Clause 299(6) as drafted is defective because if the derivative related to a large basket of shares, no single stock being a substantial part of the basket, the holder of the derivative would still have a discloseable interest in all the underlying stocks.	*We understand that Clause 299(6) is to be redrafted, and the SFC is thinking of imposing a requirement that no stock represent more than 30% of the basket.* This figure may be problematic since HSBC currently represents over 27% of the weighting of the Hang Seng Index.
Clause 301 - duty of disclosure - cases in which it may arise	Generally, the legislation requires a substantial shareholder to disclose his "short positions" if representing 1% or more of the company's relevant share capital. However, Clause 301(5) appears to have the effect that, when the legislation comes into force, substantial shareholders would need to disclose <u>any</u> short position, however small..	*We understand that the Administration is prepared to make an amendment so that only short positions <u>of 1% or more</u> would require disclosure on the coming into force of the legislation*

Provision	Group's comments	Administration's response
Clause 304 - circumstances in which duty of disclosure arises	Clause 304(1)(d) requires disclosure of a change in the nature of a substantial shareholder's interests. As indicated above, our preference would be for this requirement to be deleted in its entirety, but the Administration is unwilling to make this change. Clause 304(9) and (10) create an exemption from disclosure in respect of intra-group transactions. We wrote to the SFC on 2 April 2001 expressing concern that: • the exemption does not apply in respect of changes in the nature of an interest • since the exemption merely creates an exemption from the duty of disclosure (rather than not being deemed to affect the relevant company's "interests" at all), any subsequent transaction in the shares by the relevant companies, however small, could trigger a disclosure obligation. • also, the intra-group exemption as drafted does not seem to avoid the consequence that, where there is a transaction between two subsidiaries, the holding company would need to aggregate the interests of both, resulting in the "double counting" that the intra-group exemption is intended to avoid.	*The Administration has indicated to the Group (and to the Bills Committee) that it is willing to introduce a minimum disclosure threshold, and a de minimis exemption, in respect of disclosure obligations arising through a change in the nature of a person's interest. (For example, that the change in nature would not be discloseable unless it affected 1% or more of the relevant share capital).* *The Group was told by the Administration that it plans to introduce Committee Stage Amendments to Clause 304(9) and (10) to better reflect the policy intention although we do not know what changes are proposed.*

Provision	Group's comments	Administration's response
	Clause 304(11) includes an exemption for "conduit" stock lending and borrowing. We have discussed with the Administration the fact that the exemption, as drafted, is too narrow to be of any practical use to the stock lending and borrowing industry.	*We understand that the Administration is proposing to introduce a new-rule making power for the SFC, in a new Clause 365A of the Bill, that would give the SFC the ability to create further exemptions from the disclosure regime in respect of stock lending and borrowing activities. This power, and exemptions to be made under it, would be very welcome. A Working Group has been established with the SFC to discuss the scope of these exemptions.*
Clause 305 - percentage level in relation to notifiable interests and short positions	As discussed above, it is intended that (as under the existing law) disclosure obligations are computed for each class of share capital separately. However, Clause 305(1) appears to require aggregation of interests in all classes of relevant share capital, and the same applies to Clause 305(4) in respect of short positions. Clause 305(2) appears to have the effect that if a person holds 10% of the issued share capital, and the company issues more shares in a rights issue that the person does not take up, no disclosure obligation under Clause 304(1)(b) or (c) arises, even though the holding is diluted by more than 0.5%. However, if the person had taken up his pro-rata entitlement, the effect of Clause 305(2) is that he would have to calculate his prior holding based on the new issued share capital. This would appear to trigger a disclosure obligation, even though in reality his percentage interest has not increased.	*In its response to comments, the Administration has said that it plans to propose Committee Stage Amendments*.

Provision	Group's comments	Administration's response
Clause 307 - notification of family and corporate interests and short positions	Clause 307(5) provides that interests held by a group company which acts as custodian, investment manager or trustee need not be aggregated with other interests of the group if certain conditions are satisfied. The purpose of Clause 307(7) is obscure. If Company A is the parent company of Company B and Company B (for example) holds warrants to subscribe for shares in a Hong Kong listed company, Clause 307(7) is not necessary in order to apply the provisions of Clause 313 (interests to be taken into account) to Company B, because Company B is a "person" to which Clause 313 applies in any event.	*We understand from the Administration that these provisions will be redrafted to some extent.* *In its response to comments, the Administration has indicated that it will propose a Committee Stage Amendment.*
Clause 314 - interests to be disregarded for the purpose of notification	Clause 314(1)(a) exempts an interest of a "bare trustee". Under many modern custody agreements, it is not clear whether the trustee is in fact acting as a bare trustee. Clause 314(1)(e) exempts an "exempt security interest". We have been discussing with the SFC whether the definition of this term is wide enough to cover industry-standard financing arrangements such as prime brokerage, and provision of collateral under ISDA credit support documentation, where the chargee is free to use the collateral for its own purposes. A drafting amendment to clarify that such arrangements were exempt from disclosure, unless and until the borrower defaulted, would be welcomed.	The Group understands from discussions with the SFC that the SFC is considering a drafting amendment to make clearer that custodians, as long as they do not have discretionary authority in respect of the securities, are exempted from having a discloseable interest. This would be welcomed.
Clause 316 - time of notification	The section refers both to "knowledge" and "awareness" of interests in shares and it is not clear whether any difference in meaning is intended. We have suggested that the drafting should be made consistent.	

Provision	Group's comments	Administration's response
Clause 317 - particulars to be included in notification		*The Administration has indicated, to the Group and to the Bills Committee, that Clause 317(1)(g), which requires disclosure of the highest and average price paid or received in relation to short positions, will be deleted. This would be welcomed.*
Clause 320 - power of listed corporation to investigate ownership of interests in its shares, etc.	We have expressed concern on the wide scope of the powers of listed corporations to require information about interests in derivatives and short positions arising in the preceding 3 years, and the burden this may impose on persons who receive a request for information.	In Paper 13/01 the Administration states that, to the extent it is necessary to extend the S(DI)O to require disclosure of equity derivatives, then it must follow that the investigation provisions also be extended in parallel.

Schedule 1 - Interpretation and general provisions

Provision	Group's comments	Administration's response
"futures contracts" and "futures market"	A "futures market" is defined widely enough to include a place at which facilities are provided for persons to negotiate contracts for differences. This could apply not just to futures exchanges but also to systems for facilitating transactions by professional investors in swaps etc. The contracts negotiated through the system would therefore be "futures contracts", which could have various implications under the provisions of the Bill relating to marketing of investments, conduct of business rules for licensed intermediaries, market misconduct etc.	The Administration has not specifically commented on this point.
"professional investor"	Currently, the laws relating to marketing and to licensing requirements contain various exemptions for activities in relation to "professionals". For example, a licence as a securities dealer is not required to effect transactions as a principal with persons whose business involves the acquisition and disposal, or the holding, of securities (whether as principal or agent). The new definition of "professional investors" in the Bill is more restrictive because it only covers specific categories of persons.	The SFC has power to make rules to treat additional categories of persons as "professional investors" and a Working Group has been set up to discuss such rules. Whether there will be problems in practice arising from the definition of professional investor will depend on the scope of the rules that the SFC may be willing to make.
"regulated investment agreement"	We commented that the definition is extremely broad and would seem wide enough to include any agreement for sale of an asset bought with a view to capital growth.	The Administration has not specifically commented on this point.

Schedule 6 - Regulated Activities

Provision	Group's comments	Administration's response
"advising on corporate finance"	The definition includes advice concerning offers of securities to the public. This should be limited to offers to the public in Hong Kong. We also raised a concern that (because of the word "including") paragraph (c) of the definition would extend to general strategic advice or advice on restructuring of loans, and not just to advice involving securities. The exemption in Part V of the White Bill for advising on corporate finance, other than on a regular basis and for remuneration, has been deleted. Therefore, for example, a securities dealer who may occasionally give incidental corporate finance advice will need to be licensed for both Type 1 and Type 6 activities.	No specific response. *In its response to comments on Schedule 6, the Administration has agreed to make a Committee Stage Amendment*. The Administration has indicated that a licensed securities dealer should not carry on the activity of giving advice on corporate finance as a business without a Type 6 licence as "advising on corporate finance is a very specialised field". This is correct as regards (for example) acting as sponsor on an IPO, or as financial adviser on a take-over bid. However, in our view, incidental advice in relation to restructuring may be somewhat different.

Provision	Group's comments	Administration's response
"advising on futures contracts" and "advising on securities"	The exemption (set out in the existing legislation and Part V of the White Bill) for a person who gives such advice otherwise than for remuneration and as part of a regular business has been deleted. As long as the advice constitutes a "business" activity, a licence would therefore be required (although there are exemptions for persons licensed as securities dealers, or futures dealers, respectively, which give advice wholly incidental to their securities dealing or futures dealing activities). We commented that this may be of concern to financial portals and website providers, which post research reports and other financial information on their sites.	*The Administration has agreed, in its response to comments, to propose a Committee Stage Amendment, to extend an exemption to publications through electronic media.*
"dealing in securities"	As compared with the existing law, there is a new limb of the definition, in paragraph (b): "… providing a facility for bringing together on a regular basis sellers and purchasers of securities, or for negotiating or concluding sales and purchases of securities." This is extremely wide, and would appear to catch vendors of dealing systems that provide facilities to licensed intermediaries to assist those intermediaries to enter into securities transaction with their clients. Arguably, even the installation of a telephone system in a dealing room of an investment bank would fall within the definition. The exemption in paragraph (b)(xiii) of the definition of "dealing in securities", for investment advisers or corporate finance advisers, who issue documents in accordance with Section 108 of the Ordinance, is difficult to follow. Section 108 as drafted does not refer to Type 6 intermediaries (i.e. corporate finance advisers) at all.	*The Administration has indicated that it shall propose CSAs to remove paragraph (b).* *The Administration has confirmed it will propose a CSA to correct this*.

Provision	Group's comments	Administration's response
"leveraged foreign exchange trading"	The exemption for contracts for hedging purposes applies under the Bill to any "corporation", but only if the hedging transaction is effected with a "company" i.e. a Hong Kong incorporated-company. We consider that there should be a wider exemption for inter-professionals business (whether or not for hedging purposes and whether or not one of the parties to the transaction is itself a licensed leveraged foreign exchange trader or bank).	*The Administration has agreed to propose a CSA to extend the exemption to transactions effected by a corporation with any other corporation.* The Administration has confirmed that it intends to re-make the existing exemptions in the Leveraged Foreign Exchange Trading (Exemption) Rules (the "Rules"), so that those entities that are currently entitled to rely on exemptions under the Rules may continue to rely on them. However, it is not willing to consider wider exemptions.
"providing automated trading services"	This is very widely defined. For example, it would appear to include a "bulletin board" on which persons accessing a website may display securities prices, even though the transactions would then be included on a bilateral basis off-line, with the bulletin board provider having no involvement.	In its response to comments, the Administration stated that the intention is not to catch vendors of technology services and that the SFC would issue guidelines, but seemed unwilling to consider amending the definition in the Bill.

Provision	Group's comments	Administration's response
"securities margin financing"	In the White Bill certain activities were excluded from the definition of "securities margin financing". In the Blue Bill, four of these excluded activities have been removed from the exemption to the definition of securities margin financing. Instead, under Clause 114(5), a person whose only securities margin financing activities are one or more of those four excluded activities would not be regarded as contravening the requirement to be licensed to carry on securities margin financing. The effect of treating these activities as excluded activities, rather than as falling outside the definition of securities margin financing, appears to be that if those activities are engaged in by a licensed securities margin financier, the rules on securities margin financing made under Part VI of the Bill will still apply (see Clause 117(1)(d)(ii)). However, it seems likely that such rules will be inappropriate in respect of these excluded activities and we would prefer to see the excluded activities being treated as exclusions from the definition of securities margin financing as in the White Bill.	The Administration has stated that applicable conduct of business rules should apply for the sake of investor protection. Since the excluded activities are: stock lending and repos, loans to banks and licensed dealers, loans by a company to its employees in connection with its own securities, and intra-group transactions, we question whether any investor protection concerns in fact arise.