Legislative Council

of the

Hong Kong Special Administrative Region

Legislative Council Panel on Financial Affairs and the Bills Committee on Securities and Futures Bill and Banking (Amendment) Bill 2000

Report on the Financial Systems in the United Kingdom and the United States of America

based on the findings of the overseas duty visit in April 2001

June 2001

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Appendices:

Chapter 1 From the Chairman of the Panel on Financial Affairs (Leader of the Delegation)

1.1 In April this year, a delegation comprising members of the Financial Affairs Panel and the Bills Committee on Securities and Futures Bill and Banking (Amendment) Bill 2000 visited London, Washington, DC and New York to study the financial systems of the United Kingdom (UK) and the United States of America (US).

Purposes of the overseas duty visit

1.2 When the Financial Affairs Panel (the Panel) discussed its work plan at the start of the 2000-01 legislative session, members noticed the large number of legislative proposals relating to financial services scheduled for introduction to the Legislative Council. Some of these proposals would have far-reaching impact on the financial infrastructure and practices of the banking, securities and futures industries in Hong Kong. To ensure that the implications of these proposals could be carefully considered by the community and the relevant trades before they were put in place, members considered it important to make reference to the experiences of other major financial centres. In December 2000, the Panel decided to visit London and New York.

1.3 Also in December 2000, a Bills Committee was formed to study the Securities and Futures Bill and the Banking (Amendment) Bill 2000 which were introduced to the Legislative Council on 29 November 2000. The former Bill aims to consolidate ten existing ordinances relating to the regulation of the securities and futures markets, while the latter proposes to enhance the regulatory functions of the Hong Kong Monetary Authority in relation to the securities business conducted by banking institutions. The Bills Committee is aware that with the progressive globalization and convergence of international financial markets, it is most important that Hong Kong should have the most effective and up-to-date regulatory regime, which is in keeping with development of the major financial centres. The Bills Committee is also aware that grave concerns have been expressed by the industry on certain proposals in the two Bills. In view of the importance of the Bills on the future

development of Hong Kong's financial infrastructure, the Bills Committee considered it necessary to seek views direct from financial experts and experienced practitioners in the field. London and New York were the obvious choices for making references not only because of their dominant position in international finance but also the affinity of their common law legal systems to that of Hong Kong. In January 2001, it was decided that the Panel and the Bills Committee would jointly conduct an overseas duty visit to the UK and the US for the purpose of understanding the financial infrastructure of these places and sharing their experiences in bringing changes to their financial systems.

1.4 In February 2001, a delegation was formed from among members of two committees. It comprised four Members of the Legislative Council and three staff members of the Legislative Council Secretariat **(Appendix I)**. The delegation visited London, Washington, DC and New York from 4 - 13 April 2001.

Programme of the visit

1.5 In drawing up the programme, we paid special attention to the following objectives of our visit:

(a) To study the working and regulatory framework of the financial markets in the UK and the US with a view to identifying areas of reference for future study by the Financial Affairs Panel;

(b) To understand their experiences in introducing changes to meet new market demands, in particular the ways to tackle issues similar to those raised in respect of the Securities and Futures Bill and the Banking (Amendment) Bill 2000 (the Bills);

(c) To establish contact with regulators, market practitioners, experts in financial laws, and advisers to legislatures and regulatory bodies on financial matters; and

(d) To document the findings and observations from the visit for future reference by the Council.

1.6 With the assistance of the Foreign and Commonwealth Office of the UK and the Department of State of the US, we were able to meet with the authorities responsible for financial matters, committees in the Legislature with a responsibility for financial services, regulatory bodies, financial institutions and trade associations in the two countries. We also met with key market players in the banking, securities and insurance sectors at informal gatherings organized by Hong Kong Economic and Trade Offices in these cities. We were invited to exchange views with the Securities Industry Association on the implications of the two Bills and to speak at a meeting of the Hong Kong Association in New York. We also took the opportunity to meet a group of Hong Kong students currently studying finance and related subjects in major universities in New York. Details of the programme and the organizations and persons we met with are given in **Appendices II and III**.

Contents of the Report

1.7 We have found the visit extremely useful and decided that the report of the overseas duty visit should cover not only the framework of the financial systems of the two countries, but also the directions taken by these economies in addressing changing market demands and in facing the challenges arising from globalization and competition, and in what way they are relevant to the Hong Kong setting.

1.8 This report is divided into three parts:

Part I: An overview of the financial systems of the UK and the US

Part II: Issues of relevance to the work of the Bills Committee and matters for further study by the Panel

Part III: General observations and conclusions

1.9 To facilitate future reference, a set of the literature on the functions and mode of operation of the institutions visited by the delegation as well as the parliamentary reports on the latest major legislative reforms in the two countries are deposited at the Legislative Council Library.

1.10 The effectiveness of the committees of the Council in scrutinizing Government's policies and legislative proposals relies heavily on the ability of the committees and individual Members to understand the subject matters and make their independent views from a wider perspective. We consider that our visit greatly enhanced our understanding of the matters and issues which are of interest and importance to the Financial Affairs Panel and we recommend that in fit and proper cases the Legislative Council should consider promoting overseas duty visits. Our delegation has the benefit of the support of a team of very competent committee clerks and legal adviser, who accompanied the delegation on this visit and helped prepare this Report. Their hard work has highly enhanced the effectiveness of this fact-finding mission.

(Signature)

Ambrose LAU Hon-chuen,
Chairman of the Financial Affairs Panel
(Leader of the Delegation)

Part I: The financial systems in the United Kingdom and the United States

This part provides an overview of the financial systems of the two countries with emphasis on latest financial reforms, functions of financial institutions and the inter-relationship of the institutions.

Chapter 2 The financial system in the United Kingdom

2.1 The financial system in UK has gone through a major reform over the past five years due to growing dissatisfaction over the regulatory framework and in response to the forces of increasing globalization in the world's financial markets and competition in the financial services industry. The delegation was fortunate to have the opportunity of meeting with some of the key persons who played an important role in this recent reform. We also had the opportunity of discussing the impact of this reform on financial institutions and market participants during our visits to these organizations and our meetings with market players.

2.2 In this chapter, we shall give a brief overview of the regulatory framework of the financial markets in the UK and the background of the reform which has taken place since 1997. Details of the issues relevant to the work of the Bills Committee and the Panel and our other observations are given in Parts II and III respectively.

The financial system

2.3 The UK has one of the most sophisticated financial systems in the world not only because of its leading position in the world's market, but its long history of development. Today, the financial system in the UK comprises a wide range of financial trading in monetary and non-monetary financial instruments and market places. The financial services sector accounts for over 6% of gross domestic product and employs more than one million people[1]. The securing of an efficient market in banking and financial services with fair and effective supervision is the responsibility of the Ministry of Treasury.

2.4 Regulation of banks, building societies, insurance companies, investment companies, securities, futures and other derivatives was historically undertaken by different regulatory bodies under different bodies of laws. For instance, the prudential supervision and conduct regulation of banks and deposit-taking institutions was the responsibility of the Bank of England. The

[1] Britain 2001, The Official Yearbook of the United Kingdom, p508.

regulatory functions of financial institutions was conferred on a Securities and Investment Board through three self-regulating organizations, namely the Personal Investment Authority, the Securities and Futures Authority, and the Investment Management Regulatory Organization, under the Financial Services Act 1986.

2.5 In May 1997, shortly after the Labour Government came into office, a proposal was announced to reform the system of financial regulation by introducing a new regime – with the regulatory functions of nine regulatory bodies centralized in a single regulator, the Financial Services Authority (FSA), under a single body of law. The reasons for the reform were:

- reducing overlaps, gaps and inconsistencies in fragmented regulation and improving public accountability on the system;
- reducing compliance costs and burdens on market participants and providing them with greater certainty;
- strengthening the regulator's ability to regulate the increasingly large, internationally integrated financial market and financial conglomerates undertaking a variety of financial activities; and
- providing a more uniform consumer protection mechanism to enhance consumer protection.

2.6 The proposal received wide community support and also the support of the Opposition Party. In October 1997, the FSA, which started as a private company by guarantee, began working on the taking-over of the functions of the various regulators. The responsibility for the conduct regulation of banks was transferred to the FSA under the Bank of England Act 1998. The taking-over of functions was carried out through contractual agreements with individual regulators. To facilitate early integration of the regulatory functions to the FSA and to retain expertise for ensuring the effectiveness of the new system, relevant staff formerly employed by the various regulators has since then been transferred to the FSA on new contracts of employment.

2.7 The Treasury published a draft Financial Services and Markets Bill for public consultation in July 1998. The Bill was mainly to provide for the formal establishment of the FSA and its statutory powers, the establishment of the Financial Services Markets Tribunal, the requirements on the FSA to establish a single compensation scheme and an ombudsman scheme to provide

for better protection for consumers. The draft Bill was referred to the Select Committee on Treasury for pre-legislative scrutiny. Some 220 submissions were received on the draft legislation. In February 1999, the Treasury Committee published its report on the draft Bill. On 2 March 1999, the two Houses decided that a Joint Committee be formed to study the draft Bill aiming at reporting back by 30 April 1999[2].

2.8 The main area of controversy on the Bill at that time was the objectives of the FSA to be included in the new legislation. Considerable discussion was focused on whether competition and competitiveness should be included as one of FSA's objectives. There were also the human rights considerations relating to the disciplinary process and the accountability arrangements. The Joint Committee, under the chairmanship of Lord Burns, published two reports: the first report in April 1999 and a subsequent report on matters relating to human rights issues in June 1999. The Joint Committee put forward a series of recommendations to the Treasury, which in turn published a number of consultation papers to solicit further views from the public. By the time the Financial Services and Markets Bill was passed in June 2000, one year after its introduction into the House of Commons, some 800 amendments had been made to the original Bill. The Financial Services and Markets Act (FSM Act) is expected to come into force in November 2001.

The Financial Services Authority

2.9 The FSA is an independent non-government body financed by levies on the financial services industry. The FSA is governed by a Board appointed and removable by the Chancellor of the Exchequer. The Board is headed by an Executive Chairman. Currently there are three Managing Directors, one Chief Operating Officer, and 11 non-executive Directors (including the Deputy Chairman). The four regulatory objectives of the FSA as stipulated in the FSM Act[3] are :

- maintaining confidence in the financial system;
- promoting public understanding of the financial system;

[2] Order of Reference, First Report by Joint Committee on Draft FSM Bill.
[3] Sections 3 - 6 of FSM Act.

- securing an appropriate degree of protection for consumers; and
- reducing financial crime.

2.10 As to whether improving competition should be included as an objective of the FSA, the subject attracted extensive discussion during the scrutiny of the Bill. Since ensuring competition was already the task of the Office of Fair Trading, and maintaining competitiveness of the UK financial markets would be among the principles by which the FSA must have regard to in carrying out its duties, it was finally decided that there was no need to add "improving competition" to FSA's list of objectives.

2.11 Businesses to be authorized and regulated by the FSA include:

- banks;
- building societies;
- insurance companies;
- friendly societies;
- credit unions;
- Lloyd's;
- investment and pensions advisers;
- stockbrokers;
- professional firms offering certain types of investment services;
- fund managers; and
- derivatives traders.

2.12 There are five supervisory divisions to regulate different types of institutions. They are: Major Financial Groups Division, Deposit Takers Division, Insurance Firms Division, Investment Firms Division and Markets and Exchange Division.

2.13 To enhance the FSA's accountability, the following arrangements have been put in place[4]:

[4] Meeting with the FSA on 6 April 2001.

- The FSA Board is answerable to the Treasury. It is required to report annually to the Chancellor of the Exchequer on the fulfillment of its statutory objectives. The report has to be laid before the Parliament.
- The FSA will be required to hold an annual open meeting to consider its annual report.
- The FSA is subject to inquiry by the Treasury Committee of the House of Commons.
- The Treasury has power to commission independent investigators to inquire into any regulatory matters of FSA which are of public concern.
- The non-executive members of the Board are responsible for , among other things, reviewing the efficient and economic operation of the FSA and oversee its system of financial control and the remuneration of the executive members of the Board.
- In exercising its rule-making powers and setting its policies the FSA must act in a way compatible with the regulatory objectives and have regards to the regulatory principles which are set out in the FSM Act.
- The FSA has a duty to consult consumers and practitioners in the industry on a wide variety of matters including its policies, rules, fees and complaints handling arrangements.

The Consumer Panel and Practitioner Panel under the FSA

2.14 The FSA has the statutory obligation under the FSM Act to establish a Consumer Panel and a Practitioner Panel to represent the interests of the two groups. The FSA is required to consider their representations and obliged to give reasons in writing where it disagrees with the views expressed or proposals made in such representations.

2.15 The ***Financial Services Consumer Panel***, comprising 13 part-time members appointed by an open recruitment process, advises the FSA on its policies, monitors the effectiveness of its work, reviews developments in financial services with an impact on consumers. The Panel makes formal responses to consultations on financial services by the FSA and the Government, commissions surveys and research on areas of consumer concern, and recommends consumer representatives to contribute to the work of the

FSA.

2.16 The ***Financial Services Practitioner Panel***, comprising members appointed through nominations by various trade associations in the industry, seeks to influence the FSA and offers a dispassionate but forceful industry view on any new or revised policies or rules of the FSA which may have a material impact on regulated firms.

Financial Ombudsman Service

2.17 The FSM Act requires the FSA to establish a single, compulsory ombudsman scheme for the resolution of disputes between authorized firms and their customers. The need to provide a single operator to deal with disputes involving customers came about when the Government found it necessary to rationalize the eight dispute resolution schemes then in existence in the financial markets. To reduce the scope for confusion about the roles and responsibilities of different schemes, and to ensure improved access for consumers by providing a single point of entry, the new Financial Ombudsman Service (FOS), currently operating as a private company but would become part of the FSA when the FSM Act comes into effect in November 2001, has already taken over the following eight schemes:

- Banking Ombudsman
- Building Societies Ombudsman
- FSA complaints service
- Insurance Ombudsman
- Investment Ombudsman
- Personal Investment Arbitration Service
- Personal Investment Authority Ombudsman
- SFA Complaints and Arbitration Service

2.18 The FOS, as the "scheme operator" under the FSM Act, provides consumers with a free one-stop service for dealing with disputes about financial services. It is funded by general levy and case fees. The "scheme operator" is made up of a chairman and a board of directors appointed by the FSA. Appointment of the chairman also requires Treasury's approval.

Financial Services Compensation Scheme

2.19 The FSM Act requires the FSA to create a new single scheme for the payment of compensation to consumers who suffer financial loss as a consequence of the inability of an authorized person to meet its liabilities. The Financial Services Compensation Scheme Limited was established by the FSA in March 2000 as the "scheme manager" to administer the Financial Services Compensation Scheme. The "scheme manager" is made up of a chairman and a board of directors appointed by the FSA. Appointment of the chairman also requires Treasury's approval[5].

2.20 The new scheme will replace the existing six compensation schemes by three sub-schemes namely, the Deposit Protection Scheme (covering deposits in banks and building societies), the Policyholders Protection Scheme (covering insurance policies written by insurance companies and friendly societies), and the Investors Compensation Scheme (covering all other authorizable business not covered by the other two sub-schemes). Each authorized firm will participate in the sub-scheme according to the business it carries on. The FSA has consulted on the main scheme rules and is finalizing the funding arrangements. Basically, the new scheme will be funded by contributions from authorized firms in the form of levies.

Bank of England

2.21 The Bank of England is the central bank of the UK. Its primary responsibilities are :

- maintaining the overall stability of the financial system including stability of the monetary system;
- administering the payments systems at home and abroad;
- monitoring developments in the financial system; and
- promoting the efficiency and effectiveness of the national financial sector at the international level.

[5] Section 212 of FSM Act.

2.22 The Bank is managed by the Court of Directors which comprises a Governor, two Deputy Governors and 16 Directors. The Directors form a Committee of Court and are responsible for the following:

- reviewing the Bank's performance in relation to its objectives and strategy;
- monitoring the Bank's financial control;
- determining the Governor's and Deputy Governors' remuneration; and
- reviewing the procedures in formulation of the monetary policy undertaken by the Monetary Policy Committee.

The Court of Directors is required to report annually to the Chancellor of the Exchequer.

2.23 In May 1997, the power to determine interest rates was given to the Bank of England. In 1998, following the enactment of the Bank of England Act, the responsibility for the supervision of banks and deposit-taking institutions was transferred to the FSA. While the FSA is responsible for the supervision of individual organizations, the Bank of England remains responsible for the overall stability of the financial system. The Memorandum of Understanding entered into by the Ministry of Treasury, the Bank of England and the FSA in 1997 provided for the establishment of a high-level standing committee which meets regularly and acts as a forum for the three organizations to develop a common position on any problems which might emerge. The Bank has established a Financial Stability Committee to oversee the Bank's performance in monitoring and improving the stability of the financial system as a whole. The Committee works closely with the FSA through information-sharing arrangements. Where a threat to the stability of the financial system is perceived, the Bank of England may intervene the market in order to facilitate payments and settlements which might otherwise not be completed. It may also consider acting as lender of the last resort where the failure of one financial institution could bring about systemic risk in the market.

Banking services

2.24 The UK is the world's largest single market for international banking. At the end of March 2000, there were 315 banks and 103 branches of European-authorized institutions entitled to accept deposits in the UK[6]. Banks from around 80 countries have subsidiaries, branches or representative offices in London.

2.25 Apart from the 'big four' (HSBC, Lloyds TSB, Royal Bank of Scotland and Barclay), there are other large-scale banks carrying out retail banking in the UK. There is also a growing trend for large building societies and other businesses, notably insurance companies and supermarkets, entering the retail banking sector. Traditionally, major banks have operated through their branches, but the number of branches is falling with the increasing use of phone-banking and Internet banking.

2.26 ***Building societies***, which specialize in housing finance, making long-term mortgage loans against security of property, are diminishing as a result of the decision of several large societies to become banks.

2.27 ***Friendly societies***, which offer a limited range of financial and insurance services, may provide a wider range of services through subsidiaries. The FSM Act 2000 removes the remaining restrictions on the activities of the subsidiaries.

2.28 ***Credit Unions***, which are mutually owned financial co-operatives providing safe, low-cost loans to those in disadvantaged community in need of credit, have been given greater flexibility in their operations in recent years. Under the FSM Act, regulation of credit unions is strengthened, including the introduction of a protection scheme similar to that for bank and building society customers.

Investment exchanges and clearing houses

2.29 Trading of equities is carried out in seven recognized investment

[6] Britain 2001, The Official Yearbook of the United Kingdom, p512.

exchanges (including the London Stock Exchange) and two recognized clearing houses. **The London Stock Exchange** (LSE) is one of the world's leading exchanges. In August 2000, it had 1 911 UK and 504 international companies listed on the main market, with a market capitalization of £1,968 billion and £3,831 billion respectively. A further 460 small, young and growing companies were listed on the Alternative Investment Market, and some 200 listed companies engaged in technology or related sectors in the "techMARK" launched by the LSE in November 1999.

2.30 The FSA is empowered under the FSM Act to recognize and supervise investment exchanges and clearing houses in the UK. Apart from taking over the current recognized exchanges and clearing houses, FSA is also in the process of taking over responsibilities from the Treasury for supervising nine overseas investment exchanges which wish to be recognized in the UK. In May 2000, the FSA acquired responsibility from LSE for acting as the competent authority for listing companies in the UK and is now responsible for the Listing Rules.

2.31 The LSE is among the first exchanges to conduct trading entirely electronically. Dealing is conducted via an off-market trading facility bringing together potential buyers and sellers for the shares of companies. Apart from providing an infrastructure for efficient and fair trading, the LSE has the capability to enhance its services to customers through providing greater access to information about the trading of any companies' shares and other information of use to brokers and individual investors.

2.32 Under the new regulatory framework, FSA will have oversight responsibility of all recognized investment exchanges. The current self-regulating organizations such as the Securities and Futures Authority will be migrated to FSA. The types of market abuse in securities trading are insider dealing, market manipulation and breaches of Exchange Rules. In tackling insider dealing, the LSE takes steps to deter, detect, investigate, and refer the report to the Trade and Industry Department (or to the FSA after the FSM Act comes into effect in November 2001) for prosecution[7].

[7] Meeting with London Stock Exchange on 6 April 2001.

Chapter 3 The financial system in the United States

3.1 This chapter provides a brief overview of the financial infrastructure in the US and its regulatory framework. Due to historical and political reasons, the US has maintained a multi-regulator system whereby regulation is undertaken at federal and state level, and different financial institutions or businesses are under the oversight of different regulatory agencies. Due to our short stay in the US, we have only had the opportunity to visit the Government and regulatory bodies at federal level in Washington DC, and major financial institutions in New York.

3.2 Owing to the complexity of the regulatory system, legislative reform in the financial services in the US has all along been incremental. Nevertheless, ongoing changes have taken place in order to enhance the transparency and competitiveness of the markets and to cater for new changes resulting from globalization and diversification of businesses in the markets.

3.3 In the absence of information at the state level, we provide in this chapter an outline of the functions of the federal regulatory bodies to the best of our knowledge with emphasis on those institutions overseeing banking, saving institutions, securities and commodity future trading. We also provide an overview of the mode of operation of the various market places we visited in New York.

Legislation and policies

3.4 The US Congress introduces legislation relating to financial services, while regulators at federal and state levels issue rules and regulations governing the practices of the industry. All legislative proposals require passage at the House of Representatives and the Senate. Committees to oversee financial affairs in the two Houses are the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Financial Services.

3.5 The Senate Committee on Banking, Housing and Urban Affairs, in particular, has oversight responsibility of the regulatory bodies. The appointment of the members of the regulatory bodies requires the consent of the Senate. The Senate Committee invites the regulators to appear before it twice a year and reviews their work. The budgets of the regulatory bodies are also approved by the Senate. Although the regulators are entirely autonomous in operation, the Senate has control over these bodies through appropriations and appointment confirmation. In order that these persons appointed to sit on the regulatory bodies can work without interference, the appointment is for a fixed term. Nevertheless, with the exception of the Federal Reserve, a new President, when elected, has the discretion to appoint a new chairman for a regulator.

3.6 In the past 10 to 15 years, considerable efforts have been made to modernize the financial legislative framework. Regulators in the US have all along been protecting their own territories. Federal laws enacted during the Great Depression such as the Glass-Steagall Act and Bank Holding Company Act blocked banks, stockbrokers and insurance companies from entering each other's line of business. However, when new financial products began to emerge, there was increasing blurring between different lines of activities. In order to create financial supermarkets that provide everything from checking accounts to auto insurance, the three industries had lobbied Congress for years to streamline regulatory hurdles that barred such operations. The passage of the Gramm-Leach-Bliley Act (GLB Act) of 1999 represented the most significant deregulation of the US financial services industry in over half of a century.

3.7 The GLB Act has established a legal and regulatory framework to allow insurance companies to affiliate with banks and securities companies through the establishment of "financial holding companies" subject to the "umbrella" supervision by the Board of Governors of the Federal Reserve System. The Act recognizes the growing convergence of various providers of financial services, and the necessity of enabling US financial service providers to compete with global financial conglomerates[1]. (Further details of the GLB Act are provided in Chapter 4.)

[1] Gramm-Leach-Bliley Act of 1999 - Cadwalader, Wickersham & Taft, September 2000, p1.

Bank and thrift

3.8 The US banking system comprises the Federal Reserve System, commercial banks, savings associations (generally known as thrifts) and credit unions.

Deposit insurance

3.9 It is difficult to explain the US banking system without first describing the federal deposit insurance arrangements and providing the historical background of deposit insurance.

3.10 The Federal Deposit Insurance Act, which now requires banks and saving associations to insure deposits up to US$100,000, derived from the Federal Reserve Act of 1933 which was enacted at the height of the Great Depression in the US. Following the collapse of the US stock market in 1929, some 9 000 banks failed. The Federal Reserve Act established a ***Federal Deposit Insurance Corporation*** (FDIC), first as a temporary corporation within the federal government, which shall insure the deposits of all banks and saving associations which are entitled to the benefits of insurance under the Act. There is a separate division of asset disposition in the FDIC which shall carry out all FDIC's responsibilities in relation to the liquidation of insured depository institutions and the disposition of assets of such institutions. The initial deposit insurance limit in 1934 was US$2 500, rising to US$100,000 in 1980. In 1935, the FDIC became a permanent corporation[2].

3.11 The US Government's policy in deposit insurance is mainly to enhance financial stability. Deposit insurance contributes to stability principally by mitigating or preventing bank runs. Today, the FDIC insures the deposits in 8 315 commercial banks and 1 590 saving associations.

3.12 The FDIC administers two federal deposit insurance funds, namely, the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF). Deposits in most commercial banks and many savings banks are insured by the BIF. Deposits in savings associations are insured by the SAIF.

[2] Meeting with Federal Deposit Insurance Corporation on 10 April 2001.

Both the BIF and SAIF deposit insurance programmes are backed by the full faith and credit of the US government.

3.13 To be insured by the FDIC, a bank must prove that it is being run profitably and fairly, and it pays insurance premiums. The amount of premium each bank pays depends on how much the bank has in its deposits and the reserve ratio of the Funds. At present, BIF has a total asset of US$31 billion with a reserve ratio of 1.35%. SAIF, which insures thrift deposits, has a total asset of US$10.9 billion with a reserve ratio of 1.44%. Current law restricts the FDIC from charging premiums to highly-rated banks as long as the insurance fund is above the Designated Reserve Rate of 1.25% of insured deposits.

3.14 As regards those bank which need to pay premiums, the FDIC uses a risk-based premium system to determine the premium rates. As at 30 June 2000, the rates ranged from zero to 27 cents per US$100 in assessable deposits per year. Only 7% of all banks and saving institutions paid premiums into the deposit insurance funds. The remaining 93% or 8 139 institutions did not need to pay any premium at all. With such a great majority of institutions not required to pay premiums, there is criticism that the system does not adequately differentiate among banks according to risk.

3.15 Credit unions are exempted from the Act, but deposit insurance (up to US$100,000 per account) is provided to Credit Union members by the National Credit Union Share Insurance Fund (NCUSIF). Deposit insurance for state-chartered credit unions is available in some states under private or state-administered insurance programmes. State credit unions may also be federally-insured by the NCUSIF.

3.16 Another responsibility of the FDIC is to arrange a resolution for each failing institution, to act as the receiver for the failing institution and to liquidate its assets. The FDIC works closely with the Office of the Comptroller of the Currency and the states to resolve failing banks. 1988-89 recorded the highest number of failing banks during which time interest rates were soaring high. According to FDIC, there is a declining number of commercial banks and a declining number of saving institutions. But the assets in commercial banks have gone up and those in saving institutions remain steady. There are more and more mergers of banks taking place in the 90s, hence less need to have

bank failures. The banking industry continues to become more concentrated, now with six banks holding 25% of domestic deposits. With globalization and the rise of electronic banking, different risks are emerging in the banking system. There is a need for a reform in deposit insurance.

Federal Deposit Insurance Corporation

3.17 As explained above, the FDIC is a federal government agency that provides insurance protection for depositors at most commercial banks and saving associations. The FDIC is managed by a five-member board of directors appointed by the US President and confirmed by the Senate. No more than three members should belong to the same political party. There are altogether 6 450 employees, but efforts are being made to downsize the Corporation.

3.18 The responsibilities of the FDIC are as follows:

- insuring deposits up to US$100,000 in all the US banks and savings institutions;
- arranging a resolution for each failing institutions, to act as the receiver for the failing institution and to liquidate its assets;
- promoting the safety and soundness of insured depository institutions and the US financial system by identifying, monitoring and addressing risks to the deposit insurance funds; and
- supervising some 5 600 state-chartered "nonmember" banks and state-chartered saving banks.

3.19 The FDIC receives no congressional appropriations. Its funds come from deposit insurance premiums paid by banks and savings institutions and from earnings on investments in US Treasury securities.

<u>The Federal Reserve System</u>

3.20 The Federal Reserve System is the central bank of the US. It comprises a Board of Governors and 12 regional Reserve Banks. The Board of Governors is made up of seven members appointed by the US President and confirmed by the Senate. Only one member of the Board is selected from any

one of the 12 regional Reserve Banks. The full term of a Board member is 14 years.

3.21 The functions of the Federal Reserve Board include:

- conducting the nation's monetary policy;
- supervising and regulating banking institutions and protecting the credit rights of consumers;
- maintaining the stability of the financial system; and
- providing certain financial services to the US government; the public, financial institutions and foreign official institutions.

3.22 The Federal Reserve Bank of New York we visited is one of the 12 Regional Reserve Banks. It implements and executes the monetary policies decided by the Federal Reserve Board. Its duties, as a regional Reserve Bank, are:

- operating a nationwide payments system;
- distributing the nation's currency and coin;
- supervising and regulating member banks and bank holding companies;
- serving as banker for the US Treasury; and
- acting as depository for the banks in its own District.

Commercial banks

3.23 The supervision of commercial bank is the responsibility of the Treasury Department. In 1998, there were 8 774 commercial banks in the US[3]. Commercial banks handle the majority of the financial transactions and services in the US. They are either federally or state chartered. Federally-chartered banks (i.e. national banks) are regulated by the Office of the Comptroller of the Currency of the Treasury Department, while state-chartered banks are regulated by banking authorities in the specific state in which they are incorporated.

[3] US Census Bureau, Statistical Abstract of the US:1999, Table No. 815.

Office of the Comptroller of the Currency

3.24 The Office of the Comptroller of the Currency (OCC) is a bureau of the Treasury Department. The Comptroller of the Currency is appointed by the US President and confirmed by the Senate for a term of five years. The principal function of the OCC is to regulate the national banking system and agencies of foreign banks.

3.25 The OCC does not receive any appropriations from the Congress. It is funded by assessments on national banks. National banks pay OCC for the examinations conducted and corporate applications. The OCC also receives revenue from its investment income[4].

3.26 In regulating national banks, the OCC has the power to:

- examine banks;
- approve or deny applications for new charters, branches, capital, or other changes in corporate or banking structure;
- take supervisory actions against banks that do not comply with laws and regulations or that otherwise engage in unsound banking practices. The agency can remove officers and directors, negotiate agreements to change banking practices and issue cease and desist orders as well as civil money penalties; and
- issue rules and regulations governing bank investments, lending and other practices.

Savings institutions

3.27 Savings institutions refer to savings banks and savings and loan associations and are generally known as ***thrifts***. Thrifts primarily provide mortgage loans to individuals. They also accept deposits from and extend credit to individuals. Thrifts are regulated by the Office of Thrift Supervision (OTS). The number of thrifts regulated by OTS stood at 1 068 at the end of 2000, a net decline of 35 for the year. The decline mainly came from the ongoing industry trend of mergers and acquisitions. Industry assets grew to US$928.6 billion at

[4] www.occ.treas.gov/AboutOCC.

the end of 2000, up 7.5% over the year.

Office of Thrift Supervision

3.28 OTS is a bureau of the Department of the Treasury and is the primary regulator of all federally-chartered and many state-chartered thrifts. As the main business of thrifts is on mortgage lending, the thrift industry is more sensitive to interest rate fluctuations than other sectors of the financial industry. OTS was established in 1989 when the thrift industry was facing tremendous pressure of high interest rates in the 80s. At that time, federal deposit insurance funds were not doing well and were about to close down. There was pressure to increase interest rates, and that had serious impact on the entire thrift industry as well as individual homeowners whose properties were held by the thrifts as collateral. The setting up of OTS was therefore to ensure the safety and soundness of thrifts and to support their role as home mortgage lenders and providers of other community credit and financial services[5].

3.29 OTS is responsible for chartering, examining, supervising and regulating federal savings associations, federal savings banks and state-chartered saving associations insured by SAIF. OTS conducts quarterly examinations which are part of the continuous monitoring and regulatory supervision of these institutions. The safety and soundness examination assesses the financial health of an institution, while the compliance examination assesses compliance with consumer-related laws and regulations. The purpose of these examinations is to alert the institutions of the issues and problems and to find solutions.

3.30 OTS is headed by a Director who is appointed by the US President with the Senate's confirmation. OTS is funded by assessments and fees levied on the institutions it regulates.

Credit Unions

3.31 Credit unions are non-profit, co-operative financial institutions owned and run by its members. They are exempted from reserve requirements and

[5] Meeting with OTS on 9 April 2001.

certain other rules that apply to other banking institutions.

3.32 In 1998, there were 6 814 federally-chartered credit unions under the supervision of the National Credit Union Administration. There were also 4 181 state-chartered credit unions with 12.3 million memberships in 1998[6]. State-chartered credit unions are supervised by the respective state supervisory authorities.

National Credit Union Administration

3.33 The National Credit Union Administration is an independent federal agency that charters and supervises federally-chartered credit unions and to manage the NCUSIF (see paragraph 3.15). It is managed by a board of three members who are appointed by the US President and confirmed by the Senate.

Securities and futures trading

3.34 In 1996, there were 45 600 security and commodity brokers in the markets.

Equities Markets

3.35 The US equities markets comprise several stock exchanges. The most important ones are located in New York City: the New York Stock Exchange, NASDAQ and the American Stock Exchange. Other smaller regional exchanges are located in Boston, Philadelphia, Cincinnati, Chicago, San Francisco and Los Angeles.

The Securities and Exchange Commission

3.36 Securities markets are regulated by the Securities and Exchange Commission (SEC). The SEC protects investors and maintains the integrity of the securities markets. SEC is empowered with broad authority over all aspects of the securities industry. This includes the power to register, regulate

[6] US Census Bureau, Statistical Abstract of the US:1999, Table No 816.

and oversee brokerage firms, transfer agents, clearing agencies as well as the nation's securities self-regulatory organizations such as the National Association of Securities Dealers.

3.37 The SEC has five Commissioners who are appointed by the US President with the advice and consent of the Senate. Their term of service is five years.

The Security Investor's Protection Corporation

3.38 The Securities Investor's Protection Corporation (SIPC) is a non-profit, membership corporation, funded by its member securities broker-dealers. It protects customers of the SEC registered broker-dealers against losses caused by financial failure of the broker-dealers. The maximum claim amount is US$500,000 with a limitation of US$100,000 in cash. In the event the SIPC Fund is insufficient for all claims, the SIPC may borrow up to US$1 billion from the US Treasury through the SEC. If the SEC determines that industry assessments cannot repay the loan, it may impose a transaction fee on purchasers of equity securities.

3.39 SIPC is run by a Board of seven directors, five of whom are appointed by the US President. The others are designated by the Secretary of the Treasury and the Federal Reserve Board.

National Association of Securities Dealers

3.40 The National Association of Securities Dealers (NASD) is the largest securities-industry self-regulatory organization in the US. NASD develops rules and regulations, conducts regulatory reviews of members' business activities and disciplines violators. It also designs, operates and regulates securities markets and services for the ultimate benefit and protection of investors.

The Securities Industry Association

3.41 The Securities Industry Association (SIA) was established in 1972 through the merger of the Association of Stock Exchange Firms and the

Investment Bankers Association of America. The SIA, as an industry association, has over 700 securities firms, investment banks, broker-dealers and mutual fund companies as its members. The main purpose is to present members-firm views to legislative and regulatory bodies at the federal and state levels, and to serve as a forum to address key industry issues.

The New York Stock Exchange

3.42 The New York Stock Exchange (NYSE), being one of the oldest operators of the US securities market, was founded in 1792. It was registered as a national securities exchange with the SEC in October 1934. The NYSE was incorporated as a non-profit corporation in 1971. Its Board of Directors is comprised of 25 members including the Chairman and the Chief Executive Officer, 12 representatives of the public and 12 representatives from the securities industry. The NYSE currently has a total of 1 366 members. Only members are allowed to trade in the exchange trading floor. To become a member firm, a company must meet rigorous professional standards set by the exchange. Membership to the exchange is transferable in the market. The price of membership fluctuates with supply and demand.

3.43 By the end of 2000, there were over 3 000 listed companies on the NYSE with total market capitalization of over US$17 trillion. Some 400 listed companies are non-US companies from 51 countries with a total market capitalization reaching US$5.4 trillion. In order to be listed in the NYSE, a company has to meet detailed listing requirements and rules, including market capitalization, financial soundness, ability to maintain minimum share prices, and willingness to keep the investing public informed on the progress of its affairs. The company also needs to meet certain qualifications. For example, its business ought to be of interest to the investing public; it has a stable position in the industry, or is engaged in an expanding industry. While the NYSE approves the listing application of a company, the latter needs to register with the SEC before trading could commence at the market place.

3.44 Being a self-regulating organization, the NYSE is responsible for enforcing its rules and federal securities laws among its member firms and their employees, as well as the listed companies. A broad range of supervisory techniques is employed for this purpose. The "Stock Watch" is a computer

system for detecting unusual trading patterns to alert the exchange of possible insider dealing abuses or other prohibited trading practices. Other regulatory activities include registration and qualification examinations for member firms and their personnel to ensure compliance with financial and operational requirements, periodic checks on broker's sales practices, and the continuous monitoring of specialist operations.

American Stock Exchange

3.45 The American Stock Exchange (AMEX), being the US's second largest floor-based exchange next to the NYSE, has a significant presence in common stocks, index shares and equity derivative securities. The AMEX merged with the National Association of Securities Dealers (NASD) in 1998. Under the merger, the NASD assumes the role of the parent company, but the AMEX operates as an independent entity within the NASD family of companies. The AMEX's members are leading brokerage houses. It has 807 regular members who transact business in equities and options, and 57 options principal members who execute transactions in options only. The AMEX is the leader in investment product development. The exchange traded funds (ETFs) which include a variety of index-based products, e.g. DIAMONDS, SPDRS (Standard & Poor's Depository Receipts), is the most successful development. There are some 100 ETF products trading on the AMEX. The AMEX established its first international joint venture with the Singapore Exchange in May 2001. Selected AMEX-listed exchange-traded funds and structured products are traded in the Singapore Exchange. A total of 112 companies were listed in the exchange in 2000. The number exceeds those in the NYSE and NASDAQ.

3.46 On the AMEX, trading is conducted through an advanced centralized specialist system combining with computer orders. A specialist is a single person who plays a central role for listed companies, providing key market information on how their stock is performing directly from the trading floor. He works to match buy orders with sell orders for a company stock. In the absence of customer orders, specialists trade for their own accounts, providing additional liquidity and establishing the public quote for stocks. The AMEX provides a wide range of services to its listed companies. Special programmes are designed to companies to enhance visibility and provide access to the

investing community. Analyses and tools are available for companies to manage their institutional shareholder base. Forums, conferences and communication meetings are organized for companies to publicize their activities. The AMEX continues to surveil the marketplace and regulate its members to ensure a fair and orderly market. Surveillance functions include options watch and stock watch, market investigations, market reports, equities and derivatives trading analyses.

NASDAQ

3.47 The NASDAQ Stock Market is operated by the NASDAQ International. NASDAQ comes from the name "NASD", i.e. National Association of Securities Dealers which founded the market in 1971. NASDAQ is the world's first electronic stock market. It is a screen-based market where transactions are done through a sophisticated computer and telecommunications network. This allows unlimited number of market participants to trade in companies stocks. The Market Makers, who are individual dealers competing with one another for investors' buy and sell orders, and Electronic communication networks, which are trading systems bringing additional customer orders into the market, are the two groups of market participants. Companies are benefited from greater access to investors, increased visibility in the market, and an environment that facilitates immediate and continuous trading. The delegation visited the NASDAQ MarketSite which is a seven-storey tower located at the heart of New York Times Squares. The tower has the largest video screen in the world on its external wall. CNBC, CNNfn, and other financial news media broadcast live throughout the day from the studio located inside the tower.

3.48 The NASDAQ National Market (NNM) lists more than 4 000 securities some of which are largest, best known companies in the world. To be listed in the NNM market, a company must satisfy stringent financial, capitalization, and corporate governance standards. The NASDAQ SmallCap Market (NSM) is a market for emerging growth companies. It lists some 1 000 individual securities. The financial criteria for listing on this market are less stringent than the NNM, though the governance standards are the same. As NSM companies become more established, they often move up to the NNM. The two markets are regulated by the NASDAQ Market Watch Department.

It surveils market activities by monitoring news released by issuers and market information disseminated to the public, and by exercising trading halt authority when appropriate. Listed companies are required to notify the public of any material information and give advance notice to the NASDAQ of certain news events. Computer detection systems also monitor and process all trading alerts and make sure certain price and volume information is reported accurately by member firms. Suspicious activities are immediately referred to NASDAQ regulation for further review and investigation. A variety of special services are provided to listed companies. Each NASDAQ company has a single point of contact to a NASDAQ Director, who serves as a link to an extensive portfolio of services. Directors provide day-to-day assistance and can offer valuable insight on investor relations, market and industry issues. Companies are invited to participate in programmes providing market information and networking opportunities. The NASDAQ Online also provides market data on all US-traded companies and real-time quotes for NASDAQ stocks.

Futures Markets

3.49 There are two forms of future contracts, namely, commodity futures and financial futures. In the US, the major futures exchanges are the Chicago Board of Trade and the Chicago Mercantile Exchange. We had the opportunity to visit the New York Board of Trade during our visit to New York.

The Commodity Futures Trading Commission

3.50 The US futures activities are regulated by the federal Commodity Futures Trading Commission (CFTC). The CFTC is an independent agency to protect market participants against manipulation, abusive trade practices and fraud. A reform has taken place in the positioning of the CFTC as a result of the Commodity Future Modernization Act passed in 2000. Details of the change are provided in paragraph 4.8 - 4.9.

3.51 The CFTC constitutes five Commissioners, appointed by the US President with the advice and consent of the Senate to serve staggered five-year terms.

National Futures Association

3.52 National Futures Association (NFA) is the industry-wide self-regulatory organization for the US futures industry. Any firm or individual that conducts futures or options on futures business with the public must be registered with the CFTC and be a Member of NFA. NFA performs the registration process on behalf of the CFTC and is overseen by the CFTC.

3.53 NFA's mission is to provide innovative regulatory programmes and services that ensure futures industry integrity, protect market participants and help its members meet their regulatory responsibilities.

New York Board of Trade

3.54 The New York Board of Trade (NYBOT), with a history of 125 year, was established in 1998 by merging the Coffee, Sugar & Cocoa Exchange and the New York Cotton Exchange. Today, through its two exchanges and their subsidiaries and divisions, including the New York Futures Exchange, FINEX, and Cantor Exchange, the NYBOT offers a wide variety of agricultural, currency and index products. This old market, which still maintains an open-cry system, has 1 000 members with 700 trading actively on the floor each day. Without losing the interaction from the open-cry system, NYBOT is adding in new technology to bring in more transparency, efficiency and research back-up for its customers.

3.55 According to NYBOT, they are maintaining both the manual and electronic systems which are operating in parallel. There is no need for 24-hour trading in NYBOT and changing the system to an entirely electronic one will put a lot of people out of job. They are therefore happy to keep the old system running, while they continue to provide instant information and back-up research through the electronic system.

<u>The Depository Trust and Clearing Company</u>

3.56 The Depository Trust and Clearing Company (DTCC), established in 1999, is a new holding company that brings together The Depository Trust Company and National Securities Clearing Corporation. Together, they are the

primary infrastructure for the post-trade processing of equities, bonds, UITs, mutual funds and insurance transactions in the US. Registered with the SEC, DTCC is US's national clearinghouse for the settlement of securities trades and it provides custody services for securities. It is a member of the Federal Reserve System and is wholly owned by members of the financial industry.

3.57 Transaction volumes for DTCC's processing has already reached 18.1 million transactions on a single day in April 2000, up from the peak of 9.3 million in 1999 and 6.3 million in 1998. DTCC is holding some US$24 trillion in assets in custody.

3.58 One of the biggest issues DTCC is working on is the setting up of a new institutional processing model for T+1. The US securities settlement is now operating in a T+3 settlement environment. The DTCC is actively pursuing plans to move to T+1 before the end of 2002.

Part II: Issues of relevance to the work of the Bills Committee and matters for further study by the Financial Affairs Panel

This part highlights the findings from the study of the UK and the US systems which have relevance to the concerns raised by the industries during the examination of the Securities and Futures Bill and the Banking (Amendment) Bill 2000. Some issues may need to be further studied by the Financial Affairs Panel in view of their importance in relation to the future development of Hong Kong's financial system.

Chapter 4 Regulatory structure

4.1 Following the introduction of the Securities and Futures Bill and the Banking (Amendment) Bill 2000 (the Bills), the Bills Committee established to scrutinize the Bills has received written submissions and heard deputation from various professional bodies, associations of market participants and local and international brokerage firms. Concern has been raised on the impact of bringing the ten existing Ordinances into one consolidated Securities and Futures Bill. The Bills propose a number of new regulatory initiatives, including the introduction of a single licensing regime to streamline the existing registration requirements for market intermediaries who increasingly have to deal in and advise on different investment products.

4.2 However, in the case of authorized institutions (AIs), which are exempted under existing legislation from regulation by the Securities and Futures Commission (SFC) of their securities dealing activities, the Bills propose that AIs will continue to be exempted but the exemption will be granted by the SFC upon the advice of the Hong Kong Monetary Authority (HKMA). This gives rise to the concern of whether there is level playing field between brokers and banks if they are subject to different levels of regulation and by different regulatory bodies. There is also the question of whether the securities business carried on by the AIs should better be supervised by the same regulator that supervises the securities and futures industry. The proposal of the Administration as reflected in the Bills is that the HKMA should be the front-line regulator of AIs which also carry on securities business. Some representatives of the securities and futures industry have expressed strong disagreement with the Administration's proposal.

4.3 We note that the increasing engagement in multi-business by financial institutions is not unique to Hong Kong. The undertaking of securities business by banking institutions has been in existence in the UK and the US markets for a long time, and with globalization the situation is becoming quite common. In finding out how the situation had been dealt with in these places, we made special efforts during the visit to understand not only their current arrangements, but also the views of the policy-making bodies, regulators and market players of what they perceived to be the major challenges in the light of

globalization and the overlapping of different lines of services.

4.4 The basic question originally raised on this subject was how a specific type of business could be regulated if conducted by different trades. However, at our discussions with the various regulators, our attention was often drawn to the more fundamental questions of how prudential supervision and conduct regulation ought to be undertaken within the regulatory framework, and which type of regulatory structure, a single regulator or a multiple regulator, would be more suitable for the effective regulation of multi-businesses of financial institutions.

Prudential supervision and conduct regulation

4.5 One of the most fundamental principles in considering how different trades are regulated is to distinguish the difference between prudential supervision and conduct regulation. Prudential supervision aims primarily at ensuring that the supervised institutions have adequate capital and liquidity to discharge their liabilities, so as to avoid a systemic crisis. Conduct regulation directs the attention to the day-to-day operations of the institutions and the compliance with the standards imposed in the relevant legislation, codes and guidelines. In the UK, the regulatory functions of the Bank of England over banking institutions were taken over by the new Financial Services Authority (FSA) through the Financial Services and Markets Act (FSM Act) passed in 2000. Even the FSA is of the view that prudential supervision and conduct regulation are two different specializations that should best be conducted by separate personnel.

4.6 In the US, the objective of bank supervision is to maintain the safety and soundness of banks. In our meeting with the Federal Reserve Bank of New York, we observe that there is a general belief that it is more effective for central banks to be responsible for bank supervision. The focus of a bank regulator is on the potential risks to the customers. It has a duty to oversee the level of assets and the standard of management in an institution.

4.7 As far as conduct regulation is concerned, there is no dispute among the regulators and market practitioners we met in both UK and US that no one would be more competent than those in a trade to regulate the conduct of the trade itself. In this respect, we find the experience in the US most relevant to our study of the subject, although our knowledge in this respect is limited to the federal level.

Functional regulation

4.8 The Glass-Steagall Act (i.e. the Banking Act of 1933) limited brokerage activities by national banks to purchase and sale transactions for actual customers of the bank. It was said that the purpose of Section 16 of the Act was to prevent national banks from engaging in the brokerage business for profit. The strict position had been gradually eroded during the last 50 years. Finally, in 1982, the limiting interpretation of the section was abandoned. The effort of the Securities and Exchange Commission (SEC) to regulate the banks as broker-dealers was judicially pronounced to be outside its jurisdiction[1]. The situation became highly unsatisfactory because the banks were exempted from registration as broker-dealers with the SEC but were expanding their securities activities outside the scope of federal securities laws. A change came with the enactment of the Gramm-Leach-Bliley Act (GLB Act) of 1999.

4.9 The GLB Act repeals the Glass-Steagall Act and permits affiliations among banks and securities firms, insurance companies and other financial services companies. This is to be done through the creation of a financial holding company (FHC). A corporation that controls a Federal Deposit Insurance Corporation insured bank could become a FHC. A FHC is permitted to engage in any activities that the Federal Reserve determines to be financial in nature or to be incidental or complementary to these financial activities. The most probable corporate structure is for a FHC to be a holding company owning various functional subsidiaries, such as a bank, an insurance company and a securities dealer. It is however equally possible for a bank or a securities dealer to own the functional subsidiaries. This is the result of following the principle that new financial activities should be conducted by an entity separate from a bank so that guaranteed deposits are not threatened.

[1] American Bankers Association v. Securities and Exchange Commission, 804 F.2d 739 (D.C. 1986)

4.10 In the realm of regulation, the dominant principle of the GLB Act is functional regulation. This means that the SEC will regulate securities activities, the banking regulators will look at banking activities, and the Federal Reserve Board will become the "umbrella regulator" of a consolidated FHC.

4.11 The combined effect of the two aforesaid principles applied in the GLB Act is to greatly reduce the exemption of bank securities activities from the SEC registration and regulation. A bank may continue to offer identified banking products such as certificates of deposit, letters of credit, bank loans and swap agreements. It may buy and sell as principal any security that it can legally own under applicable banking rules as well as the several types of securities specified in the Act. As a broker, a bank may carry out up to 500 non-exempted transactions per year and may purchase any type of securities for the account of an affiliate or in connection with transfer agent, fiduciary and other described functions.

Single regulator or multiple regulators

4.12 While the US introduces changes to its legislative framework to cater for new demands within the confines of its long-standing multi-regulator system, the UK has adopted a different approach in meeting its challenges. Prior to 1997, there was increasing dissatisfaction in the UK over the self-regulation of the different sectors of the industry. Some sectors had begun to merge together. In 1997, the Government decided to put in place a new regime – bringing in a single regulator called the FSA for the entire financial services industry, and a single body of law. This had become necessary both on account of a blurring of the distinctions between different kinds of financial businesses and the complexity of financial regulations. This concept of a single regulator was not new in the European Union, as Sweden had already adopted a single regulator. But in terms of laws, the UK was the first country trying out the concept of a single body of law for financial services. Nevertheless, a consensus may be emergent in Europe in favour of a single regulator model.[2]

[2] Please see the Lamfalussy report, i.e. the Final Report of the Committee of Wise Men on the Regulation of European Securities Markets of 15 February 2001.

4.13 With the enactment of the FSM Act which provides the legislative framework for the single regulator, the FSA took over the functions of Investment Management Regulatory Organizations, Securities and Futures Authority, Personal Investment Authority, Building Societies Commission, Friendly Society Commission, Insurance Directorate of the Department of Trade and Industry, and the Supervision and Surveillance Department of the Bank of England. The taking-over process in fact lasted for three years allowing time for the new FSA to take over the regulatory functions through a contract arrangement with the respective bodies, to assess the risks involved in each sector of the markets and to review the 80-90 sets of regulations.

4.14 In the US, largely due to historical reasons and the diversified interests of the different sectors of the industry, separate regulators are maintained for individual trades. The delegation has been able to meet some of the most important regulators in the financial industry: the SEC which regulates the securities markets, the Commodity Futures Trading Commission (CFTC) which regulates the commodity futures markets, and the Federal Reserve Bank of New York which regulates the member banks and bank holding companies in the Reserve District of New York. From our meetings with these bodies, we do not notice any urge for a single regulator.

4.15 The US markets also see the impact of globalization and the growing trend of multi-business operation in the markets. Instead of moving towards a single body of regulation, a whole range of modernization efforts have taken place. Apart from the GLB Act which introduces the creation of financial holding companies, the Commodity Futures Modernization Act passed in 2000 also creates a flexible structure for regulation of futures trading. The Modernization Act codifies an agreement between the CFTC and the SEC to repeal the ban on trading single stock futures and provides legal certainty for the over-the-counter derivatives markets. The Modernization Act also puts in place the recommendations of a Task Force set up to design a regulatory structure that is tailored to the specific products and participants of a given market, specially taking into account the manipulability of the products and eligibility of the participants. It also moves the CFTC from a direct to an oversight regulator. Under the new structure, markets, based on their own characteristics, may choose their own regulatory tier. The tiered markets increase potential for reciprocal recognition and allow greater innovation to

develop new derivatives, yet providing legal certainty in the markets for such derivatives. This approach aims to provide the US financial markets the flexibility needed to maintain a leadership role in the global market arena.

Things to consider

4.16 The drive towards a single regulator is spurred on by the convergence of the financial markets and the need for a simple, effective and cost efficient regulatory regime. In the UK, it was made possible by the government initiative to enact a single body of legislation to govern the financial services and markets. In the US, such magnitude of legislative change is currently politically infeasible. The general feeling among US market practitioners is that the single-regulator model has yet to be tested[3]. It is still too early to judge which is the more preferred model. In the UK model, it is extremely important for the FSA and the Bank of England to work in harmony. If the two do not co-operate or fail to ensure the safety and soundness of banks under the new working relationship, the banking market will be in serious risk. Bank supervision in the US is the responsibility of the central banks. If the system functions effectively, there is no need to change.

4.17 Despite the different ways of going forward to meet the challenges posed by the convergence of financial markets and services, both the UK and the US have adopted the same approach to the regulation of securities activities. Whether one calls it functional regulation or otherwise, it is in essence nothing more than the same regulator for the same regulated activities. We observe that the requirements for prudential supervision and conduct regulation are different. The conduct regulator must be familiar with the conduct of the trade. The US approach is particularly noteworthy because despite its keeping of all the existing regulators, it has so strictly applied the principle of functional regulation that the Federal Reserve Board and other state level regulators are expressly prohibited from interfering with activities not within their respective jurisdictions.

[3] The full implementation of the Financial Services and Markets Act 2000 is scheduled for later part of 2001.

4.18 In Hong Kong, it would appear that although the supervision of AIs by the HKMA does cover prudential and conduct supervision, the emphasis is on prudential supervision. The HKMA has to a considerable extent relied on the AIs themselves to carry out conduct supervision of staff. In contrast, the SFC has maintained prudential supervision as the starting point, and invested much resources in conduct supervision both at a corporate/firm level and at individual level. It appears that very compelling argument would be needed to go against the common conclusion of the world's two foremost leaders in financial services and markets and permit AIs to be exempted from the regulatory regime under the SFC.

Chapter 5 Autonomy and accountability

5.1 A number of concerns have been raised when examining the extent of autonomy to be given to regulators during the scrutiny of the Securities and Futures Bill (the Bill). These concerns include -

(a) whether there is any need for the reserved power of the Chief Executive (CE) to give the SFC written directions and obtain information in respect of individual files (Clause 11);

(b) to whom should the SFC be accountable; and

(c) how to ensure the autonomy of the SFC yet provide sufficient checks and balances to guard against any abuse of its powers.

5.2 In considering the legislative framework of a regulatory body, there is often the dilemma of whether sufficient autonomy has been given to the regulator so that it would not be subject to the interference of the Government. But in giving the regulator the powers it needs to carry out its functions effectively, there is often the fear that the regulatory body will become so powerful that there is no way to make it accountable for its deeds.

5.3 The SFC, the statutory regulatory body to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures markets, is charged with the responsibility to minimize crime and misconduct and to enhance investor protection in the securities and futures industry. To enable the SFC to perform the above regulatory functions, the Bill proposes to empower the SFC to make rules in respect of financial resources requirements and conduct of business of the intermediaries. The powers of the SFC will also be strengthened in relation to inquiries into listed corporations, supervision of intermediaries, and investigations into misconduct and offences under the Bill. The Bill empowers the SFC to seek from a listed corporation explanations of entries in documents when it appears that there is fraud or other misconduct in the listing or management of the corporation. The SFC can also request contractual counterparties of the listed corporation to

produce documents relating to dealings with the corporation, and can request access to the working papers of the corporation's auditors. The SFC is also empowered to make rules providing that any contravention of the rules would be an offence and punishable by substantial penalties. While there is general support in the industry for bringing the functions of the SFC into line with modern regulatory standards and practices, there is concern among market participants that the powers to be vested in the SFC by the Bill are too wide.

5.4 We also note that the powers conferred upon the SFC are subject to certain safeguards, including the reserved power of the CE to give written directions to the SFC regarding the performance of its duties and functions. Although the Government has given an assurance that this is a reserve power and the CE may only give a direction to the SFC if it is in the public interest to do so and that this power is not to be used lightly, there is concern that the independence of the SFC will be compromised. We therefore took the opportunity to ascertain from the respective regulatory bodies in the UK and the US regarding the extent of their independence in performing their functions independently and the manner in which they are accountable to the Government and the public.

Autonomy and accountability

5.5 In the UK, the new FSA is an independent statutory body charged with the responsibility of carrying out the functions set out in the FSM Act[1]. The Board of the FSA comprises an executive chairman, three managing directors, and 11 non-executive directors (including a lead non-executive director as the deputy chairman). Members of the Board are appointed by and may be removed by the Treasury[2]. The non-executive directors are appointed in accordance with the principles of appointment set out in the Nolan Report[3], i.e. on the basis of experience and personal qualities. There is no provision in the FSM Act empowering the Treasury or any officer of the executive branch of the UK Government to give any direction to the FSA.

[1] Section 1 of FSM Act.
[2] Paragraph 2(3) of Schedule 1 of FSM Act.
[3] First Report of the Committee on Standards in Pubic Life. May 1995.

5.6 According to FSA, it is important for the FSA to be independent of the Government and free from any political interference. One of the major objectives of establishing the FSA is to maintain confidence in the UK financial system. It was the Government's decision that it would not retain any residual power as once the power is there, the Government would be made to exercise it. The Government is fully aware that any attempt to direct the FSA is a "resignation" issue. Nevertheless, the accountability arrangements put in place include[4]:

- The FSA Chairman and Board are appointed and removable by the Treasury[5];

- In exercising its rule-making power and setting its policies, the FSA must give regard to a number of regulatory principles set out in the legislation[6];

- The FSA is required to make an annual report to the Treasury upon the discharge of its functions. The Treasury is required to lay the report before Parliament[7];

- The Treasury and the FSA are to give periodic evidence to the Treasury Committee;

- The Treasury has power to commission inquiries into regulatory matters of public concern;

- The Treasury may direct the FSA to change its rules, procedures and practices in response to an adverse competition report from the Director General of Fair Trading[8]. It may direct the FSA to comply with the UK's international obligations[9]; and

[4] Paragraph 3.2 of FSM Bill Progress Report published HM Treasury on 5 March 1999.
[5] Schedule 1 of FSM Act.
[6] Sections 2 & 155 of FSM Act.
[7] Schedule 1 of FSM Act.
[8] Sections 162 & 308 of FSM Act.
[9] Section 405 of FSM Act.

- The Treasury may also appoint an independent person to conduct a review of the economy, efficiency and effectiveness with which the FSA has used its resources in discharging its functions.[10]

5.7 As regards the system in the US, we have had the opportunity of meeting with the SEC, which regulates the securities markets, and the CFTC, which regulates the commodity futures trading. The SEC was created by the Congress in 1934[11] as an independent, quasi-judicial agency. It administers and enforces the federal securities laws of the US in order to protect investors and maintain fair, honest and efficient markets. The SEC, appointed by the US President with the consent of the Senate, shall make an annual report to the Congress on its work for the preceding year containing such information as required by the relevant legislation[12]. Apart from the power of appointment, the executive branch of the government does not have any power of direction over the Commissioners. The Senate may hold hearings and require the attendance of the Commissioners at such hearings. It has no power to interfere with the work of the SEC. According to SEC, how to strike the right balance between autonomy and accountability has been an ongoing argument. So far the SEC has not been alleged to have abused its powers.

5.8 The CFTC also functions independently. It was created by the Congress in 1974 as an independent agency with the mandate to regulate commodities futures and option markets. The CFTC, also appointed by the US President with the consent of the Senate, reports to the Congress in the same way as other regulatory bodies.

Additional safeguards

5.9 We notice that one of the new measures in the Securities and Futures Bill to guard against possible abuse of powers and discretion is the inclusion of the SFC's regulatory objectives in the Bill, which will serve as benchmarks for the monitoring of the SFC's performance. There are also other measures including the establishment of a Securities and Futures Appeals Tribunal and a

[10] Section 12 of FSM Act.
[11] Section 4 of the Securities Exchange Act of 1934.
[12] Section 23b.1. of the Securities Exchange Act of 1934.

Process Review Panel. The new Tribunal is to improve on the current Securities and Futures Appeals Panel (SFAP) which is a part-time merits review panel to deal with appeals against the SFC's decisions. The new Tribunal will be full-time and has a wider remit.

5.10 The current SFAP or the future Tribunal is to deal with grievances from practitioners, i.e. intermediaries, over the decisions of the SFC. In the UK, a more proactive approach has been adopted by the new FSA. In addition to the Financial Services and Markets Tribunal[13] which deals with aggrieved applicants for permission to carry on regulated activities and aggrieved authorized persons over the exercise of the FSA's power, the FSA has the duty to consult practitioners and consumers.[14] Under the Act, the FSA must make and maintain effective arrangements for consulting practitioners and consumers on its policies and practices and for this purpose, a Consumer Panel and a Practitioner Panel are formed[15]. The FSA is required by law to consider representations made to it by either the Practitioner Panel or the Consumer Panel and, where it disagrees with the views expressed or proposals made in such representations, to give its reasons in writing[16].

5.11 In other words, the setting up of the Practitioners Panel has ensured that practitioners' views are heard and taken into consideration before a new policy or rule to regulate the trade is put in place. The Practitioner Panel comprises representatives from the businesses regulated by the FSA. When the FSA established the Panel voluntarily in 1998, it appointed high level representatives with intimate knowledge of the regulatory framework through consultation with the trade associations.[17] The maintenance of the Practitioner Panel was subsequently made a statutory requirement in the FSM Act. While appointment of members of the Panel remains the jurisdiction of the FSA, the appointment or the dismissal of the chairman of the Panel by the FSA needs the approval of the Treasury.

5.12 We observe that the Practitioner Panel has found it important for the Panel to remain invisible if it wants to be effective. The more effective way to

[13] Section 132 of FSM Act.
[14] Section 8 of FSM Act.
[15] Sections 9 & 10 of FSM Act.
[16] Section 11 of FSM Act.
[17] Meeting with the FSA on 6 April 2001.

achieve results is through the pre-consultation work. The Practitioner Panel does its work quietly, but it provides a channel for issues to be examined in a transparent manner, without relying solely on individual trades to lobby for support on their own. The Panel finds that it has become effective in influencing decisions and steering results which would not have been achievable under the previous structure. Even the Consumer Panel has found that through working with the Practitioner Panel, members representing consumers are able to understand more about the needs of the trades and there are now more compromises.

5.13 The Consumer Panel also plays a significant role in checking the powers of the FSA. We shall explain the subject in the wider context of consumer protection in Chapter 7.

5.14 Extensive consultation is also carried out each time when a new direction or a new rule is proposed. The information is widely distributed to the public and to the trades through pamphlets, consultation papers and the Internet.

Things to consider

5.15 It appears that both the UK and the US legislation has refrained from giving the executive branch of the government any overriding power to direct the activities of the regulators. This may in truth be unnecessary because each regulator is subject to the close attention of a powerful legislature. In both countries, safeguard is provided in the power of the Treasury, in the case of the UK, and the US President, to appoint the governing officers of the regulatory bodies. In the US in particular, the appointments require the endorsement of the Senate. The Congress has oversight responsibility of the regulatory bodies. In other words, the regulatory bodies are accountable to the authority which appoints them. The means to make them accountable is not through reserved power of the government but the power to appoint and the requirement for the regulatory bodies to make reports to the government and to give evidence to the legislature.

5.16 Hong Kong has a different political structure, but the power to appoint the SFC is vested with the CE. Consideration should therefore be given to the need for reserved power and the manner of making the SFC accountable for its work.

5.17 The arrangement in the UK in requiring the FSA to consult the Practitioner Panel is worth noting. We are aware that in Hong Kong, as a standard practice, the SFC does consult with the market. The SFC has also formed various working groups with market participants and, if required, professional bodies to seek market input during the drafting of rules. However, the formalizing of the pre-consultation arrangement has not been considered. The proposal to set up a formal mechanism for finding out the response of the affected trades before putting in place any new policies or rule is worth pursuing.

Chapter 6 Powers of sanction and burden of proof

6.1 Following the publication of the draft Securities and Futures Bill, grave concern has been expressed on the increased rule-making power of the SFC. The markets have found it worrying that the SFC should have the power, in effect, to create criminal offences punishable with substantial fines and imprisonment. Although the Administration has assured that full consultation with the markets would be conducted to seek input on draft rules to allay market concerns, it may not be appropriate to vest the power to create offences of strict liability (which are only subject to the defense of "reasonable excuse") with the SFC. It is felt that any matters that attract criminal liability should be provided for in the Bill itself and subject to the normal legislative procedure, i.e. public consultation, approval by Chief Executive-in-Council and by the Legislative Council.

6.2 The examination of the powers of the SFC and burden of proof for offences, in particular the burden of proving the intention to commit offences, is therefore one of the main areas of study by the Bills Committee. The delegation, in meeting parliamentary committees and regulatory bodies, focused much of its attention on the rule-making powers of regulatory bodies, how far rules which may have criminal effect may be made, and the burden of proof for offences under their legislative framework. The subject was discussed in great depth particularly in the UK in view of the similarity of the two legal systems.

Rule-making power of regulators

6.3 In the UK, the FSA has extensive rule-making powers under the FSM Act[1]. The FSA may make rules applying to authorized persons with respect to the carrying on of regulated activities or other activities as appear to it to be necessary or expedient for the purpose of protecting the interests of consumers[2]. It may also make other rules for ancillary and specific matters[3].

[1] Part X of FSM Act.
[2] Section 138 of FSM Act.
[3] Section 139-147 of FSM Act.

6.4 We notice that the Select Committee on Treasury, House of Commons, was aware of the concern relating to the giving of too much powers to the regulator, especially in the case of a super-regulator like the FSA. As the financial markets are changing very rapidly, there is a need for the guidelines governing market practices to be up-to-date. Regulation through secondary legislation and rules is considered the best way to cater for the circumstances in the financial markets. Rules made by the FSA do not require parliamentary input, but the FSA is required to appear before the Select Committee on Treasury twice a year. The sanctions for breaches of the FSA rules are civil in nature and for the purpose of discipline, e.g. fines and making public the name of the firm concerned, although at times the civil sanctions could be quite substantial.

6.5 According to the FSA[4], the following restrictions would apply when making rules:

(a) rules are only made under the expressed power of the FSA under the Act;

(b) rules are only made for achieving the regulatory objectives of the FSA;

(c) rules cannot be made rules unless cost-benefit analysis and public consultation are conducted, including consultation with the Practitioner Panel and Consumer Panel and publishing the FSA's response to the views solicited from the consultation;

(d) the rules made are subject to external scrutiny by:

(i) the Government (which has a duty to ensure that the FSA acts consistently with the agreed policies and the rules are not in breach of existing laws); and

(ii) the Competition Authority.

[4] Meeting with FSA on 6 April 2001.

6.6 In the US, the SEC is empowered to make such rules and regulations as may be necessary or appropriate to implement the provisions of the Securities Exchange Act of 1934[5]. It is expressly required to consider among other matters the impact of such rules and regulations would have on competition[6].

Criminality of market behaviours

6.7 In view of the extensive rule-making power of regulatory bodies in the UK and the US, one of our most frequently asked questions put to them was whether they had the power to make rules which would lead to criminal sanctions.

6.8 According to the FSA, the rules it makes cannot impose a criminal sanction on their own. Breaking a rule is therefore not criminal unless the act itself constitutes an offence under a piece of legislation already in place, such as "market manipulation", which is criminal. Prior to the FSM Act, "market abuse" had never been set out in specific terms, making enforcement difficult. The lack of definition had also made market participants uncomfortable, and the industry had always wanted it to be spelt out in expressed terms. The FSM Act has now defined what "market abuse" is and provided the FSA the duty to prepare and issue a code to give guidance to what amounts to market abuse. The code has provided what is proper practice and afforded a defense to the accused. It is further noted that market abuse is described in the FSM Act in an objective and behavioral manner. Hence, it appears that in the civil enforcement, there is no need to prove intent.

6.9 In the US, the rules and regulations made by the SEC under Securities Exchange Act of 1934 and Securities Act of 1933 do prescribe unlawful acts, e.g. manipulative and deceptive devices and contrivances[7], but no sanction is imposed by the rules and regulations. The criminal penalties are provided in the principal legislation[8].

[5] Section 23a.1. of the Securities Exchange Act of 1934.
[6] Section 23a.2. of the Securities Exchange Act of 1934.
[7] Section 10 of Securities Exchange Act of 1934.
[8] E.g. Section 32 of Securities Exchange Act of 1934 & Section 24 of Securities Act of 1933.

Civil and Criminal Enforcement of Securities Laws

6.10 We notice that in the Securities and Futures Bill, the provisions in respect of the market misconduct regime provide civil and criminal sanctions against conducts which are described in same terms[9], e.g. the misconduct of price rigging (clause 266) and the offence of price rigging (clause 288). In other words, the same conduct may be subject to civil or criminal sanctions provided that it is so provided in law.

6.11 In the course of our study of the US system, our attention was drawn to the dual system of enforcement of securities laws, i.e. by civil and criminal proceedings. On the civil side, the SEC can through a quasi-judicial process known as "administrative proceedings" to suspend or revoke a broker-dealer's registration, issuing a stop order halting the distribution of a new public offering, make a cease or desist order, or impose monetary penalties. The SEC can also seek in the federal courts an injunction restraining a wrongdoer from present and future violations or the equitable remedies for disgorging the ill-gotten gains from a wrongdoer. On the criminal side, it is the Department of Justice and FBI that would investigate and prosecute people for securities laws violations. A violator of securities laws in the US would often find himself being investigated and prosecuted by both the SEC and the Department of Justice at the same time on two totally different tracks. There is no question of double jeopardy.

6.12 The advantages of a dual system, as seen from the perspective of the prosecution, are many. The integrity of the decision-making process is enhanced by the checks and balances created by the institutional interdependence of agencies and criminal prosecutors. The regulatory authority enjoys extra leverage over potential defendants by being able to pursue two avenues simultaneously. Since many violations are too complex or subtle for effective presentation to a jury or the evidence available simply could not meet the high burden of proof for criminal trials, successful criminal prosecution may not be possible in every serious case. Relying solely on criminal remedies would render the enforcement system entirely inadequate to achieve overall deterrence. The dual system allows the regulator to conserve

[9] Please compare the provisions of Part XIII and Part XIV; particularly clauses 261 & 283, 265 & 287; 266 & 288; 267 & 289; 268 & 290; and 269 & 291.

prosecutorial energies for the most appropriate cases. The civil enforcement powers of the SEC enable action to be taken even in most difficult cases to ensure remediation and effective deterrence.

Burden of proof

6.13 How far rules which may have criminal effect could be made without being subject to the scrutiny of their legislatures, and what standard of proof is required for proving breach of rules are the subjects in which members of the delegation have shown enormous interest. In this respect, we notice that whether the disciplinary regime should be civil or criminal was also one of main areas of study in the Joint Committee on the FSM Bill in the UK. On the face of the FSM Bill as drafted, the disciplinary regimes would be civil rather than criminal[10]. However, there were arguments that the market abuse regime of the FSM Bill, which overlaps with criminal offences on insider dealing and market manipulation, and the high monetary penalties are for the purpose of ECHR regards criminal in nature. For this reason, regards will have to be given to the human rights principle of the "right to a fair trial", i.e. criminal charges must be proved beyond reasonable doubt and other safeguards e.g. privilege against self discrimination, while civil actions are decided on the balance of probabilities.[11]

6.14 We note that the Joint Committee in its report on the draft Bill has made the following remark: "…it is well-established that courts or tribunals in a civil action can apply a "sliding scale" of proof, applying more or less the criminal standard where criminal-type penalties are at stake. The FSA confirmed that this was its understanding; and we understand that this would be sufficient to satisfy the European Convention on Human Rights"[12].

Things to consider

6.15 We observe that the rules made by the regulatory bodies in the UK

[10] Paragraph 163 of First Report of the Joint Committee on Draft FSM Bill.
[11] Paragraph 175 of First Report of the Joint Committee on Draft FSM Bill.
[12] Paragraph 176 of First report of the joint Committee on Draft FSM Bill.

and the US are basically civil in nature and would not impose any criminal penalty on its own. Where a breach of rule also constitutes a criminal offence under laws such as insider dealing or market manipulation in the UK, or fraud or market abuse in the US, the standard of proof will be that applied to criminal proceedings. Although the regulatory bodies appear to have extensive power in making rules and regulations, their actions are subject to the careful scrutiny of the legislature and the existence of quite a number of safeguards, including legislative principles set out in the legislation. In Hong Kong, unless the rules made by the SFC are regarded as subsidiary legislation, hence require the positive or negative vetting by the Legislative Council, the powers so given to the SFC could be unchecked in the absence of a formal consultative process.

Chapter 7 Consumer protection

7.1 One of our major achievements in this overseas duty visit is the opportunity to understand the way in which the two countries protect the rights of consumers. All regulatory legislation is said to be for the purpose of protecting consumers' interests. What those interests are and how they may be ascertained are usually not clearly explained. Protection of consumers' interests in fact covers a much wider scope than the handling of customers' complaints. Industries are often under the impression that by ensuring the protection of customers' interests, the rights and interests of the industries are forgone. We observe that the concept of consumer protection has been very comprehensively implemented in the FSM Act of the UK which links the protection of consumers to the macro interest of maintaining the international competitive position of the financial markets. With globalization, it is no longer realistic to believe that market players and investors would solely engage their investment activities in any single market or any single economy. To enhance the competitiveness of one's own markets, the government has the obligation to ensure the interests of all those who play a part in the markets are protected.

7.2 Both the UK and the US have placed much emphasis on the protection of consumers' rights, but they have adopted different approaches which seem to fit into the individual characteristics of their respective businesses and living environments. In studying the mechanisms adopted by these countries, it is important to refer to the wider context of how financial services are provided to customers in these places, the range of services available and how far these services are regulated.

Consumer protection under the FSM Act of the UK

7.3 The FSM Act of the UK has tackled the subject of consumer protection from the macro perspective of competition scrutiny to the handling of complaints from individual customers. As we have not had the opportunity to study the issue of competition during the overseas visit, we focus in this report on the consultation mechanism and redress systems in relation to consumer protection.

7.4 Under the FSM Act, the protection of consumers is an objective written into the legislation to secure the appropriate degree of protection for consumer. In considering what degree of protection may be appropriate, the FSA must have regard to[1] --

(a) the differing degrees of risk involved in different kinds of investment or other transactions;

(b) the differing degrees of experience and expertise that different consumers may have in relation to different kinds of regulated activity;

(c) the needs that consumers may have for advice and accurate information; and

(d) the general principle that consumers should take responsibility for their decisions.

7.5 The FSM Act provides the ante facto duty of the FSA to consult a Consumer Panel, and the post facto redress through an ombudsman scheme.

Consumer Panel

7.6 A consumer panel was at first established voluntarily by the FSA in 1998 as a consultative body to gauge the consumer reaction to the proposed Financial Services and Markets Bill. In the course of the scrutiny of the Bill, it was felt that the consumer panel should be given a statutory basis and the FSA should have a duty to consult the panel. The FSA is now by statute required to consult consumers on the extent to which its general policies and practices are consistent with its general duties under the Act[2]. It is also under a duty to establish and maintain a panel of persons to represent the interests of consumers[3]. The panel so established is called the Financial Services Consumer Panel.

[1] Section 5 of FSM Act.
[2] Section 8 of FSM Act.
[3] Section 10 of FSM Act.

7.7 The current Consumer Panel has 13 members including the chairman. They have been appointed by an open recruitment process based on the principles recommended by the Nolan Committee. The appointees are on contract terms for a fixed period. The remuneration for an ordinary member is £ 8,000 per annum, not enough for a full time job. One is expected to work about 25 days a year, but the actual workload demands much more time. The Panel meets formally about 10 times a year. It has its own budget and is supported by a secretariat of four full time staff. The Panel has to issue annual reports which would be laid before the Parliament.

7.8 During the past two and half years, the Consumer Panel has responded to 86 consultation papers and 20 other major papers on the new regime in addition to the FSM Bill itself. We are advised that as members of the Panel are basically part-time, there is not much chance for them to be proactive, but with the opportunity to respond to proposals, members have become broader in outlook when looking at the regulatory framework. Although they are appointed by the FSA and the four full-time staff come from the FSA, the experience they had in the past two and half years shows that they could be entirely independent in operation. The Panel is completely transparent in its operation although its meetings are closed. All proposals put to the Panel for views are published and put on the Internet, so that views from the public could be channeled to the members before they formulate their views on the proposals. The Panel also has close working relationship with the Financial Ombudsman Service, the Consumer Help-line and consumer associations. The fact that the FSA needs to explain to the public why the Panel's representations are not accepted has compelled the FSA to be more aware of the interests of consumers[4].

The Ombudsman system

7.9 The delegation had the benefit of visiting the Financial Ombudsman Service (FOS) in the midst of a major organizational change in the ombudsman system of the financial sector of the UK. The FSM Act, which may come into effect in November 2001, provides for the creation of a single, compulsory ombudsman scheme for the resolution of disputes between authorized firms

[4] Meeting with FSA on 6 April 2001.

and their customers. The object of the scheme is to resolve disputes involving customers quickly and with minimum formality. The operator of the scheme must be a body corporate[5].

7.10 The proposal to provide a single operator to deal with disputes involving customers came about when the Government saw the need to rationalize the eight dispute resolution schemes in the financial markets in the mid 90s. To reduce the scope for confusion about the roles and responsibilities of different schemes, and to ensure improved access for consumers by providing a single point of entry, the FSM Act establishes "the ombudsman scheme" to replace the following eight schemes:

- Banking Ombudsman
- Building Societies Ombudsman
- the FSA complaints service
- Insurance Ombudsman
- Investment Ombudsman
- Personal Investment Arbitration Service
- Personal Investment Authority Ombudsman
- SFA Complaints and Arbitration Service

7.11 We understand that these various schemes were formerly set up by the respective industries. Some of these schemes were compulsory, while others voluntary. Some were set up under statute, while others were based on contract. When a complaint could not be resolved to the satisfaction of the complainant, he still had the right to go to court. But the chance of winning was very little as the ombudsmen of the respective services had already taken the legal considerations into account. In the case of the Complaints and Arbitration Service of the Securities and Futures Authority (SFA) which the FOS has now taken over, its role was mainly arbitration as the decisions of SFA were by law final.

7.12 We notice that when the proposal was examined by the Joint Committee on the FSM Bill, despite the general support for the single ombudsman scheme, there was concern that "the scheme, given the due process

[5] Section 225 of FSM Act.

requirements of the European Convention on Human Rights, might resemble a court or Tribunal rather than an Ombudsman scheme". Attempts had been made by the various Ombudsmen "to consider and plan how reformed procedures might comply with these requirements while retaining the informality and flexibility that are hallmarks of an Ombudsman approach". The Joint Committee therefore considered it "important that the procedures should be fair and transparent but within those parameters … it will prove possible to ensure that the Financial Ombudsman Scheme does not become over-legalistic"[6].

7.13 Under the FSM Act, all firms authorized by the FSA are required to submit to the jurisdiction of the ombudsman scheme. The FSA is to make rules determining which activities of authorized persons fall within the compulsory jurisdiction. Firms can join the ombudsman scheme under the voluntary jurisdiction where they are not authorized by the FSA or in respect of activities falling outside the scope of compulsory jurisdiction. Voluntary jurisdiction rules can be made by the scheme operator with the approval of the FSA.

7.14 To enable a smooth transition, the FOS was established as a company incorporated by guarantee to serve as the interim scheme operator until the FSM Act comes into force in November 2001. With its budget approved by the FSA, it provides the appropriate complaints-handling service on behalf of each of the boards of the existing complaints-handling and ombudsman schemes under service agreements signed with the boards. Those staff who originally worked for these various schemes were taken over by the FOS.

7.15 The service of the FOS is free to consumers. Any unsatisfied customers may bring their complaints to the FOS but they must have lodged their complaints with the financial firms first. The firm should try to resolve the issues first. The complainants may then bring their cases to the FOS or to court. The FOS may only deal with cases with a value up to £ 100,000 (excluding costs of the redress).

[6] Paragraph 295 of the First Report of the Joint Committee on Draft FSM Bill.

7.16 The ombudsman will make a decision about the complaint on the basis of what he considers is fair and reasonable in the circumstances. If the complainant accepts the ombudsman's decision, it is then binding on both the complainant and the firm. If the decision is made in favour of the complainant, the respondent may be ordered to pay compensation up to a maximum limit which may be set by the FSA. The yardstick in determining the level of compensation is on the basis of "no change to the consumer", i.e. putting back to the position should the situation have not taken place[7].

7.17 As the scheme operator, the FOS is given the power to make rules concerning the costs which can be awarded by the ombudsman but subject to certain constraints. Where a complaint is settled in favour of the complainant, the rules can allow the firm concerned to be required to meet the costs of both the complainant and the scheme operator. Once a prima facie case is established, the firm will be asked to pay a case fee of £ 500 (recently reduced to £ 400) which is not refundable even if the complaint is not upheld in the end. The firm may not get the legal costs back even though the process is done through legal representatives. While the ceiling of compensation currently set by the FSA for each case is £ 100,000 (excluding redress fees), the ombudsman may recommend to the courts for a higher compensation.

7.18 The ombudsman's role is inquisitorial but the whole process is informal and principally paper-based. Public hearings may be conducted if considered appropriate. Legal representation is allowed but it is not an absolute right. The scheme operator is provided the powers to require the production of specified information necessary for the fair determination of the complaint. Failure to comply with the requirement can be dealt with as if it were a case in contempt of court. Although consideration of the case must be legally based, the ombudsman also looks at the practices and other circumstances. The particular circumstances of the consumer will be given more consideration than a court would normally do. Having concluded his investigation, the ombudsman would make an award. It would be binding on the firm but not the consumer, who may resort to the courts if not satisfied with the outcome of investigation or the award.

[7] Meeting with FOS on 6 April 2001.

7.19 Although all costs in supporting the FOS come from the industries, with 50% funded by levies (based a formula calculated from income) and 50% from case fees, the FOS is independent of the government and financial firms. Members of the FOS Board are appointed and liable to be removed from office, by the FSA[8].

7.20 We also understand from the FOS that while a completely free system to customers may be subject to abuse, the existence of the system of redress helps the industries to restore the confidence in the business. The in-flow of work may at times be influenced by press reporting, but on the whole there is no indication of abuse especially in the banking sector. According to the information provided to the delegation, out of about 6 000 complaints against the banking sector in a month, only about 7 get to the ombudsman. The law requires all complaints to be dealt with by the banks first before they can be forwarded to the ombudsman. On average, of 1 000 calls received by the FOS on banking-related matters, only 400 would subsequently be put down as written complaints. Of these 400 cases, only about 250 need to be followed up and 150 could already be resolved at the bank level. For the 100 cases dealt with by the FOS, efforts will first be made to bring the two parties together and reach a compromise on the settlement. If no settlement can be reached, a full investigation will then be conducted.

7.21 The situation in other industries may be different especially in the insurance and investment sectors. In the investment sectors, the regulation is on both prudential and how the detailed work is done. More involvement by the regulator is therefore inevitable. As a result, a large proportion of complaints may subsequently go to the ombudsman. Generally speaking, there still remains a danger that a free ombudsman service might encourage investors who have suffered loss in a volatile market to make unsubstantiated complaints.

The US system

[8] Paragraph 3 of Part I of Schedule 17 of FSM Act.

7.22 In the US, the rights of consumers are protected by laws. All legislation, regulations and rules must not contravene the individual rights enshrined in the US Constitution. The statutory requirements to protect consumer's rights are embedded in the statutes in respect of the specific trade. We have only had the opportunity to understand the system in the banking field through our meeting with the Federal Reserve Bank of New York. It is however illustrative of the protection of consumer rights as reflected in the US laws.

7.23 Taking credit protection as an example, the Consumer Credit Protection Act of 1968, which launched Truth in Lending disclosures, had for the first time required creditors to state the cost of borrowing in a common language that every ordinary consumer could figure out what the charges are, compare costs, and shop for the best credit deal. Since 1968, the concepts of "fair" and "equal" credit have been written into laws that bar unfair discrimination in credit transactions, require that consumers be told the reason for the denial of credit, allow customers to find out about their credit records from credit-reporting agencies, and set up a way to settle billing disputes. These laws set a standard for how individuals are to be treated in their financial dealings. Today, on credit protection alone, there are acts on truth in lending and consumer leasing, equal credit opportunity, fair credit billing, fair credit reporting, and electronic fund transfer.

7.24 Another example is the Gramm-Leach-Bliley Act which the delegation studied in some depth during the visit. The Act requires the Federal Trade Commission, the enforcement body of a variety of federal antitrust and consumer protection laws, along with the Federal banking agencies, the National Credit Union Administration, the Treasury Department, and the SEC, to issue regulations ensuring that financial institutions protect the privacy of consumers' personal financial information. Such institutions must develop and give notice of their privacy policies to their own customers at least annually, and before disclosing any customers' personal financial information to a nonaffiliated third party, must give notice and an opportunity for that customer to "opt out" for such disclosure. While the Federal Trade Commission stops actions that threaten consumers' opportunities to exercise informed choice, the respective regulatory bodies also have the responsibility to institute complaint-handling mechanism to deal with customers' complaints.

7.25 To ensure that customers are aware of their rights, handbooks and pamphlets are published by the enforcement and regulatory bodies to explain their rights under the laws. Regulatory bodies also lay down detailed regulations setting out the consumer complaint procedures and defining unfair or deceptive acts or practices. Each bank or financial institution must have its own complaints handling office to help the redress customer grievances. If customers are unable to resolve the problem, they may file a written complaint with federal agencies responsible for enforcing the related laws. Many of the agencies however do not handle individual complaint, but they will use information about the customers' experiences to help enforce the credit laws.

Complaints against banks

7.26 Bank customers may direct their complaints to the Federal Reserve System. The Federal Reserve investigates all cases against state-chartered banks and refers all other cases to the relevant federal regulatory agencies. Under the Federal Reserve System, the Division of Consumer and Community Affairs (DCCA) is responsible for handling consumer complaints. Once a complaint has been received, it will be reviewed by the consumer affairs staff. The relevant Reserve Bank will investigate each issue raised in the complaint and ask the bank concerned for information and records. The bank's response will be analysed to ensure the consumer's concern is addressed. The complainant will be informed of the Reserve Bank's findings in writing.

7.27 If the investigation reveals violation of the laws, the Reserve Bank will direct the bank to take corrective action. The Federal Reserve does not have the authority to resolve all types of problems, such as contractual or factual disputes or disagreements about bank policies or procedures. If the matter cannot be resolved with the bank even after a complaint has been made, the customer may consider taking legal action against the institution.

7.28 The laws also lay down the penalties a creditor, i.e. the bank, must pay if the customer wins in a lawsuit[9]. For example, if any creditor fails to disclose

[9] Page 36, Consumer Handbook to Credit Protection Laws.

information required under the various acts, or give inaccurate information, etc., the customer as an individual may sue for actual damages and any money loss he suffer. In addition, the customer may sue for twice the finance charge in the case of certain credit disclosure, or if a lease is concerned, 25% of total monthly payments. In either case, the court may award the customer, if he wins, a minimum of US$100, or a maximum of US$1,000. The customer who wins in the lawsuit is entitled to reimbursement for court costs and attorney's fees. In the case of violation of the Fair Credit Reporting Act, again the customers who are successful in the lawsuits are entitled to actual damages, court costs and attorney's fees, plus punitive damages that the court may allow if the violation is proved to have been intentional. In addition, a person who obtains a credit report without proper authorization or an employee of a credit-reporting agency who gives a credit report to unauthorized persons may be fined up to US$5,000 or imprisoned for one year or both. Class action suits are permitted for filing claims on behalf of a group of people with similar claims.

Complaints against institutions regulated by the Securities & Exchanges Commission

7.29 As regards complaints related to securities, the Office of Investor Education and Assistance (OIEA) of the SEC is charged with the duty to ensure that the problems and concerns of the individual investors are known to the SEC and considered when the agency takes action. Members of the public can lodge their complaints with the SEC Complaint Center. After a complaint is received, it would be thoroughly reviewed and evaluated. General questions of securities laws and complaints relating to financial professionals or a complainant's personal financial matters will be handled by the OIEA. It may counsel the complainant of possible remedies and may, in appropriate circumstances approach the brokerage firms, advisers or other financial professionals concerned. Any complaints implicating violation of securities laws will be referred to the Division of Enforcement. Confidential investigation would be carried out if necessary and enforcement actions taken. The OIEA does not have the power to make any awards or any official capacity to resolve disputes. It is meant to provide advisory services only. The SEC does not mete out penalties. Those are the responsibilities of the administrative judges.

Things to consider

7.30 In Hong Kong, protection of consumers' rights is done through prudential supervision and conduct regulation by the respective regulatory bodies. The regulations governing the conduct of the markets are made on the basis of what constitutes good practice. Under the current system, redress is sought through civil proceedings in courts. By legislating consumers' rights and providing statutory remedies as in the US, unfair practices in the markets may be deterred. However, in seeking redress, the usual avenue of litigation is time-consuming and costly. There is no specific provision in the Securities and Futures Bill setting out the SFC's obligations on consumer protection. To make Hong Kong's securities and futures markets competitive and to uphold the principle of fair trading, consideration should be made to conducting a comprehensive review on the subject with a view to formulating an overall policy on the protection of customer's rights.

7.31 The financial system in Hong Kong is different from those in the UK and the US; the redress system should therefore be congruent with the circumstances in Hong Kong rather than a copy of the systems from other jurisdictions. The particular difficulty in Hong Kong lies in the collation of the views of consumers. That is because consumers are not a homogeneous group and there is no strong consumer association in Hong Kong representing a sufficiently broad cross-section of consumers. We are therefore particularly impressed by the work of the Consumer Panel and the Practitioner Panel of the FSA in the UK. The two Panels, though working independently, have maintained some form of informal link with each other. The two Panels appear to have worked harmoniously together, with each putting forward its own representation from its own angle, but fully aware of the concerns of the other. The FSA has been able to make the two Panels working as partners rather than opponents although they represent different interests. One interesting thing we observe is that the two Panels are involved in the appointment of the key positions of the FSA. This arrangement enhances the accountability of the key staff to the achievement of the FSA's objectives.

7.32 It is pre-mature to suggest if a neutral body similar to the single ombudsman system in the UK is needed in Hong Kong. The free service of the

FOS may appear very attractive to consumers. However, the problem of preventing the making of unsubstantiated complaints remains unresolved. The possible abuse of a free ombudsman service needs serious consideration as the funding of which might cut into the competitiveness of Hong Kong as an international financial centre.

7.33 It is obvious that the US does not have an ombudsman system similar to the UK regime for consumer protection, nor any formalized pre-consultation machinery like the Consumer Panel of the FSA. Nevertheless, proposals on new rules are widely published for public consultation. We notice that services similar to the OIEA are already provided by our SFC. However, protection of customers' rights is a pre-requisite in ensuring confidence in the industries and therefore deserves special attention. In the absence of an overall policy on consumer protection, the principles enunciated in the relevant Articles of ECHR are of high referential value. To maintain Hong Kong as an international financial centre, it is not only the hardware of infrastructure that needs to be comparable to leading markets, but also the software of the spirit of the rule of law and the respect for human rights.

Part III: General observations and conclusions

This part describes the delegation's other observations, in particular those related to the policy-making process, mode of public consultation, the industry's concern for the community and the development of human resources for the financial services industry. We also summarize the findings from this visit and the areas which the Financial Affairs Panel or other committees of the Council may wish to pursue in future.

Chapter 8 Other observations

8.1 The delegation finds the visit to the UK and the US very timely. Hong Kong is in the middle of a major revamping in its financial infrastructure. Since 1998, some 70 legislative proposals, including 17 bills and 52 pieces of subsidiary legislation related to Hong Kong's financial system and regulatory framework have passed through the Legislative Council. Some of these legislative changes, such as the structural reform of exchanges and clearing houses, strengthening of the regulation of securities margin financing and short-selling, criminalizing the provision of false information, etc., were introduced to address some of the major misgivings in the operation of the financial services industry. Today, the Legislative Council is scrutinizing a legislative proposal which aims to set up a new regulatory regime for the securities and futures market. Our visit to the UK and the US has provided us an opportunity to pause and think where all these legislative changes are going to take us to.

8.2 The financial services industry, including insurance and related business services, has since mid 1990s accounted for over 20% of the Gross Domestic Product of Hong Kong. Hong Kong, in face of the keen competition from its neighbouring regions, relies heavily on its financial services industry to steer the growth of its economy. To maintain its leading position as an international financial centre, Hong Kong needs to be alert to the changes in the world markets, including the emergence of new business trends and changes in market behaviours, and provide a level playing field for all market participants with sufficient protection for investors.

8.3 In view of the importance of our financial services industry, there is every reason for us to ensure that we have a financial system which would continue to serve Hong Kong well. Therefore, in studying the financial systems in Hong Kong, the UK and the US, we are conscious of the difference in the constitutional structures and historical backgrounds which shapes the development of these financial markets. What serve the UK and the US well may not be entirely applicable in the Hong Kong setting. Nevertheless, there are a few observations we consider particularly enlightening and of special value in spite of the difference of their political and constitutional structure.

Need for a strategic direction for development

8.4 During our visit, we had the opportunity to meet different people from different spectrums of the financial hierarchy – from the government, the legislature, the regulators, traders, major market players to consumer representatives. We observe that despite their different roles and interests, they share the same objectives and same understanding of the general direction of development in their systems. With this common understanding of the long-term goal, it has made compromises and cooperation much easier. For example, in the UK, it has taken two years for the FSM Bill to pass through the two Houses, and more than one year for the FSA to pave the way for the FSM Act to come into effect. The Government is aware of the need to have the full commitment of the different trades in the financial services industry to the new regulatory structure and has therefore provided ample time for public discussion and for the assessment of risks in implementing the new structure. Much of the discussion on the Bill was focused on the regulatory objectives of the FSA, and on the basis of which the FSA would make its rules for the authorized persons. The extensive discussions on the objectives to be included in the Bill helped bring out the concerns of different parties and facilitated the achievement of common understanding despite their different interests. The four regulatory objectives, namely market confidence, public awareness, the protection of consumers and the reduction of financial crime, now embodied in the FSM Act have become the basis of the direction to be pursued by the entire industry.

8.5 In Hong Kong, regulatory objectives are for the first time included in the Securities and Futures Bill. Whilst it is definitely one step forward, questions remain in how far the objectives would fully be implemented by the Bill and in what manner would these objectives also apply to other sectors, e.g. banking, insurance, of the financial services industry. There is no overall picture of whether this will eventually be the way forward for the entire industry, and without this overall picture, it is difficult to ensure that the development of individual sectors is moving in a direction of common interest to the industry.

8.6 We consider that there is a general lack of discussion in the community, especially among the trades and institutions concerned, about the strategic direction which Hong Kong should take to maintain or elevate its status in the international financial arena. Since the attack on Hong Kong dollar in 1997 and the Asian financial turmoil that followed, the general public and the financial services sector have been receptive to proposals from the Government to restore confidence in the Hong Kong currency and the stock markets. There is however little discussion on what direction Hong Kong should take in building its financial infrastructure. Without a shared understanding of the strategic direction, it is not easy for different trades, different regulators and different policy bureaux to work in concerted efforts for the long-term development of the Hong Kong financial markets. There would even be inconsistencies in the standard of regulation for different trades, lack of long-term plans to cope with global changes and mismatch of human resources for the sustainable growth of the financial services industry.

Transparency of the decision-making process

8.7 Notwithstanding the different regulatory structures and different modes of market operation in the UK and the US, one thing which is common to both jurisdictions is the emphasis they place in consulting the public and the parties concerned before deciding on the way forward or making changes to the current system, no matter how small the changes may appear to be. The consultation process is often done in an open and systematic manner so that views from all parties can be documented and considered before a decision is made. We mentioned in Chapters 5 and 7 that the FSA has the statutory duty to consult practitioners and consumers and to consider their representations. Where it disagrees with the views made in such representations, the FSA also has the duty to give its reasons in writing. The formalization of the consultation process has made it possible for all supporting or opposing views to be brought to open discussion. This has effectively drawn public attention to the implications of the subject matter during the formative stage of the proposal.

8.8 We notice in the US, some agencies, instead of just publishing a paper for consultation, have provided information in different forms for consumption by people from all walks of life. To facilitate a meaningful exchange of views,

the parameters that may have a bearing on the subject are also set out for public reference.

8.9 Quoting deposit insurance as an example, the US has operated its deposit insurance scheme for 67 years. The Federal Deposit Insurance Corporation (FDIC) is at present conducting a major review to reconsider the policy objectives of the scheme and to address the flaws in the current system. The FDIC has provided hyper-link on its homepage to the homepage of the Working Group on Deposit Insurance of the Financial Stability Forum[1], of which the US is a member. The Working Group was established in April 2000 to develop guidance on deposit insurance. Such guidance aims at identifying the issues associated with deposit insurance, the options available to policymakers to self-assess and to address those issues, and the trade-offs involved in choosing particular approaches. It has identified 16 guidance topics and issued 12 discussion papers on those topics. These discussion papers help economies in assessing their own situation when deciding whether to establish or modify a deposit insurance system. In other words, instead of just trying to convince the public the merits of its proposal, the agency has provided as much information as possible to the public on the subject so that the exchange of views can be analytical, thorough and comprehensive.

8.10 A meaningful consultation exercise is one way to enhance the transparency of the decision-making process. In both the UK and the US, policy-makers are aware of the importance of arousing public discussion on a new policy or a scheme before deciding on it. The general public, or even those who are in the trades, may not have any knowledge of the implications involved. It is therefore the responsibility of the government to assist the general public to understand not only the merits of the proposal but its implications and the extent of the commitments required of all parties concerned, in a language that they would understand. It is only through open and thorough discussion that uncertainty could be reduced and resistance due to lack of understanding minimized.

[1] The Financial Stability Forum was convened in April 1999 to promote international financial stability through information exchange and international co-operation in financial supervision and surveillance. It established the Working Group on Deposit Insurance in April 2000 to develop guidance on deposit insurance.

8.11 We observe that our government has also placed much emphasis on public consultation in recent years. We believe that the more a proposal is debated by the community, the more information the Government would be able to ascertain for deciding its way forward. Extensive and meaningful public discussion at an early stage of the formulation of a policy is the root to greater understanding of the subject matter and support by the community.

Concern for the community

Public education

8.12 All jurisdictions including Hong Kong are aware of the importance of public education so that individuals will know how they may benefit from any new policy or legislation or its impact on them. We notice the efforts made by some agencies or regulators in helping the public understand their rights and obligations in a totally customer-oriented manner. Complex subjects are explained by way of situation illustrations to help even an ordinary citizen understand what he/she would face or can pursue in his/her daily life. Even for matters involving complicated procedures, such as application for a license, the explanatory notes are written in an easy-to-read fashion, so that anyone would be able to know the procedural steps involved without having to rely on professional advice. Public education has become an essential part of the job of the government and the regulators. The challenge to them now is how public education can be done in the most inexpensive yet effective manner.

Proactive approach to cater for social needs

8.13 We have had the opportunities of meeting trade associations and major market players in this visit. We notice that some of the trade associations do place their concern for the community as an objective for their work. For example, in the UK, upon the outbreak of the Foot-and-Mouth disease, the British Bankers' Association requested its members to proactively look into the special needs of those of their customers who were affected by the spread of the disease and offer special terms to help them tide over their financial hardships.

8.14 In the US, we note the decision of the New York Board of Trade to maintain the manual and electronic systems on the grounds that "changing the system to an entirely electronic one will put a lot of people out of job". The operating of the two systems in parallel is obviously more expensive especially when the Board has to continue to inject money into the electronic system to make its market competitive. Yet, with the interest of the workforce in mind, the Board has decided to keep the old system running.

8.15 Another example is the American Stock Exchange which gives special attention to companies with small and medium capital. One of their objectives is to help these companies grow. A dedicated team is deployed to teach these individual companies how to develop their business.

Long-term planning for the human resources required

8.16 Our visit ended at a luncheon seminar with some 20 Hong Kong students studying finance and other related subjects in three major universities in New York. The meeting was organized in response to the request from the students who approached the Legislative Council Secretariat. The Hong Kong Economic & Trade Office of New York kindly offered to organize a luncheon seminar for the delegation.

8.17 We have found this meeting a most worthwhile opportunity to understand the worries and aspirations of this younger generation of Hong Kong who are being trained in a field which will face severe manpower shortage in a few years' time. We observe a general concern among these undergraduates that they would not be able to find jobs in Hong Kong that offer comparable remuneration and development opportunities as those offered in the US. It is apparent that these young people have a strong desire to return to Hong Kong for work, but having been in the US for some time, they are faced with a lot of uncertainties and some of them expressed their views as follows:

(a) They have lost their link with the job market in Hong Kong and therefore have little knowledge about the job opportunities available in Hong Kong;

(b) They are not very familiar with the market operation in Hong Kong and are afraid that they could not be immediately functional, which they believe to be a prerequisite for working in Hong Kong;

(c) Unlike major market players in New York which conduct rounds of career seminars for final year students in universities, firms in Hong Kong do not provide such orientation to undergraduates overseas, making it difficult for these students to have knowledge of the opportunities available in Hong Kong except from hearsay or through personal connections;

(d) Financial companies in the US provide continuing education for their staff, hence allowing individuals to further equip themselves and keep up with new market practice, but such development opportunities are not common in Hong Kong;

(e) They are under the impression that the remuneration package offered by financial companies in Hong Kong is only half of that offered in major financial centres in the US; and

(f) They do not feel that they are needed in Hong Kong as the Government has already decided on the importation of talents from the Mainland.

8.18 We consider it a great pity to have given insufficient attention to the needs of Hong Kong's young people studying overseas. While the Advisory Committee on Human Resource Development in the Financial Services Sector is reviewing the manpower shortfall in the industry, there is no mention in its First Report about the prospect of bringing Hong Kong students educated overseas back to serve our needs. We believe that a lot of these students, with their families still based in Hong Kong, intend to return to Hong Kong for work. There is however no avenue for these students to have access to information about the opportunities available to them. We are grateful to the Director, HKETO, New York, who after listening to the students, undertook to consider

maintaining a link with these students and explore the feasibility of setting up a dedicated homepage for these students. We believe this part of the work goes beyond the normal duties of the HKETO, but this is something we must pursue if we are to adopt a more dynamic approach in developing the human resources we need for our financial services industry. We are advised that the manpower required in the financial services sector is expected to rise from 176 500 in 1999 to 219 300 by 2005 with an accumulative shortfall of 16 800 at professional and managerial level in 2005. We therefore urge that more proactive actions should be undertaken through coordinated efforts among the Policy Bureaux concerned to facilitate Hong Kong students educated overseas with the requisite knowledge and skills to return to Hong Kong.

Services to committees of the Legislature

8.19 In this visit, we had the opportunity of meeting with the Members, clerks and advisers of the committees responsible for financial affairs in both Houses of the UK Parliament and in the US Congress. We are particularly impressed by the high-level specialist support provided to these committees for the examination of policies and legislative proposals. For example, a number of specialist advisers were enlisted to provide support to the Joint Committee on Financial Services and Markets. They are academics with expert knowledge in financial services and they provided advice to the Joint Committee on different aspects of the Draft Bill.

8.20 The committees in our Council are also supported by highly professional clerks and legal advisers. It is however not common for us to enlist the help of experts for assisting the work of our committees. We consider that a review of current working mechanism of our committees, in particular Bills Committees, as well as the professional support to be provided to these committees, should be conducted.

Chapter 9 Conclusions and recommendations

9.1 In this Report, we have provided a detailed account of the financial systems in the UK and the US as well as our observations of the experiences of these two countries in addressing the developments which have threatened the leading position of their financial markets. With globalization, convergence of businesses, and new products coming onto the markets, every financial market is facing the same challenges and has to devise its own strategies to meet new market demands and at the same time provide legal certainty to the development of a robust market.

9.2 The delegation has set off on a mission to find out how the world's two most leading financial centres have coped with these challenges, maintained market confidence and enhanced the competitiveness of their markets. In making our observations, we are mindful of the need to attach importance to the different characteristics of these economies from those of Hong Kong – including the political and constitutional setting, market size, historical development of the financial services industry, degree of consumer awareness, etc. The purpose of this Report is therefore no more than providing some reference points for the Bills Committee for its scrutiny of the two Bills, as well as setting out a number of significant issues which the Financial Affairs Panel may wish to pursue in future.

9.3 We consider that we have fully accomplished our mission and we have brought home not just useful information about the financial systems of the two countries, friendship from the parties we met during the visit, but also some insight into how policy-making is done in these economies through public participation and involvement. We have summarized in Part II of this Report our observations on matters which are of relevance to our examination of the Securities and Futures Bill and the Banking (Amendment) Bill 2000. We are aware that the UK or the US system cannot be directly transplanted into our system as our circumstances are different. Nevertheless, the process they took and the extent of efforts made to analyse their needs and assess their risks so as to find the best possible solutions to address their problems do shed light on how these two countries are able to maintain their leading position.

9.4 To facilitate follow-up actions by the Bills Committee and the Panel, we summarize here-below our main observations from this visit and our recommendations:

General direction for development

(a) Without a shared understanding of the strategic direction, it would not be easy for different trades, different regulators and different policy bureaux to work in concerted efforts for the long-term development of the financial markets. There should be more discussions in the community, especially within the financial circle, on the strategic direction which Hong Kong should take in order to maintain its premier status as an international financial centre.

(b) Consideration should be given to the establishment of comparable regulatory objectives for all other sectors in the financial industry, apart from the securities and futures sector. More discussion is required in respect of the implementation of the regulatory objectives by the legislation governing the various sectors, so as to avoid inconsistencies in the standard of regulation for different trades and the provision of safeguards to protect the rights of individual parties.

The regulatory principles

(c) With globalization and convergence of businesses in the financial market, it has become necessary for the government to provide a regulatory regime which will enable financial institutions, big and small, to remain competitive and have the maximum opportunity for growth and development.

(d) In the context of financial services, "regulation" refers to prudential supervision and conduct regulation. The requirements for prudential supervision and conduct regulation are different. The conduct regulator should be familiar with the conduct of the trade. In the UK, regulators are funded by levies

on the industry, while in the US, they are funded either by Congress appropriations or assessment charges or levies on the industry. Despite their different regulatory structures, both have adopted functional regulation. There appears a need for Hong Kong to examine in the long run whether functional regulation is a more preferred option in the regulation of the financial industry in order to provide room for development and maintain a level playing field.

Consumer protection

(e) The success of the financial industry relies heavily on the extent of public confidence in the financial markets. Protection of consumers is one of the prerequisites in building up confidence in the markets and fostering the continued growth of the industry. Consideration should be given to arouse public discussion on how far the public could be made aware of their rights and obligations, and on a more uniform consumer protection mechanism to enhance consumer protection.

Decision-making process

(f) There should be genuine and comprehensive consultation with trades and the public before deciding any changes to the current infrastructure or rules which may have impact on the trades and the general public. In view of the large number of small and medium capital institutions involved in the financial market in Hong Kong, consultation should be carried out in a manner which is easily understood by the general public. Where feasible, consultation should be done in an open and organized manner.

(g) To enhance the transparency of the decision-making process of public policies, the parameters which may have a bearing on the subject matter should be provided to facilitate more comprehensive consultation and public discussion. The government has the responsibility to assist the general public to

understand not only the merits of the proposal but its implications and the extent of commitments required of the parties concerned.

Concern for the community

(h) The industry should be encouraged to have regard to the interest of the community and consider adopting more proactive approach to help their customers especially at uncertain and difficult times.

Human resources development

(i) With an anticipated shortfall of 16 800 practitioners at professional and managerial level in Hong Kong's financial services industry in 2005, every effort should be made to attract those with financial background and knowledge of Hong Kong to join the industry. There should be a link with the Hong Kong students studying overseas to enable them to keep abreast of the developments in Hong Kong and provide an avenue for them to understand Hong Kong's job market. There should be more coordinated efforts among Policy Bureaux to facilitate those students educated overseas with the required training and skills to return to Hong Kong.

9.5 Finally, we wish to highlight that we have found fact-finding visits of this nature extremely useful to committees of the Council. It is the first time that a Bills Committee has taken part in an overseas duty visit and we have found it very worthwhile. It fully illustrates the need for more in-depth study of the subject matters of legislative proposals and relevant government policies. We hope that a review could take place in the near future on how far the effectiveness of committees can be enhanced through more in-depth study of this nature and the strengthening of the professional and specialist support to the committees in particular on more technical and important subjects.

Chapter 10 Acknowledgements

10.1 The delegation wishes to thank the organizations which have kindly assisted the delegation in lining up the programmes and helping with the logistic arrangements during the visit. They include the Foreign and Commonwealth Office of the UK, the British Consulate General (Hong Kong), the United States Department of State, the American Consulate General (Hong Kong), the Economic and Trade Offices of the Hong Kong Government in London, Washington DC and New York.

10.2 The delegation would also like to thank all persons and organizations listed in Appendix III of this Report for the time they have taken to brief the delegation on their work objectives, details of operations in individual institutions, and the legislative framework of the UK and the US financial systems.

10.3 The delegation is grateful to the staff of the Legislative Council Secretariat for their assistance in the visit. They include staff members from the Council Business Division 1 and the Legal Service Division who accompanied Members during the visit and provided support in compiling this Report, and those from the Research and Library Services Division who provided the pre-visit background research for the delegation.

Appendix I

Overseas Duty Visit on Financial Services

Delegation of LegCo Panel on Financial Affairs and Bills Committee on Securities & Futures Bill and Banking (Amendment) Bill 2000 (4 - 13 April 2001)

Membership list

Legislative Council Members

Hon Ambrose LAU Hon-chuen, JP (Delegation leader)	*(Chairman of Panel on Financial Affairs & members of Bills Committee)*
Hon SIN Chung-kai (Deputy leader)	*(Chairman of Bills Committee on Securities and Futures Bill and Banking (Amendment) Bill 2000 & member of FA Panel)*
Hon Henry WU King-cheong, BBS	*(Deputy Chairman of FA Panel & member of Bills Committee)*
Hon Margaret NG	*(Deputy Chairman of Bills Committee)*
* Hon James TO Kun-sun	*(Member of FA Panel & Bills Committee)*

Staff members of the Secretariat

Ms Pauline NG Man-wah, Assistant Secretary General

Ms Connie SZETO Siu-wa, Senior Assistant Secretary

Mr KAU Kin-wah, Assistant Legal Adviser

* Mr TO joined the delegation on 6 April 2001 on a self-paying basis.

Appendix II

Overseas Duty Visit on Financial Services
(from 4 to 13 April 2001)

Programme

(A) London

Date	Time	Details
5.4.01 (Thur)	9:30 am - 10:15 am	- Briefing by HM Treasury on the Financial Services and Markets Act & banking services reform
	10:30 am - 11:15 am	- Meeting with Howard Flight MP, Opposition Spokesman on Treasury, Joint-Chairman of the HK Committee of the All Party China Parliamentary Group
	11:45 am - 12:10 pm	- Visit to Hong Kong Economic Trade Office (HKETO), London
	12:30 pm - 2:00 pm	- Lunch with financial services associations and trade advisers, hosted by HKETO, London
	2:15 pm - 3:00 pm	- Meeting with Members of Select Committee on Treasury
	3:15 pm - 4:15 pm	- Meeting with the Chairman of the Joint Committee on Financial Services and Markets
	4:45 pm - 5:45 pm	- Meeting with the Bank of England
	6:30 pm - 8:30 pm	- Dinner hosted by HKETO, London in honour of the Financial Affairs and Environmental Affairs Panels

Date	Time	Details
6.4.01 (Fri)	9:00 am - 10:00 am	- Meeting with the Financial Ombudsman Service
	10:30 am - 11:30 am	- Visit to the London Stock Exchange
	12:30 pm - 2:15 pm	- Lunch hosted by the Foreign and Commonwealth Office - Working lunch with the Specialist Adviser of the Joint Committee on Financial Services and Markets and Clerks of the House of Commons
	3:00 pm - 5:00 pm	Meeting with the Financial Services Authority

(**B) Washington DC**

Date	**Time**	**Details**
8.4.01 (Sun)	6:00 pm	- Dinner hosted by Commissioner, Economic and Trade, USA
9.4.01 (Mon)	9:00 am	- Opening programme meeting at the State Department
	10:30 am	- Meeting with Ambassador Darryl Johnson, Deputy Assistant Secretary, Bureau of East Asian and Pacific Affairs
	12:00 noon	- Lunch with market players/trade associations hosted by HKETO, Washington
	2:15 pm	- Meeting with the Office of Thrift Supervision
	4:30 pm	- Meeting with the Senate Banking Committee
10.4.01 (Tue)	9:00 am	- Meeting with the Federal Deposit Insurance Corporation
	11:00 am	- Meeting with Ambassador Alan Larson, Undersecretary for Economic and Business Affairs
	2:00 pm	- Meeting with the Securities and Exchanges Commission
	3:30 pm	- Meeting with the Commodity Futures Trading Commission

(C) New York

Date	Time	Details
11.4.01 (Wed)	10:00 am - 11:45 am	- Meeting with the Nasdaq International
	12:45 pm	- Lunch meeting hosted by Securities Industry Association
	2:30 pm - 4:00 pm	- Meeting with the New York Stock Exchange
	5:30 pm - 7:30 pm	- Reception for market players/trade associations
12.4.01 (Thur)	8:00 am - 9:30 am	- Breakfast meeting with Hong Kong Association in New York (hosted by the Association)
	9:45 am - 11:45 am	- Meeting with the American Stock Exchange
	1:00 pm	- Meeting with the New York Board of Trade
	3:00 pm	- Meeting with the National Securities Clearing Corporation
13.4.01 (Fri)	9:00 am - 10:00 am	- Meeting with the Federal Reserve Bank of New York
	12:00 noon	- Luncheon seminar with Hong Kong students studying in New York, hosted by HKETO, New York

Appendix III

Overseas Duty Visit on Financial Services

List of organizations visited and parties met

Thursday, 5 April 2001

HM Treasury

Mr Richard Bent, Head, Financial Services Regulation Team
Mr Robin Fellgett, Director, Financial Regulation Industry Directorate

House of Commons

Mr Howard Flight MP, Opposition Spokesman on Treasury, Joint-Chairman of the HK Committee of the All Party China Parliamentary Group
Mr Michael Fallon MP, Member of Select Committee on Treasury
Mr Nigel Beard MP, Member of Select Committee on Treasury
Lord Burns, Chairman, Joint Committee on Financial Services and Markets
Dr Eilis Ferran, Specialist Adviser of the Joint Committee on Financial Services and Markets
Ms Jane Fox, Committee Assistant

Bank of England

Mr Mervyn King, Deputy Governor
Mr P M W Tucker, Deputy Director, Financial Stability

Luncheon and dinner hosted by Hong Kong Economic and Trade Office, London

Ms Lise Bertelsen, Deputy Director Operations, China-Britain Business Council
Mr A J Clarke, Head of Asia Pacific Dept, Confederation of British Industry
Mr Hugh Davies, Executive Director, Prudential Assurance Company
Ms Patricia Duncan, Head of Public Affairs, Futures and Options Association
Mr David Matcham, Director of Operations, International Underwriting Association
Mr Ken Robbie, Head of Section, China Hong Kong Department, Foreign & Commonwealth Office
Mrs Sally Scutt, Deputy Director-General, British Bankers' Association
Sir Peter Wakfield, Chairman, Asia House
Mr Edward Whitley, Chief Executive (designate), International Financial Services, London

Mr Alan Murray, Director, Asia Pacific, Trade Partners UK
Mr Owen Chi, Director Europe, Hong Kong Trade Development Council
Mr Dirk Hazell, Chief Executive, Environmental Services Association
Mr Barry Dennis, Deputy Chief Executive, Environmental Services Association

Friday, 6 April 2001

Financial Ombudsman Service

Ms Iris Baker, Public Relations Manager
Mr David Thomson, Principal Ombudsman, Banking and Loans Division

London Stock Exchange

Ms Jane Zhu, Head of Asia Pacific
Mr Alan Wilson, Head of Training & External Affairs

Luncheon hosted by Foreign and Commonwealth Office

Mr Andrew Seaton, Head of China Hong Kong Department, Foreign and Commonwealth Office
Mr Hugh Davies, Executive Director, Prudential Assurance Company
Mr John Cooke, Head of International Relations, Association of British Insurers
Mr Yi Meng, J P Morgan
Mr Michael D Pentecost, Head of Asia Pacific Division, ECGD

Luncheon meeting with staff of the Houses of Parliament

Dr Eilis Ferran, Specialist Adviser to the Joint Committee on Financial Services and Markets
Ms Jacqy Sharpe, Principal Clerk, Select Committees, House of Commons
Mr Simon Patrick, Clerk, Treasury Committee, House of Commons
Mr Andrew Makower, Clerk, Joint Committee on Financial Services and Markets

Financial Services Authority

Sir Howard Davies, Chairman
Mr Colin Brown, Chair, Financial Services Consumer Panel
Mr David Challen, Chair, Financial Services Practitioner Forum
Mr Andrew Whittaker, General Counsel to the Board
Mr David Fisher, Head of Consumer Panel Secretariat
Ms Lieselotte Burdorf-Cook, International Relations

Monday, 9 April 2001

United States Department of State

Ambassador Darryl Johnson, Deputy Assistant Secretary, Bureau of East Asian and Pacific Affairs
Mr Robert Goldberg, Deputy Director for Economic Affairs, Office of Chinese & Mongolian Affairs
Ms Deborah Underhill, Chief, Voluntary Visitors Division
Ms Rhonda Martin, Program Officer, Voluntary Visitors Division
Mr Adam King, Program Associate, Voluntary Visitors Division
Ms Pat Kowall, Program Officer, Meridian International Center
Ms Maria Ellis, Program Associate, Meridian International Center
Mr Alan Ponikvar, Escort Officer
Mr James Bodnar, Escort Officer

United States Department of the Treasury

Mr Richard I Lung, International Economist

Senate Committee on Banking, Housing & Urban Affairs

Mr Thomas Loo, Senior Economist
Mr Steven Harris, Democratic Staff Director and Chief Counsel

Office of Thrift Supervision of the Treasury Department

Ms Ellen Seidman, Director
Mr Scott Albinson, Managing Director, Supervision
Ms Carolyn Buck, Chief Counsel

Tuesday, 10 April 2001

Federal Deposit Insurance Corporation

Mr Claude Rolin, Senior Counsel
Ms Rose Kurshmeider, Financial Economist
Mr Michael Krimminger, Senior Policy Analyst, Resolutions and Receiverships

United States Department of State

Ambassador Alan Larson, Undersecretary for Economics and Business Affairs
Bureau for Economic and Business Affairs
Mr Thomas J White, Special Negotiator/Director, Office of Aviation Negotiations

Securities & Exchange Commission

Mr Robert Strahota, Assistant Director, Office of International Affairs
Mr Scott Birdwell, Senior Counsel, Office of International Affairs

Commodity Futures Trading Commission

Ms Myra Silverstein, Attorney, International Division
Mr Paul M Architzel, Chief Counsel, Division of Economic Analysis

Luncheon hosted by Miss Jacqueline Willis, Commissioner to USA, Hong Kong Economic and Trade Office

Mr Gary Goldsholle, Associate General Counsel,
National Association of Securities
Mr Kevin MacMillan, Counsel, House Committee on Financial Services
Mr Ben Brown, FDIC Fellow, House Committee on Financial Services
Mr Richard Lung, International Economist, US Department of the Treasury
Mr Sheldon L Ray, Jr., Associate Vice President - Investments,
Prudential Securities Incorporated
Mr Kevin Mulvey, Director, International Government Affairs,
American International Group, Inc
Mr John Fei, Program Manager for China Trade, Coalition of Service Industries
Mr Eric Bjornlund, Fellow, Woodrow Wilson Center

Wednesday, 11 April 2001

NASDAQ International

Ms Wyanie Bright, Director

Luncheon hosted by Securities Industry Association

Mr David Strongin, Vice President & Director, International Finance, Securities Industry Association
Mr Gerald Quinn, Vice President & Associate General Counsel, Securities Industry Association
Mr Geogia Bullitt, Principal, Morgan Stanley Dean Witter
Mr David Youtz, Vice President and Head of Asia Desk, Morgan Stanley Dean Witter
Ms Emily Altman, Managing Director, Head of International Relations, Morgan Stanley Dean Witter
Mr Peter Russell, Senior Vice President, Government Affairs, J P Morgan Chase & Co
Mr Anil Bhalla, Managing Director, Asia-Capital Markets & Corporate Finance, J P Morgan Chase & Co
Mr Carlos M Morales, Senior Vice President and General Counsel, Corporate & Institutional Client Group, Merrill Lynch & Co Inc
Mr Marlene Nicholson, Director, Government Relations, Barclays Capital
Mr Carl Landauer, Vice President and Associate General Counsel, Charles Schwab & Co Inc
Mr Michael Crowl, Managing Director, Associate General Counsel, Goldman, Sachs & Co
Mr Norman Feit, Managing Director, Director of Litigation & Regulatory Proceedings, Goldman, Sachs & Co
Mr Hans-Linhard Reich, Vice President, Director of Compliance, Goldman, Sachs & Co

New York Stock Exchange, Inc

Mr Georges Ugeux, Group Executive Vice President, International & Research
Mr Alain Y Morvan, Senior Vice President, International Relations
Mr Glenn Tyranski, Vice President, Financial Compliance
Ms Marian Herbert, Manager, International Relations
Ms Caroline Yap, Managing Director, International Client Service
Mr Joseph R Lomnicky, Managing Director, International Listings
Mr Leslie E Tepper, Manager, International & Structural Products, Financial Compliance
Ms Michele Van, International Relations

Reception hosted by the delegation

Ms Therese Feng, Associate Director Sovereign, Fitch IBCA, Duff & Phelps
Mr Joseph Gallino, Chief Compliance Officer, HSBC Brokerage
Ms Rory Hayden, Head, External Affairs, Standard Chartered Bank
Mr Frederic Lau, Chief Representative, Hong Kong Monetary Authority, New York
Mr Kent Chen, Deputy Chief Representative, Hong Kong Monetary Authority, New York
Mr Henry Wan, President, Wan Development Corporation
Mr Lewis Lowenfels, Partner, Tolins & Lowenfels
Mr Charles Geisst, Professor of Economics, Manhattan College
Mr Carlos M Morales, Senior Vice President & General Counsel, CICG, Merrill Lynch & Co Inc.
Mr Jerome Cohen, Paul, Weiss, Rifkind, Wharton & Garrison
Mr David Youtz, Vice President/Asia Desk, Morgan Stanley Dean Witter
Mr William J Williams, Jr, Partner, Sullivan & Cromwell
Mr Bill Whelan, Program Officer/East Asia, US State Department
Mr Heejin Kim, Intern (East Asia), International Visitors' Program, US State Department

Thursday, 12 April 2001

Breakfast meeting hosted by
The Hong Kong Association of New York, Inc.

Mr Les Greenwald, Executive Director, The Hong Kong Association of New York, Inc.
Mr Marty Bloom, MBI Associates
Mr Philip Chan, Deloitte & Touche
Mr Bill Lazar, Deloitte & Touche
Mr Paul Pion, Deloitte & Touche
Mr Todd Wang, Deloitte & Touche
Ms Kelly Chow, Merrill Lynch & Co Inc
Mr Frank Desiderio, Counselor at Law, Customs & International Trade, Grunfeld, Desiderio, Lebowitz, Silverman & Klestadt LLP
Mr Norb Garrett, Kroll Associates
Ms Pat Wood, Kroll Associates
Mr Kay Ikawa, Managing Director, Continental Airlines
Mr Ulrich Kahlow, Dresdner Kleinwort Wasserstein
Mr Patrick Kidd, Regent Hotels
Ms Judi Kilachand, Asia Society
Mr Mike Kulma, Asia Society
Mr Stanley Kung, Bank of East Asia
Mr Frederic Lau, Hong Kong Monetary Authority
Mr Yuan Lee, Morgan Stanley
Mr Howard Li, Chairman & CEO, Waitex International
Ms Peggie Liu, Hong Kong Trade Development Council
Mr John McLean, Principal, Hong Kong Consultants Co
Mr Michael O'Rourke, Rode & Qualey
Ms Melinda Parsons, Soho4 Associates
Ms Mary Agnes Pan, HSBC Bank
Mr Fred Ruggiero, Cathay Pacific Airways
Mr Edward S Seeley Jr., Consulting Economist (Transportation & Finance)
Mr Barry Spaulding, Global Strategies
Ms Betty B Wu, Bloomberg LP
Mr Charles P Wang, Director, Child Care Center Development Fund

The American Stock Exchange

Mr Salvatore F Sodano, Chairman & Chief Executive Officer
Mr Richard Chase, Executive Vice President for Member Firm Regulation
Mr James M McNeil, Chief Examiner, Financial Regulatory Services

New York Board of Trade

Mr Patrick L Gambaro, Executive Vice President, Floor Operations & Systems
Mr Matt M Gordon, Senior Vice President, Market Development
Mr James E Goodwin, Senior Vice President, Market Regulation

The Depository Trust & Clearing Corporation

Mr Dennis Dirks, Chief Operating Officer
Mr Jack R Wiener, Vice President & Senior Counsel
Mr Jeffrey T Waddle, Vice President & Senior Legal Counsel
Mr Jeffrey H Smith, Managing Director, International Services Division
Ms Cecilia Humphrey, Director, International Division
Ms Martha I Fernandez, Relationship Manager, International Services Division

Friday, 13 April 2001

Federal Reserve Bank of New York

Mr William J McDonough, President & CEO
Mr Terrence Checki, Executive Vice President
Mr Christopher J McCurdy, Senior Vice President
Ms Michele S Godfrey, Senior Vice President
Mr Peter Bakstansky, Senior Vice President

Hong Kong students studying finance in universities in New York met at the luncheon seminar conducted by Hong Kong Economic and Trade Office, New York

Mr Luke Chiu, Pace University
Ms Lavina Chan, Pace University
Mr Ning Zhuang, Pace University
Mr Szeman Li, Pace University
Ms Victoria Chow, Pace University
Ms Shery Fong, Pace University
Mr Steven Siow, New York University

Mr Albert Wei, New York University
Mr Tommy Yu, New York University
Ms Kathy Li, New York University
Mr Samuel Wu, New York University
Ms Elaine Lam, New York University
Ms Maggie Ching, New York University
Mr Hazel Chiu, Columbia University
Mr Leo Lau, Columbia University
Mr Jacky Leung, Columbia University
Mr Jerry Liu, Columbia University
Mr Dominic Fung, Columbia University
Mr Leo Chiu, Columbia University
Mr Samuel Wu, Columbia University

Appendix IV

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