Bills Committee on Clearing and Settlement Systems Bill

The Administration's Response to
LegCo Assistant Legal Adviser's Letter of 10 March 2004

Definition of "book-entry securities"

Is there any need to define "securities" referred to in the definition of "book-entry securities"? It is noted that "securities" is defined in the Securities and Futures Ordinance (Cap.571) ("SFO"). Should the same be done in this Bill?

The intention is to include all "securities" transferable by book-entry and settled through a clearing and settlement system. Since "securities" is a technical term of known meaning to those in the trade, a definition is considered not necessary. There was also no comment made by the industry in this regard in the earlier consultation.

The term "securities" has been defined in Schedule 1 of the SFO by specifying certain instruments and excluding other instruments in order to suit the particular regulatory functions of the Securities and Futures Commission under the SFO.

There are two potential disadvantages in attempting to define "securities". First, the Bill applies to "securities" cleared or settled by clearing and settlement systems operating outside Hong Kong; and any definition would have to be capable of encompassing "securities" as defined in the legislation of the relevant jurisdictions. Secondly, no definition will remain exhaustive for long, as new forms of securities may come into being at any time.

Clause 3

To avoid regulatory overlap with the Securities and Futures Commission ("SFC") under the SFO, it is proposed that the Monetary Authority ("MA")'s power to designate a clearing and settlement system under clause 3(1) will not apply to a clearing and settlement system that is, or is operated by, a company recognised as a clearing house under the SFO. Would the converse be the same, i.e. if the Monetary Authority has designated a clearing and settlement system under this Bill, the SFC would not give recognition to the same system for the purposes of section 37 of the SFO? If this is the case, is it necessary to amend the SFO to avoid the possible regulatory overlap?

We see no need to seek reciprocal treatment from the SFC. The Bill should not result in any regulatory overlap with the SFO. In case of doubt, the MA would consult the SFC before he designates the particular system. It is also relevant to note that our intention is that the designation of a designated system which subsequently becomes a "recognised clearing house" under SFO will be revoked under clause 4(1)(a). After the Bill is enacted, the Hong Kong Monetary Authority ("HKMA") will discuss further with the SFC with a view to articulating in some form the understanding on the co-ordination relating to overseeing clearing and settlement systems.

Part 3 – Finality of Transactions and Proceedings

(a) After the Monetary Authority has issued a certificate of finality in respect of a designated clearing and settlement system, will the Monetary Authority publish this fact in the Gazette or otherwise? Similarly, will the suspension or revocation of a certificate of finality be published? If not, how will other people know whether a certificate of finality has been issued, suspended or revoked? If it is considered necessary to publish the relevant facts, should provisions be made to cover this?

We will publish notice of the issuance, suspension and revocation of the certificate of finality in the Gazette for public information. Appropriate committee stage amendments ("CSAs") will be proposed.

(b) Will the suspension or revocation of a certificate of finality in respect of a designated system affect any transaction effected through the system prior to the suspension or revocation? Is it necessary to make provisions to cover this?

No. Such suspension or revocation will not affect the transactions effected prior to the same, and this has been reflected in clause 14(5) and (6). If an initiated transaction is not yet completed, it will not have the benefit of finality. As regards whether the transaction has been completed or not, this will be determined in accordance with the rules of the designated system (clause 17(1)).

(c) In clause 16(1), should the reference to "the general law of insolvency" be amended to read "the law of insolvency" to make the reference consistent with the reference used in clause 13?

Similar references to the two terms in one piece of legislation are found in the corresponding legislation of the United Kingdom and Singapore. Nevertheless, we will review the usage of "the general law of insolvency" versus "the law of insolvency".

(d) Clauses 18 to 20, as drafted, appear to favour heavily the interests of designated clearing and settlement systems as opposed to the interests of the stakeholders, if any, of the insolvent's estate. This appears to be inconsistent with the underlying intentions of the law of insolvency which has been designed to protect the interests of all parties involved in the event of insolvency. To strike a balance between the interests of designated systems and those of other stakeholders involved in transactions effected through the systems, should appropriate measures be put in place in the Bill to ensure that the interests of other stakeholders will not be unduly prejudiced as a result of the operation of these clauses?

The interests of the stakeholders are affected only to the extent considered strictly necessary for protecting the integrity of important clearing and settlement systems, by preventing the disruption that might be caused if transactions or dispositions were to be reversed within them. Clauses 18 to 20 apply only in respect of transfer orders and the immediate disposition of property pursuant to such transfer orders. The right to pursue redress regarding the underlying transactions is preserved by clauses 25, 26 and 27. There is no intention to prefer a creditor who happens to receive an asset through a designated system.

(e) In clause 18(1), apart from making reference to distribution of the assets of a person on bankruptcy or winding up, is it necessary to refer to distribution of the assets of a person on insolvency as well? As you are aware, a similar provision (i.e. section 45) of the SFO refers to "insolvency, bankruptcy or winding up". Moreover, the reference to bankruptcy alone may not cover voluntary arrangements under the Bankruptcy Ordinance (Cap. 6).

We are reviewing this point and will consider whether any amendment is required.

(f) Upon completion of any default proceedings, is the system operator or settlement institution of a designated system required to make a report on such proceedings? Under the SFO, a recognised clearing house is under a duty to make a report on completion of default proceedings. Should

similar provisions be provided in respect of designated systems under the Bill?

We agree with your suggestion to adopt a similar approach for the designated systems and will introduce appropriate CSAs to reflect this.

(g) It is noted that unlike section 51 of the SFO, the right to recover gain from transaction at undervalue between two participants under clause 26 of the bill is not exercisable in the event that a winding up statement in respect of the second participant is made by its directors pursuant to section 228A(1) of the Companies Ordinance (Cap. 32)? Is there any reason why different considerations should apply between participants of clearing houses under the SFO and participants of designated clearing and settlement systems under the Bill?

We agree that the same considerations should apply in the case of a company's voluntary winding-up as in the case of a winding-up by its creditors. Appropriate CSAs will be introduced to reflect this.

(h) In the light of (g) above, please also consider whether it is necessary to make the right to recover transfer between two participants giving unfair preference under clause 27 also exercisable in the event that a winding up statement is made in respect of the second participant by its directors pursuant to section 228A(1) of the Companies Ordinance.

See comments on (g) above.

(i) In clause 28, is it intended that the obligation to notify insolvency should also apply in the event that a participant intends to make a proposal relating to voluntary arrangements under the Bankruptcy Ordinance? Is so, should this scenario be included in clause 28(1)?

Yes. We will introduce appropriate CSAs to clause 28(1) to include this scenario.

(j) In clause 28(1)(e), please replace "statutory declaration" by "statement in the specified form" to reflect the amendment made to section 228A of the Companies Ordinance in the Companies (Amendment) Ordinance (28 of 2003).

We will revise it accordingly.

Requirement to give information (clauses 10, 51 and 52)

Can a system operator or settlement institution of a designated system refuse to provide information on the ground that it is privileged? If it is intended that privileged information need not be provided, should this be made clear in the Bill?

Clauses 10 and 51 empower the MA to request information to enable him to perform his functions thereunder, and the system operator or settlement institution of a designated system cannot refuse to provide information on the ground that it is privileged. Under clause 10, the information that can be requested from a system operator or settlement institution of a designated system is limited to information "relating to the system" that is required "for the better carrying out of his (the MA's) functions under this Ordinance". Under clause 51, the information that can be requested is limited to such information regarding the system as the MA considers may assist him in making a determination as to whether the system is eligible to be designated and, if so, whether the system is to be so designated.

The MA and any person appointed either under the Exchange Fund Ordinance or under the proposed legislation to assist him in carrying out his functions will be subject to a confidentiality obligation and the disclosure of any information received in the performance of any function under the proposed legislation is only allowed in the specific instances set out in clause 49(3) and (4).

Under clause 52, the MA is empowered to direct a system operator or settlement institution of a designated system to provide information to a specified nominated official as such official may request in relation to a defaulting participant in the system or to any matter connected with such default. It is noted that such information is to be provided to the nominated official direct.

Time when decisions of Monetary Authority take effect

If the Monetary Authority decides to revoke a designation under clause 4 or a certificate of finality under clause 15, when will such decision take effect? Since there may be some time gap between the making of the decision by the Monetary Authority and the receipt of the notice of decision by the relevant designated clearing and settlement system, please consider the need to provide expressly the time when the revocation will take effect.

A revocation of designation under clause 4 will take effect on the date of publication of the notice in the Gazette.

The suspension or revocation of a certificate of finality under clause 15 will take effect on the date and time specified in the notice given by the MA to the system operator and settlement institution. Such notice will be published in the Gazette for public information. The intention is that the MA will only specify a future date and time, to facilitate a smooth operation of the systems. There will not be retrospective revocation.

Review of decisions made by the Monetary Authority

To assist a person aggrieved by a decision of the Monetary Authority under clauses 3(1), 4(1), 14(1) or 15(1) to apply for a review of the decision by the Clearing and Settlement Systems Appeals Tribunal, should provisions be made in the Bill to require the Monetary Authority to give reasons for his decision, in particular, if he decides not to designate a clearing and settlement system or to revoke a designation.

As our regime will only designate those systems which are important to the monetary or financial stability of Hong Kong or to Hong Kong's functioning as an international financial centre and bring them under the oversight regime, it is the MA's discretion to decide whether a system should be designated or not. There should be no case for an appeal if the MA considers that a system is not important for the purpose of designation.

Part 4 – Appeals Tribunal

(a) Clause 33

(i) In clause 33(8), apart from delivering its determination made under clause 33(6), is the Appeals Tribunal required to deliver any cost order made under clause 34(1)(k)? If so, should this be stipulated in the relevant provision?

Under clause 34(1)(k), the Tribunal will have the power to order costs to be paid to any party to the review or any person who is required to attend before the Tribunal.

While the interests of justice require that the determination of a review be delivered "as soon as practicable after completing the review", the same considerations do not apply as regards orders for costs. There may be occasions when it is appropriate for an order for costs to be made either before or after the determination under the appeal. The present drafting gives that flexibility.

(ii) In the event that part of the determination relates to material received by the Tribunal at any sitting, or any part of a sitting, that is held in camera, is the Tribunal obliged to deliver that part of the determination under clause 33(8)? Should provisions be made to allow the Tribunal to prohibit the publication or disclosure of any determination, or any part thereof, in such circumstances? You may wish to refer to a similar provision (i.e. section 224) applicable to the Securities and Futures Appeals Tribunal under the SFO.

Please refer to clause 34(1)(h) which should address the concern expressed.

(iii) In clause 33(9), what is the procedure for registering a determination made by the Tribunal in the Court of First Instance? Should provisions be made to cover this?

Although there is no specific provision on the procedure for registering a determination by the Tribunal similar to section 226 of the SFO, the Chief Justice can make rules regarding such a procedural matter under clause 38(a).

(b) How and from whom are the costs awarded under clause 34(1)(k) recoverable? Should provisions be made to cover this?

Costs are payable by the party against whom the costs are awarded by the Tribunal. They are recoverable by virtue of the authority of this clause of the Bill.

(c) <u>Clause 37</u>

(i) Does the lodging of an appeal to the Court of Appeal under clause 37 operate as a stay of execution of a determination of the Tribunal? Should provisions be made to cover this?

It is not intended that the lodging of an appeal to the Court of Appeal should operate as a stay of execution of a determination of the Tribunal. However, under Order 59 r13(1)(a) of the Rules of the High Court (Cap. 4 sub. leg.), the Court of Appeal has power to direct that there is a stay of execution.

(ii) In clause 37(2), instead of using "reverse", would it be more appropriate to use "set aside" to make the reference consistent with clause 33(6)(a)?

We will introduce an appropriate CSA in this regard.

(iii) Can the Court of Appeal remit the matter in question to the Tribunal? Should a provision similar to clause 33(6)(b) be provided in clause 37?

We intend that the Court of Appeal should be able to do so and will propose any necessary CSAs.

(d) In clause 38, is it necessary to confer on the Chief Justice the power to make rules providing for the award of costs under clause 34(1)(k) and the taxation of those costs?

Under the Bill, questions regarding costs are matters for the tribunal to determine in the exercise of its powers under clause 34(1)(j) and (k), and this approach is considered appropriate for this Bill.

<u>Clause 49</u>

Is there any reason why disclosure of information to the Clearing and Settlement Systems Appeals Tribunal is not allowed under clause 49?

It is considered that the powers of the Tribunal to compel the giving of evidence under clause 34(1)(e) and (f), especially when read together with the preamble to clause 49(1), i.e., *"[e]xcept in so far as is necessary for the performance of any function under this Ordinance or for carrying into effect any provision of this Ordinance"*, clearly provide for the disclosure of information to the Tribunal. Nevertheless, we will consider introducing an appropriate CSA to make it explicit that the Bill does not prohibit disclosure of information to the Tribunal.

Clause 50

(a) **Clause 50(1) and (2), as drafted, appears to be wide enough to cover immunity from criminal liability. Does this reflect the Administration's intent? Please refer to section 380 of the SFO which grants immunity from civil liability only.**

We will make clear that the immunity granted under this clause is limited to civil liability. An appropriate CSA will be introduced.

(b) What is the rationale for exempting the system operator or settlement institution of a clearing and settlement system from liabilities for tortious acts or other wrongful act of his employees?

This immunity only applies in respect of acts done in good faith when carrying out a direction given to the system operator or settlement institution by the Monetary Authority under the proposed legislation. The provision does not confer on a system operator or settlement institution any exemption from liability for the tortious or other wrongful acts of its employees.

(c) Is it intended that the scope of immunity under clause 50(2) should be confined to the relevant persons of a designated clearing and settlement system instead of any clearing and settlement system? Is so, should the references to "clearing and settlement system" be replaced by "designated clearing and settlement system"?

We agree with your comments and will introduce appropriate CSAs to reflect this.

(d) Who is an "officer" referred to in clause 50(2)(b)? Is it necessary to define the term? Please also consider the need to define "officer" as used in clause 55(1)(a).

We will consider the need to clarify the meaning of "officer" in clauses 50(2)(b) and 55(1)(a).

Clause 54 and Schedule 2

Clause 54(3) would have the effect of exempting a clearing and settlement system specified in Schedule 2 from the obligations of a designated system and from the

oversight of the Monetary Authority as provided in Part 2 of the Bill. This appears to be inconsistent with the object of the Bill which is to establish a regulatory regime for important clearing and settlement systems. What is the rationale for granting the exemption? How can the Monetary Authority ensure that the systems specified in Schedule 2 will be operated in a safe and efficient manner?

The systems specified in Schedule 2 are systems operated by or on behalf of the MA. These systems have been assessed by the International Monetary Fund which is satisfied as to the safety and efficiency of their operations. Even though the MA would in any event exercise oversight of these systems to the standard applicable to other important clearing and settlement systems, we agree that it might not be appropriate to exempt the systems from the statutory oversight requirements under the Bill. We are prepared to remove clause 54(3) so that all designated systems are required by law to comply with the oversight standards and requirements. A CSA will be proposed accordingly.

References to "by notice published in the Gazette"

References to "by notice published in the Gazette" can be found in various provisions of the Bill, for example, clauses 3(1), 4(1) and (2), 12(5) and 26(4). Please confirm whether notices made under those provisions are all subsidiary legislation subject to the negative vetting of the Legislative Council. In the event that some of these notices are not intended to be subsidiary legislation, instead of using the reference "by notice published in the Gazette", would it be more appropriate to adopt the reference used in clause 3(5)(a) instead?

Our intention is that only the regulations under clause 48 should be regarded as subsidiary legislation for the purpose of negative vetting by the Legislative Council. We will move a CSA to state this explicitly.

Hong Kong Monetary Authority
Financial Services and the Treasury Bureau
April 2004