For discussion on
23 February 2001

Paper No. 6/01

Bills Committee on
Securities and Futures Bill and Banking (Amendment) Bill 2000

Securities and Futures Bill
Part VI – Capital Requirements, Client Assets, Records and Audit relating to Intermediaries
Part VII – Business Conduct, etc of Intermediaries

Banking (Amendment) Bill 2000

INTRODUCTION

At the meeting on 16 February 2001, Members considered Paper No.5/01[1] which gives an overview of the regulatory regimes for a licensed corporation, a licensed representative, and an exempt authorized institution ("exempt AI") and its relevant employee (collectively referred to below as "market practitioners").

2. This paper outlines the key proposals under Parts VI and VII of the Securities and Futures Bill (the "SF Bill") and the corresponding proposals in the Banking (Amendment) Bill (the "BAB"), which primarily concern the ongoing financial and operational requirements that apply to a market practitioner and an associated entity (see paragraph 4 below) under the proposed regulatory regimes. At Annex is a table comparing the provisions in Parts VI and VII with the existing law.

MAJOR PROPOSALS

The overall framework

3. Several existing Ordinances applicable to the securities and futures market empower the Securities and Futures Commission (the "SFC") to make subsidiary legislation to govern detailed regulation of market practitioners. Perhaps the best example is in the Securities and Futures Commission Ordinance (Cap.24) which empowers the SFC to make Financial Resources Rules ("FRRs"). The SFC can also make rules under the Securities Ordinance (Cap.333) (the "SO") and the Commodities

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1. Part V of and Schedule 6 to the SF Bill delineate the activities for which a licence granted or an exemption declared by the SFC is required (the "regulated activities"), and also deal with the application procedures, the approval criteria and the conditions attached to a licence or an exemption. Annex A to Paper No.5/01 compares the regulatory frameworks respectively for a licensed corporation and an exempt AI by setting out the detailed requirements prescribed in Parts V to VII of the SF Bill, the BAB and the relevant provisions in the Banking Ordinance (the "BO").

Trading Ordinance (Cap.250) (the "CTO"), etc to prescribe requirements relating to the preparation of accounts and audits. This approach is considered appropriate as the relevant regulatory requirements are detailed, technical and require regular updating to reflect latest market development. We take the view that a flexible regulatory system is essential as it enables the SFC to respond rapidly to evolving market needs. Under the SF Bill, we have adopted the same approach and extended it to some additional types of requirements currently dealt with in the primary legislation which we believe would be better dealt with by subsidiary legislation. This approach follows the trend amongst other market regulators in leading international financial centres like London. Further elaboration on the scope of the rule making power and our responses to the related market comments are set out in paragraphs 5 to 17 and paragraphs 19 to 20 below respectively.

Associated entities

4. There is an apparent regulatory gap under the existing legislation. A securities dealer can discharge his obligation to his client in respect of that client's securities held in the dealer's safe custody in Hong Kong by registering those securities in the name of his nominee. To bring the nominee into the regulatory net for better investor protection, clause 160 of the SF Bill prescribes the types of persons that are allowed to receive or hold in Hong Kong client assets; i.e. the intermediary, its associated entity, an exempt AI and a person falling within the definition of "excluded person". Then, in respect of an associated entity[2] (defined to be, among others, in a controlling entity relationship with a licensed corporation or an exempt AI), the rules to be prescribed under Part VI, except for the FRRs, would also be applicable.

Financial resources requirements

5. Clause 141 of the SF Bill empowers the SFC to make FRRs to prescribe requirements on the maintenance of financial resources by a licensed corporation. In view of the importance of FRRs, the SF Bill, as is in existing law, obliges the SFC to consult the Financial Secretary before making any FRRs. This is viewed generally by the market as an effective safeguard. The FRRs to be made under the SF Bill will, to a large extent, be based on the existing FRRs made in June 2000 under section 28 of the SFCO when we first brought securities margin financiers within the regulatory net.

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2. "Associated entity" is defined in Schedule 1 to mean a company (or an overseas company complying with the provisions of Part XI of the Companies Ordinance) which is in a controlling entity relationship with an intermediary and receives or holds in Hong Kong client assets of the intermediary. Then, "controlling entity relationship" is also defined in Schedule 1 as existing between 2 companies if, for example, either would, either alone or with any of his associates –
   (a) be entitled to exercise or control the exercise of not less than-
      (i) subject to subparagraph (ii), 20%; or
      (ii) where any other percentage is prescribed by the rules made under section 384 of the SF Bill for the purposes of the definition of "controlling entity" in Schedule 1 such other percentage, of the voting power at general meetings of the other; or
   (b) have the right to nominate any of the directors of the corporation; or
   (c) have an interest in shares carrying the right to-
      (i) veto any resolution; or
      (ii) vary, modify, limit or add conditions to any resolution, at general meetings of the other.

In addition, the current FRRs applicable to leveraged foreign exchange traders will be merged to create a single set of FRRs. It is anticipated that, except for rectifying known anomalies and clarifying ambiguities, any further amendments to the FRRs would be confined to those which seek to adjust the risks arising from the new kinds of regulated activities and which are related to the implementation of the single licence regime. We believe a licensed corporation will be able to reduce its compliance cost in this area under the single licence regime, for example, through filing a single return in relation to the compliance with FRRs to cover all regulated activities it conducts.

6. A securities dealer, a securities margin financier and a leveraged foreign exchange trader are required under the existing law to cease trading when they breach any of the requirements prescribed in the FRRs. Clause 142 of the SF Bill draws a distinction between breaches of the key provisions (those relating to the amount of financial resources to be maintained) and the more routine ones (such as those in relation to notification and reporting). Cessation of business is required only if a licensed corporation no longer maintains the required amount of financial resources. Moreover, the clause provides the SFC with the flexibility to allow a licensed corporation to continue business subject to conditions as the SFC may impose. We consider the two changes appropriate because "unnecessary" cessation of business by a licensed corporation is indeed not in the clients' best interest.

7. The FRRs are not applicable to an exempt AI. The BO already imposes stringent statutory requirements on the financial resources of an authorized institution ("AI") covering the aspects of initial paid-up capital, capital adequacy and liquidity. The SF Bill therefore continues the existing practice of not applying the FRRs to exempt AIs for avoiding regulatory overlap.

Proper handling of client assets

8. The existing requirements as regards the handling of client assets are set out in the primary legislation of the SO, the CTO and the LFETO. As mentioned in paragraph 3 above, such type of detailed and technical requirements are better prescribed by rules made by the SFC in order to enable a timely response to changing market needs. Clause 144 of the SF Bill empowers the SFC to make rules prescribing the manner in which a licensed corporation, an exempt AI and an associated entity are to handle clients' securities and collateral. Clause 145 of the SF Bill empowers the SFC to make rules prescribing the manner in which a licensed corporation and its associated entity not being an AI are to handle clients' money.

9. The rules in relation to client money do not apply to an AI whether in its capacity as an exempt AI or as an associated entity. An AI is specifically authorized to take deposits from the public. There are already prudential requirements imposed on an AI under the BO in respect of large exposures, liquidity, capital adequacy and provision adequacy, for example, to ensure that the depositors' interests are safeguarded. It would serve no useful regulatory purpose to require artificial

distinction between client money received from banking operations and that received from securities/futures operation, and to subject the latter to the regulatory requirements under the SF Bill.

Keeping of accounts and records, and provision of records to clients

10. Clause 147 concerns the rules that the SFC may make to regulate the keeping of accounts and records. Clause 148 is about the rules the SFC may make to govern the issue of contract notes, receipts, statements of accounts and notifications to clients. The two sets of rules would apply to licensed corporations, exempt AIs and associated entities. These requirements are currently scattered in various primary legislation (the SO, the CTO and the LFETO), as well as the Leveraged Foreign Exchange Trading (Books, Contract Notes and Conduct of Business) Rules made under the LFETO. Apart from consolidating the relevant existing requirements, we are also looking for ways to help reduce compliance cost without compromising investor protection. By way of illustration, currently, separate contract note has to be prepared for each contract made for a client on a single day (required to be delivered at day-end). We propose to relax this to allow the preparation of a consolidated contract note for all contracts made for a client on a single day. This is also an area where compliance cost can be reduced with the introduction of the single licence regime.

Audit related requirements

11. Clauses 149 to 159 apply to a licensed corporation. They also apply to an associated entity of such licensed corporation, though some clauses do not apply to an associated entity that is an AI (see paragraph 12 below). In addition to routine audit related matters, these provisions detail the circumstances under which an auditor is to report to the SFC and those under which the SFC may appoint an auditor to examine and audit a licensed corporation or its associated entity. Also, clause 152 enables the SFC to make rules regarding the preparation of accounts and what an auditor's report must contain. The SFC is discussing with the Hong Kong Society of Accountants draft rules based on current subsidiary legislation under the SO, the CTO and the LFETO regarding accounts and audit. In this process, we seek to canvass views on means to enhance the effectiveness of an audit and related reporting for regulatory purposes under Part VI of the SF Bill.

12. An AI is already subject to audit-related requirements under the BO. Efforts have been made to identify the difference between the BO and the SF Bill in this respect. Where considered necessary, we have proposed amendments in the BAB or applied direct the requirements under the SF Bill to an associated entity that is an AI. Accordingly, clause 6 of the BAB proposes adding a new section 58B to the effect that an AI is required to give notice to the HKMA about the date on which its financial year ends; and to seek the approval of the HKMA for any change in the date on which its financial year ends or for having a financial year in excess of 12 months. Clause 8 of the BAB proposes a new section 63A to replace the existing section 63(3A)(b)(iii) and (3E) to the effect that an auditor is required to inform the HKMA as

soon as is reasonably practicable after he becomes aware of a matter which, in his opinion, adversely affects the financial position of an AI to a material extent. Under the existing legislation, an auditor of an AI is only required to inform the HKMA of the above matters if the AI is specifically required by the HKMA to submit the information.

Business Conduct

13. By virtue of clause 163 of the SF Bill, the SFC may make rules requiring any market practitioner to comply with prescribed practices and standards in its/his conduct of regulated activities. Alternatively or additionally, the SFC may publish codes of conduct under clause 164. While the codes do not have the force of law, compliance would be secured by virtue of the negative implications that breaches of the codes would have on the assessment of the fitness and properness of the market practitioner. The continuous training requirement falls within this subject area. Codes are sometimes preferred to rules as they are more flexible and may be expressed in simple market language to promote good practice, particularly in areas where detailed prescription is neither necessary nor desirable. This is also the approach adopted by other international market regulators.

14. In early 2001, the SFC revised the Code of Conduct for Persons Registered with the Securities and Futures Commission. Primarily, this was to absorb the conduct rules which were to be deleted from the respective rules of the Exchanges and to introduce certain new requirements for persons providing securities margin financing. While the SFC does not envisage an immediate need to revise this document substantially, it remains subject to periodic review together with other codes, guidelines and guidance notes it issues. The SFC is currently in the process of turning the conduct-related parts of the existing Leveraged Foreign Exchange (Books, Contract Notes and Conduct) Rules into codes to make the approach consistent with that adopted for registered persons.

Short selling

15. Clauses 165 to 167 essentially reiterate the restrictions in respect of short selling that appear in sections 80 to 80C of the SO, which came into effect in July 2000[3].

Miscellaneous

16. Clause 168 is derived principally from section 76(1)(a) of the SO which prohibits options trading for exchange-traded options (i.e. stock options traded on the Stock Exchange) unless conducted in a manner prescribed by rules. We are sympathetic to the market concern that the prohibition restricts the ability to trade in derivative products. Clause 168 adopts a different regulatory approach by which such options trading is permitted unless and until prohibited by rules. This approach

[3] The new short selling provisions are enshrined in the Securities (Amendment) Ordinance 2000.

facilitates market development while equipping the SFC with the reserve power to regulate if necessary.

17. Clause 169 is based largely on section 39 of the LFETO which prohibits cold calling. This restriction is applicable to both a licensed person (including a licensed corporation) and an exempt AI. The major change in substance is to adopt a broad definition of "call" so as to cater for emerging communication means, while empowering the SFC to exclude, among others, certain types of calls that pose little investor protection concern by means of subsidiary legislation.

MAJOR MARKET COMMENTS AND CHANGES MADE

18. During the public consultation exercise, certain areas of market concern in respect of Parts VI and VII were identified. They are discussed below.

Rule-making power of the SFC

19. The stockbrokers and the Law Society are concerned that the SFC has power under the SF Bill to create criminal offences punishable with substantial fines and imprisonment, and that it can do so without market consultation. They advanced the view that any matters that would attract criminal sanctions should be set out in the SF Bill itself, or that any rules proposed to be made by the SFC that would attract criminal sanctions should be subject to public consultation, vetting by the Legislative Council and/or approval by the Chief Executive in Council.

20. We have already mentioned in paragraph 3 above that the rule-making approach is adopted to prescribe detailed and technical requirements. This is fundamental to the scheme of the SF Bill. The basis for this approach is that, consistent with modern securities legislation such as the UK Financial Services and Markets Act, effective regulation depends upon the regulator having the flexibility to address changing market practices and global conditions by amendments to rules rather than amendments to the primary legislation. Such rule-making power is already a part of the existing law[4]. The rules made by the SFC are and shall continue to be subsidiary legislation and require negative vetting by the Legislative Council. In any case, the penalty maxima for contravention of any rules made by the SFC are already stipulated in the SF Bill. As a standard practice, the SFC does conduct consultation with the market on emerging draft subsidiary legislation, just as it does with codes and guidelines. To illustrate, the SFC has already started preparing the key rules[5] and guidelines to be made under the SF Bill. As a first step, the SFC has formed various working groups with market practitioners, and where appropriate, professional bodies

4. To illustrate, the FRRs introduced by the SFC in April 2000 was laid before the Legislative Council and examined by a Subcommittee before they came into effect.

5. They include, among others, the Securities and Futures (Financial Resources) Rules; Securities and Futures (Client Securities) Rules; Securities and Futures (Client Money) Rules; Securities and Futures (Keeping of Accounts and Records) Rules; Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules; and Securities and Futures (Accounts and Audit) Rules.

to seek market input at an early stage in drafting those rules which are of more concern to the industry. The plan is to expose the draft rules to the market for consultation by phases. This should allay market concerns that either unworkable rules will be produced in a vacuum or that there might not be an early chance to consider and comment on the draft rules. Moreover, we have introduced changes to the effect that an offence will only be committed for breaches of most of the rules made under Parts VI and VII if the relevant act or omission is done without reasonable excuse or with intent to defraud.

Time limits for compliance and penalties for certain criminal offences

21. There were comments that the proposed time limits in the White Bill for compliance with certain notification requirements were unduly onerous, and certain penalties disproportionate. After review, we considered this a fair comment and accordingly revised the relevant provisions for the SF Bill. One example is that under clause 146(3) and (5) of the White Bill, a licensed corporation and an associated entity of a licensed corporation shall within 5 business days after its appointment of an auditor notify the SFC of the name and address of the auditor, and failure to comply constitutes an offence that on conviction attracts a fine of $200,000 and imprisonment for 6 months. Clause 149(3) and (6) are the equivalent provisions under the SF Bill. The notification period and the sanctions have been changed to 7 business days and a maximum fine at level 5 (currently $50,000) respectively.

Management liability

22. Given that the activities of a licensed corporation, an exempt AI and an associated entity are ultimately directed by their controlling minds, we consider it important to instil a strong sense of responsibility among the senior management for supervising their staff in conducting regulated activities. Having regard to the concerns expressed and overseas practice, we have removed strict liability of the senior management in the White Bill and restricted criminal sanctions to those officers who have aided, abetted, counselled, procured or induced, or consented to or connived in the act or omission under question, or whose recklessness has caused it (see clause 378).

Applying the requirements to an exempt AI or an AI that is an associated entity

23. It has always been our intention that the regulatory frameworks for an exempt AI and an associated entity that is an AI should not unnecessarily impede their core banking business or other non-regulated activities. As the definitions in the White Bill in relation to client assets did not distinguish between assets arising from regulated activities and those from other activities, we have accordingly revised the relevant definitions in the SF Bill such that they refer, in relation to an exempt AI and an associated entity that is an AI, only to client assets received or held in the conduct of the regulated activities.

24. The banking sector has stressed the importance that in prescribing any requirements under the rules and codes to be made under the SF Bill, the SFC should take into account the operation of AIs to make sure that the requirements would not result in practical compliance difficulties for banks. In this connection, we are engaging the banking sector (and the broking community as well) in preparing the rules with a view to ensuring the requirement to be imposed are appropriate. Finally, having reviewed the White Bill and considered the detailed comments received during the public consultation, we have introduced refinements in respect of an exempt AI and an associated entity that is an AI that are consistent with the overall principles of the design of the regulatory frameworks.

Professional investors

25. Professional investors are generally considered to be capable of protecting their own interest. On this ground, there were comments that a lighter regulatory regime should be applied to regulated activities conducted with professional investors. In the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules to be made under clause 148, we plan to propose to relax some of the requirements where the client is a professional investor. The term "professional investors" is defined in Schedule 1 to the SF Bill. This concept will be further developed in light of market developments. Moreover, it is envisaged that in time, the SFC will propose to relax certain requirements prescribed in other subsidiary legislation where the client is a professional investor.

Appointment of auditors by the SFC

26. Under clause 156, the SFC may appoint, upon application by any person, an auditor to examine or audit the accounts and records of a licensed corporation and any of its associated entities. A person may make an application if he considers that the licensed corporation or any of the associated entities has failed to account to him for his assets held with it, or if he considers it has failed to act in accordance with his instructions. Some stockbrokers are concerned that the second ground cannot be established concretely in most cases, and may be abused by their clients who are trying to settle a hard bargain against them. We consider that there is a need to retain this ground for protecting the investor, but agree that the channel should only be available to investors subject to adequate safeguards. The SFC will only appoint an auditor where, having considered the explanations from the licensee or its associated entity, the SFC is satisfied that the person making the application has a good reason to do so, and that the appointment would be in the interest of all parties. Moreover, the SFC may, having taken into consideration, among other matters, the conduct of the person, order the person making the application to bear the cost of the examination and audit. We consider this would deter irresponsible applications. However, in the light of the concerns expressed, we have introduced in the SF Bill an additional safeguard that the person making the application must verify all statements in his application by statutory declaration. Moreover, we have confined the previous immunity available to the person making the application against any civil liability (proposed under the White Bill) to liabilities arising from the law of defamation only.

This revised scope of immunity is in line with the existing immunity conferred under section 121AX(4) of the SO which is the origin of clause 156.

Cold calling

27. There were market submissions to the effect that, while agreeing on the need to restrict high-pressure sales techniques through phone calls or personal visits, the scope of clause 169 was so wide that all means of communication would be covered. The cold calling prohibition is designed to protect the interests of the investing public and to curtail improper selling techniques by intermediaries. The reason for not agreeing to limit the provision to calls in person and by telephone is that the other means of communication specified in the definition of "call" (including internet) may be used also to pressure a person into investing and raise regulatory concern from the investor point of view. The rule-making power under the clause would be available to modify the strict application of the prohibition, if that is considered necessary.

Financial Services Bureau
20 February 2001

Annex

Securities and Futures Bill
Parts VI & VII

Derivation Table

Legend:

CTO – Commodities Trading Ordinance (Cap. 250)
LFETO – Leveraged Foreign Exchange Trading Ordinance (Cap. 451)
SFCO – Securities and Futures Commission Ordinance (Cap. 24)
SMFAO – Securities(Margin Financing)(Amendment) Ordinance 2000 (Ord. No. 20 of 2000)
SO – Securities Ordinance (Cap. 333)
sc. - subclause

Clause	Contents	Derivation	Notes
	PART VI – CAPITAL REQUIREMENTS, CLIENT ASSETS, RECORDS AND AUDIT		
	Division 1 – Interpretation		
140	Interpretation of Part VI	New	This term was introduced to differentiate the "core" financial resources requirements from the rest.
	Division 2 – Capital requirements		
141	Financial resources of licensed corporations	SFCO s.28 ; LFETO ss. 17 & 18	Sc. (1) follows existing law. Sc. (2) substantially follows existing law, save that paragraph (a) makes explicit what is implied in the current law and paragraphs (g) and (h) are new.

142	Failure to comply with financial resources rules	SO s.65C; SMFAO s.121AC(1), (3) & (6); LFETO s. 19	Sc. (1) and (2) follow existing law and sc.(3) is a refinement thereof. Sc. (4) is new, whereas sc.(5) enlarges on s.19(2) of the LFETO notably facilitating the SFC to grant permission and impose conditions orally. Sc. (6) – (9) are new. Sc. (10) is existing law with penalty levels updated, whereas sc.(11), (12) & (13) are new.
143	Monitoring compliance with financial resources rules	LFETO s. 20; SO s.65D; s.121AC(4) SMFAO	Sc. (1) is new but influenced by s.20 of the LFETO. Sc. (2) follows existing law. Sc. (3) – (9) are new and introduced for consistency with clause 142.
	Division 3 – Client assets		
144	Client securities and collateral held by intermediaries and their associated entities	CTO s.47; SO s.81, s.75A SMFAO ss. 121AA & 121AB; New	These provisions are new in that they empower the SFC to make rules with regard to matters that are currently provided in the body of existing Ordinances, and apply the rules to associated entities of intermediaries that receive or hold assets belonging to clients of the intermediaries. The rules may provide offences for breach without reasonable excuse of specified rules and offences for breach of such rules with intent to defraud. Sc. (6) and (7) are wholly new. These features are reflected in clauses 147 and 148.
145	Client money held by licensed corporations and their associated entities	CTO ss.46 & 47; SO ss.83 & 85; SMFAO ss. 121AJ, 121AK, 121AL, 121AM, 121AN & 121AP; New	
146	Claims and liens not affected	CTO s.48; SO ss. 81B (SMFAO) & 86; SMFAO s. 121AO ; LFETO s. 25	This provision derives largely from s.81B of the SO in its application to associated entities of intermediaries.
	Division 4 – Records		
147	Keeping of accounts and records by intermediaries and their associated entities	CTO s.45; SO s.83; SMFAO s. 121AG; New	Please see notes for clauses 144 and 145.

148	Provision of contract notes, receipts, statements of account and notifications by intermediaries and their associated entities	CTO s.45A; SO ss.75 & 75A; SMFAO s. 121Z; New	
	Division 5 – Audit		
149	Auditor to be appointed by licensed corporations and their associated entities	SO s.87; SMFAO s. 121AR; New	Sc. (1) follows existing law, the remainder of the provision is new.
150	Notification of proposed change of auditors by licensed corporations and their associated entities	CTO s.49A; SO s.87B; SMFAO s.121AS; LFETO s. 28; New	This provision derives largely from s.121AS of the SMFAO but is new in its extension to associated entities. The penalty level in sc.(2) is updated and sc.(3) is new.
151	Notification of end of financial year by licensed corporations and their associated entities, etc.	CTO s.101; SO s.87A; LFETO s. 26; SMFAO s. 121AH; New	Sc. (1) and (2) follow existing law, save that they are extended to associated entities. Sc. (3), (4) and (6) are new.
152	Audited accounts, etc. to be submitted by licensed corporations and their associated entities	CTO s.50; SO s.88; LFETO s. 29; SMFAO s. 121AI; New	Sc. (1) follows existing law, save that it applies to associated entities. Sc. (2) derives from s.29(2) of the LFETO , whereas sc.(3) is new. Sc. (4) derives from existing law and sc.(5) from s.29(5) of the LFETO and sc.(6) from s.29(7). Sc.(7) is new.
153	Auditors of licensed corporations and their associated entities to lodge report with Commission, etc. in certain cases	CTO s.51; SO s.89; SMFAO ss. 121AT & 121AU ; LFETO s. 31; New	Sc. (1) essentially follows the existing law, though it is extended to associated entities and allows for reporting to the HKMA. Sc. (2) follows existing law, save that it applies to associated entities and paragraph (c) is new. Sc.(3) essentially follows existing law, save for its extension to associated entities. In addition, the scope of paragraph (b) of "prescribed requirement" is enlarged to include rules made under clause 148. Paragraph (b) of "reportable matter" is new.

154	Immunity in respect of communication with Commission, etc. by auditors of licensed corporations and their associated entities	CTO s.51A; SO s.89A; LFETO s. 32; SMFAO s. 121AV; New	Sc.(1) essentially follows existing law, save that it extends to auditors of associated entities and authorized institutions and, consequently, allows for reporting to the HKMA. Sc. (2) is new; sc.(3) is basically existing law.
155	Power of Commission to appoint auditors for licensed corporations and their associated entities	CTO s.52; SO s.90; SMFAO s. 121AW ; LFETO s. 33; New	Sc.(1) is derived from existing law but new in its application to associated entities and the scope of matters defined in the new sc.(6) as "prescribed requirement(s)" for the purpose of sc.(1)(b). The extension to client assets (in sc.(1) and (2)) derives from s.121AW(1) of the SMFAO. Sc.(3) is new. Sc. (4) represents an elaboration of existing law, whereas sc.(5) is existing law.
156	Power of Commission to appoint auditors for licensed corporations and their associated entities on application of clients	CTO s.53; SO s.91; SMFAO s. 121AX ; LFETO s. 34	Sc.(1)(a) follows existing law, save that it is extended to associated entities and sc.(1)(b) is new. Sc.(2) is new, whereas sc. (3) is substantially existing law. Sc. (4) enlarges on existing law; sc.(5) is new. Sc. (6) is existing law and sc.(7) derives from s.121AX(4) of the SMFAO. Sc. (8) enlarges on existing law and sc. (9) derives from s.34(6) of the LFETO.
157	Auditors appointed under section 155 or 156 to report to Commission	CTO s.54; SO s.92; SMFAO s. 121AY; LFETO s. 35	This provision rationalizes existing law.
158	Powers of auditors appointed under section 155 or 156	CTO s.55; SO ss.93 & 95; SMFAO s. 121AZ ; LFETO s. 36	Save in its application to associated entities, sc.(1) basically follows existing law. However, sc.(1)(a)(ii) is new in its application to auditors appointed under the Banking Ordinance; sc.(1)(b) is new in the power to require an explanation, similarly sc.(1)(c); paragraphs (d) in its reference to a recognized exchange company and (e) are new, whereas sc.(1)(f) and (g) follow existing law. Sc. (2) is new. Sc. (3) is derived from s.36(2) of the LFETO; sc.(4) is new. The new sc.(4) is influenced by s.29A(9)(a) of the SFCO with updated penalty levels, whereas sc.(5) is new.

159	Offence to destroy, conceal, or alter accounts, records or documents, etc.	CTO s.56; SO s.96; SMFAO s. 121BC ; LFETO s. 37	Sc. (1) is substantially current law, though applied to associated entities and updated. Sc.(2) follows existing law, but with an updated penalty level in sc.(2)(b). Sc.(3) is a slightly enlarged version of the current law.
	Division 6 – Miscellaneous		
160	Restriction on receiving or holding client assets	New	This provision seeks to limit the persons who may lawfully receive or hold client assets.
161	Associated entities	New	Note also the new definition of "associated entity" in Part 1 of Schedule 1, which requires a particular corporate structure and a "controlling entity relationship" (also defined there) with the intermediary whose clients' assets it receives or holds.
	PART VII – BUSINESS CONDUCT, ETC.		
	Division 1 - Interpretation		
162	Interpretation of Part VII	New	The definition of "representative" is mainly to facilitate reference to individuals described in paragraph (b).
	Division 2 – Business conduct		
163	Business conduct of intermediaries and their representatives	SO s.146(1)(f), (2) & (3); LFETO s.73 ; New	Sc. (2) is new in the extent of its description of the scope of the rule-making power. Sc. (4) enlarges upon s.73(2) of the LFETO with updated penalty levels. Sc.(2), (3) and (5) are new.
164	Codes for business conduct of intermediaries and their representatives	SFCO s.4(2); LFETO ss. 76 & 77	Sc. (1) reflects the existing law. Sc. 2(c) follows existing law, whereas sc.(2)(a) and (b) are new. Sc. (3) and (6) are new; sc.(5) is inspired by s.146(2)(a) and (3) of the SO.

	Division 3 – Restriction on short selling		
165	Short selling restricted	SO s. 80; S(A)O s. 3; Securities (Exchange- Traded Stock Options) Rules (Cap. 333 sub. leg.)	This provision follows existing law. Sc.(3)(d) derives from s.3 of the Securities (Exchange- Traded Stock Options) Rules.
166	Requirements to confirm short selling order	S(A)O s. 4 : SO ss. 80A & 80B	This provision follows the current law. It will be noted that "short selling order" is defined in Part 1 of Schedule 1. Sc.(1)(b), (3) & (4) correctly add reference to "the other person" (omitted from s.80B(1)(b), (3) & (4)). Sc.(9) clarifies the meaning of s.80B(9).
167	Requirements to disclose short sales	S(A)O s. 4 : SO ss.80A & 80C	This clause follows existing law.
	Division 4 – Other requirements		
168	Requirements for options trading	CTO s.61; SO s.76(1)(a) & (2)	The innovation in this provision is that it is passive; Type 1 and Type 2 intermediaries may issue options of the type permissible for each but, if rules are made under this provision they must comply with the same. Sc.(2) enables the SFC to introduce an offence of failing to comply with rules (just as s.76(2) contains an offence and penalty provision). Sc.(3) is new; a drafting device.

169	Certain agreements not to be made during unsolicited calls	CTO s.60A; SO s.74; LFETO s. 39 & Leveraged Foreign Exchange Trading (Calls) Rules (Cap. 451 sub. leg.)	Sc. (1) rationalizes existing law, save that sc. (1)(a)(ii) is new. Sc. (2)(a) follows existing law, whereas sc. (2)(b) is new in being made explicit. Sc. (3) enlarges on existing law. Sc. (4) reflects s.39 (2)(b) and the Leveraged Foreign Exchange Trading (Calls) Rules. Sc. (5) derives from s.39 (3)(b) of the LFETO and sc. (6) is new. Sc. (7) is based on existing law but updated; in this way the definition of "call" extends the prohibition to other forms of communication.
170	Certain representations prohibited	SO s.78	This provision essentially reproduces the existing law.