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

Summary of Public Comments and Administration's Response on Part VII of the Securities and Futures Bill

Clause no.	Respondent	Respondent's comments	Administration's response
Part VII – Business Conduct, etc. of Intermediaries			
163	HKSbA	Under this section, the Commission may make rules regarding conduct in carrying on the regulated activities. Failure to comply with these rules will be a criminal offence. Until the rules are available in draft, no constructive comments can be made.	The SFC has already started preparing the key rules 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 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 the comment on the draft rules. As regards the specific concern here regarding business conduct related requirements, the SFC will upon commencement of the SF Bill continue the current practice to prescribe them through codes (to be made under clause 164), instead of through rules (to be made under clause 163) (see also the response immediately below). The enabling power under clause 163 to make rules, which is subsidiary legislation that requires negative vetting by the Legislative Council, is included to cater for future market development. As a standard practice, the SFC does conduct consultation with the market on any emerging draft subsidiary legislation. Finally, we wish to clarify that breaches of specified requirements in the business conduct rules constitute an offence only if the relevant omission or act is done **without reasonable excuse**.

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163 & 164	HKAB	There should be a requirement for public consultation before the conduct of business rules or codes of conduct are issued. There should also be guidance on when the SFC will exercise its rule-making power or instead choose to issue a code of conduct.	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 (see also the response immediately above). Upon commencement of the SF Bill, the SFC will continue the current practice to prescribe business conduct requirements through codes. This is because codes 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. The enabling power to make business conduct rules is included to cater for future market development.
163, 164, 384 & 385	HKAB	The SFC has further rule making powers in Clause 384 and further power to issue codes or guidelines in Clause 385. It is confusing that its various powers are to be found in different Parts of the Bill. Clause 384(7) and 385(9) require consultation with the HKMA in respect of rules and codes applying to exempt AIs and associated entity AIs. It would be clearer if equivalent provisions were included in Clauses 163 and 164 as well.	The SF Bill confers the SFC with the power to make rules / codes on key and distinct subjects in its relevant parts. The general power to make rules in clause 384 and codes in clause 385 complements the specific power to deal with other miscellaneous issues and serves also as a general enabling power to cater for future market development. This will be further considered in a paper to be prepared on Part XVI of the SF Bill. The consultation requirement is an arrangement between the SFC and the HKMA. Clause 384(7) and 385(9) state clearly that the SFC shall consult the HKMA in respect of rules / codes made under any provision of the SF [Ordinance], in so far as such rules / codes apply to AIs by reason of their being exempt persons or associated entities of intermediaries. We do not consider it necessary to add further to the length of the SF Bill by repeating the requirements throughout the SF Bill.
163, 164, 384 & 385	HKAB	In order to avoid the risk of overlapping and potentially inconsistent requirements being imposed on exempt AIs by the SFC and the HKMA (eg, in relation to money laundering), there should be a general provision in the Bill which states that where the HKMA has published guidelines, in relation to exempt AIs, these will take precedence over rules and codes made by the SFC.	The concern over significant risk of overlap or inconsistency should not arise as the SFC is obliged to consult with the HKMA regarding rules (clause 384(7)) and codes (clause 385(9)) it proposes to make, in so far as they may affect AIs that are exempt persons or associated entities of intermediaries. Moreover, we do not see the argument that the guidelines published by the HKMA should as a general application take precedence over the rules / codes made by the SFC, which in most instances concern the regulation of the securities and futures industry.

Clause no.	Respondent	Respondent's comments	Administration's response
163 & 164 (See also comment at 102 & 109, above)	WOCOM	Certain classes of persons who give investment advice to the public or investors are not subject to the rules and codes made by the SFC under these sections, e.g. journalists or authors of financial articles in newspapers, DJs or emcees in radio or television shows, etc. The commentaries of some of these persons are very popular and sometimes create a gambling ambience. If this loophole is exploited, the regulatory objective of maintaining financial stability might not be achievable.	The exclusion referred to in the market comment is available to a person who gives the advice through publication which is made generally available to the public, or broadcast for reception by the public or a section of the public. While the person does not require a licence from the SFC, there are however general provisions governing the dissemination of information under Parts IV (clauses 106 and 107), X (clause 208) and XIII/XIV (clauses 268, 290 and 293), and such person would not be in a position different from members of the public contravening such provisions. Moreover, the SFC will continue the current practice to provide investor education, and advise the public to exercise "discretion" with respect to the advice under concern.
165	HKSbA	Human error can cause short selling without any intent (eg, pressing the wrong button on the trading terminal is a frequent occurrence). It is therefore suggested that genuine human error should be a defence. Clause 165(4) should be amended to read as follows: "A person who contravenes subsection (1) without any reasonable excuse commits an offence and is liable on conviction to a fine at level 6 and to imprisonment for 2 years." This approach is in line with section 166(12) on requirements to confirm a short selling order.	It was not our policy intention to extend "lawful excuse" to clause 165 on "naked" short selling. However, in the Guidance Note for Short Selling Reporting and Stock Lending Record Keeping Requirement (published August 2000), the Commission has stated that it is not the Commission's intent to penalise short selling arising from genuine mistakes or errors. It is the Commission's intention to promulgate same guidance note under the new Bill.
168	Group of nine investment bankers	There is no reason to include Clause 168 (option trading) as a separate section - any rule-making power should be included in Clause 163.	This is a response to market concern. In current law, (s.76, SO) options trading is prohibited except where specified in rules. Clause 168 reverses this position by enabling options trading unless prohibited by rules. This is a discrete matter that is better dealt with in a separate clause in our view.

Clause no.	Respondent	Respondent's comments	Administration's response
169	HKAB and Group of nine investment bankers	The rationale for the prohibition on cold calling is to prevent high-pressure sales techniques. The definition of "call" in Clause 169(7) is too wide and the prohibition in Clause 169 should only apply in respect of personal visits or telephone calls.	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" in sub-clause (7) may be used also to pressure a person into investing. The submission is too much focused on the current state of technology. The legislation must allow for and anticipate developments that would facilitate new ways of exerting unacceptable pressure. The rule-making power in sub-clause (3) will be used to modify the strict application of the prohibition. We are currently drafting the relevant rules that specify the detailed circumstances in which the cold calling provisions do not apply. Such rules will be subject to market consultation in the usual manner. In particular, we are looking at the question of "real time" communications, a concept defined in the draft subsidiary legislation made under the UK Financial Services and Market Act 2000, and where considered appropriate, shall make rules to exempt the relevant calls.
169	Group of nine investment bankers	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. This is in some respects narrower and the previous exemption should be reinstated (in addition to the exemption for calls on professional investors).	The test is possibly narrower but it is a more reliable test for ensuring that person was likely to be able to resist unacceptable pressure. The old test, as using the word "involves" was rather vague and in our view, too wide in scope.
169	HKAB	It is noted that calls made in compliance with guidelines published by the HKMA relating to unsolicited calls may be declared exempt from Clause 169 in rules made by the SFC. It is suggested that (analogous to Clause 169(2)(b) relating to securities margin financing) the Bill should state that such calls are automatically exempt, without any declaration by the SFC.	The approach is modelled on the Leveraged Foreign Exchange Trading (Calls) Rules made under the Leveraged Foreign Exchange Trading Ordinance. It has been working well and we see no reason for changes. The formulation also serves the purpose to ensure that the guidelines to be published by the HKMA are those which the SFC is satisfied would be capable of achieving results similar to the requirements under the SF Bill (analogous to the requirement on the SFC to consult the HKMA under the SF Bill). That in relation to securities margin financing is different as it is an AI's core business to provide financial accommodation, and for this reason, the activities of AIs in the area are indeed specifically excluded from the licensing / exemption requirements, as carried down from the recently enacted Securities (Margin Financing) (Amendment) Ordinance 2000.

Clause no.	Respondent	Respondent's comments	Administration's response
169(2)(a)(i)	Group of nine investment bankers	Under Clause 169(2)(a)(i) there is an exemption for calls on an "existing client". "Existing client" means "a client who has entered into an agreement … in accordance with requirements prescribed by rules made under S384 …". Clarification is sought on the matters which may be prescribed for this purpose.	The general criterion is to assess whether or not the relationship between an intermediary and its client is sufficiently active, and will be expressed in terms of the number of previous transactions entered between the intermediary and the client over a specified period of time, etc.
169(6)	Group of nine investment bankers	Clause 169(6) (right of rescission) is far too widely drafted. A person may use it to avoid an unprofitable contract long after it was made by arguing that he had only just become aware of the contravention.	We agree with the market comment and will propose Committee Stage Amendments to limit the rescission to 28 days from the date of the contract.

Details of Submissions referred to in the Comment / Response Table

Date received	Organization /party
29 January 2001, 15 February 2001	Hong Kong Stockbrokers Association ("HKSbA")
23 January 2001	Hong Kong Association of Banks ("HKAB")
23 January 2001	Wocom Holdings Limited ("WOCOM")
23 January 2001, 15 February 2001	Linklaters & Alliance representing – Bear Stearns Asia Limited – Credit Suisse First Boston (Hong Kong) Limited – Dresdner Kleinwort Wasserstein – Goldman Sachs (Asia) L.L.C. – Merrill Lynch (Asia Pacific) Limited – JP Morgan – Morgan Stanley Dean Witter Asia Limited – Salomon Smith Barney Hong Kong Limited – UBS Warburg ("Group of nine investment bankers")

Financial Services Bureau
1 March 2001