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Legislative Council

LC Paper No. CB(1)1337/05-06
(These minutes have been seen by the Administration)

Ref : CB1/PL/FA/1

Panel on Financial Affairs

Minutes of meeting
held on Monday, 6 March 2006 at 10:00 am
in the Chamber of the Legislative Council Building

Members present	**:**	Hon Bernard CHAN, JP (Chairman) Hon Ronny TONG Ka-wah, SC (Deputy Chairman) Ir Dr Hon Raymond HO Chung-tai, S.B.St.J., JP Hon LEE Cheuk-yan Hon James TO Kun-sun Hon SIN Chung-kai, JP Hon Emily LAU Wai-hing, JP Hon Jeffrey LAM Kin-fung, SBS, JP Hon Andrew LEUNG Kwan-yuen, SBS, JP Hon WONG Ting-kwong, BBS Hon CHIM Pui-chung Hon Albert Jinghan CHENG Hon TAM Heung-man
Members absent	:	Hon James TIEN Pei-chun, GBS, JP Dr Hon David LI Kwok-po, GBS, JP Hon CHAN Kam-lam, SBS, JP Hon Abraham SHEK Lai-him, JP

Public officers attending : Agenda Item IV

Mrs Sarah KWOK
Deputy Secretary for Financial Services and the Treasury (Financial Services)

Miss Alice CHEUNG
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)2

Agenda Item V

Mrs Dorothy MA
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)1

Agenda Item VI

Mrs Millie NG
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)5

Attendance by invitation : Agenda Items IV and V

Mr Peter AU-YANG
Executive Director and Chief Operating Officer
Securities and Futures Commission

Agenda Item IV
Mr Leo LEE
Director, Finance and Administration
Securities and Futures Commission

Agenda Item V

Mr Charles GRIEVE
Director (Corporate Finance)
Securities and Futures Commission

Mr Richard WILLIAMS
Head of Listing
Hong Kong Exchanges and Clearing Limited

Ms Kelly WICK
Assistant Vice President, Listing Division
Hong Kong Exchanges and Clearing Limited

Agenda Item VI

Mr Raymond LI, JP
Chief Executive Officer
Hong Kong Deposit Protection Board

Mr Raymond CHAN
Deputy Chief Executive Officer (Operations)
Hong Kong Deposit Protection Board

Clerk in attendance : Miss Salumi CHAN
Chief Council Secretary (1)5

Staff in attendance : Ms Rosalind MA
Senior Council Secretary (1)8

Mr Justin TAM
Council Secretary (1)3

Ms May LEUNG
Legislative Assistant (1)8

Action

I. Confirmation of minutes of meeting

(LC Paper No. CB(1)996/05-06 — Minutes of special meeting on 14 December 2005)

The minutes of the special meeting held on 14 December 2005 were confirmed.

II. Information paper issued since the last meeting

2. Members noted that an information paper on "Securities and Futures Commission Quarterly Report for October to December 2005" (LC Paper No. CB(1)893/05-06) had been issued since the last regular meeting held on 6 February 2006.

III. Date of next meeting and items for discussion

(LC Paper No. CB(1)997/05-06(01) — List of outstanding items for discussion

LC Paper No. CB(1)1025/05-06(01) — Letter dated 2 March 2006 from Hon SIN Chung-kai

LC Paper No. CB(1)997/05-06(02) — List of follow-up actions)

Items for discussion at the next meeting on 3 April 2006

3. The Chairman advised that as agreed at the Panel meeting on 5 January 2006, the subject on "Conflict of interest issue and other financial issues involved in and after the listing of The Link Real Estate Investment Trust" had been scheduled for further discussion at the Panel meeting to be held on Monday, 3 April 2006 at 10:45 am.

4. The Chairman also drew members' attention to Mr SIN Chung-kai's request that the subject on "Regulation of market misconduct" be discussed at the Panel meeting in April (LC Paper No. CB(1)1025/05-06(01)). Referring to the oral question raised by Mr Albert HO at the Legislative Council (LegCo) meeting on 1 March 2006, Mr SIN Chung-kai pointed out that the issues related to the regulation of market misconduct had not been fully addressed. Whilst appreciating the need to observe the statutory secrecy provisions governing the disclosure of information by the Securities and Futures Commission (SFC), Mr SIN considered it necessary to strike a proper balance between the statutory secrecy provisions and SFC's accountability to the public. He proposed that the subject be scheduled for discussion by the Panel. Members agreed that the subject be placed on the agenda for the meeting on 3 April 2006.

Other discussion items for future meetings

Impact of branch closure by banks on the public

5. The Chairman informed members that pursuant to the Panel's decision made at the last meeting on 6 February 2006 to invite the Hong Kong Association of Banks (HKAB) to discuss the impact of branch closure by banks on the public, the Clerk to Panel had liaised with HKAB on the meeting arrangement. As advised by HKAB, its working group established for the purpose of exploring means to alleviate the effects of branch closure had first met on 22 February 2006 and would meet again in the end of March. Given that the working group had not yet come up with any concrete proposals, it might not be ready to discuss with the Panel on the subject at the meeting on 3 April. The Chairman sought members' views on the timing for discussion of the subject.

6. Mr SIN Chung-kai suggested that more time be allowed for the working group of HKAB to formulate concrete proposals. Noting that there were a number of discussion items for the Panel meetings in May and June on the list of outstanding items for discussion, Mr SIN suggested that the subject on impact of branch closure by banks on the public be scheduled for the meeting on 3 July 2006. Ms Emily LAU however suggested that the subject be scheduled for discussion at an earlier meeting. After discussion, members agreed that the subject be scheduled for discussion at the Panel meeting on 4 May 2006. The Chairman directed the Clerk to take follow-up actions accordingly.

(*Post-meeting note*: Given HKAB's advice that its working group needed more time to look into the issues relating to the closure of bank branches and it aimed to discuss the subject with the Panel in July, members subsequently agreed at the meeting on 3 April 2006 that the subject be scheduled for discussion at the meeting on 3 July 2006.)

Policies on remuneration for and post-termination employment of senior executives of the Hong Kong Monetary Authority (HKMA) and SFC

7. The Chairman informed members that as agreed at the Panel meeting held on 6 February 2006, HKMA and SFC had been invited to provide, by late March 2006, written information on their policies on remuneration for and post-termination employment of senior executives. Mr SIN Chung-kai suggested that such policies of HKMA and SFC be discussed at the Panel meeting in May or June. Members agreed that Mr SIN's suggestion should be considered when the written responses from HKMA and SFC were available.

(*Post-meeting note*: Members subsequently agreed at the meeting on 3 April 2006 that the subject in paragraph 7 above be scheduled for discussion at the meeting on 4 May 2006.)

IV. The Securities and Futures Commission Budget for the financial year 2006-07

(LC Paper No. CB(1)997/05-06(03) — Paper provided by the Administration)

Briefing by SFC

8. At the Chairman's invitation, Mr Peter AU-YANG, the Executive Director and Chief Operating Officer of SFC briefed members on the main features of the revised estimates for 2005-06 and the proposed estimates for 2006-07, with a brief account of SFC's resources requirements. He highlighted the following points:

(a) 2005-06 was a very good year in terms of market activities. The average daily turnover in the Stock Exchange of Hong Kong (SEHK) in the first seven months of the year to 31 October 2005 was $19.9 billion (over 50% higher than that assumed in the approved estimates), while trading in the futures market was about 29% more active than expected. Higher number of licensing applications and more corporate activities would continue to bring in more fees and charges income. On these bases, the revenue for 2005-06 was expected to increase by 42% from $512.9 million to $730.2 million. On the expenditure side, the revised estimated operating expenditure for 2005-06 was $485.9 million, which was slightly above the approved estimates by $4.21 million (0.87%).

(b) As regards the budget for 2006-07, SFC projected a surplus budget of $25.3 million with a reduction of 19.6% in estimated revenue and an increase of 10.3% in operating expenditure as compared with the revised estimates of 2005-06. Securities levy income was expected to decrease as the average daily turnover of SEHK for 2006-07 was projected to be $16.5 billion which was 13% below the $19 billion assumed in the 2005-06 revised estimates. The transaction levy for securities trading and futures and options contracts would be reduced by 20% from the prevailing rates. Income from fees and charges was expected to increase by $9 million arising from more licensing activities. In the 2006-07 budget, provisions had been made for two exceptional items, i.e. $11.8 million for SFC to host the 31st Annual Conference of the International Organization of Securities Commissions (IOSCO) in June 2006 in Hong Kong; and $5 million contribution to fund the proposed Financial Reporting Council (FRC). Excluding these two items, the net increase in operating expenditure for 2006-07 was 7.4%, which was attributable to increase in personnel expenses by about 9%, increase in training and development expenses by 16.1%, and increase in professional and others expenses by 20.1%.

(c) On staff remuneration, there had not been any general salary increase for SFC staff since April 2001, and no variable pay had been awarded to staff in 2001-02 and 2002-03. Owing to the recovery of the Hong Kong economy and improved market conditions, SFC had experienced increasing staff turnover since the beginning of 2004. The overall staff turnover in 2005 was 14.1% as compared with 11.8% in 2004. The turnover rate in 2005 for executive and non-executive staff was 16.2% (12.7% in 2004) and 10.2% (10.3% in 2004) respectively. The problem was most serious at the Manager and Assistant Manager levels, which experienced turnover rates ranging from 13% to 29%. Majority of the departed staff was attracted to the private sector which offered better pay packages. In order to deal with the staff retention issue, SFC made provision for an average fixed pay adjustment of 3% ($10.7 million) and $29.5 million for the award of variable pay in the budget for 2006-07. The workload of SFC was expected to increase further as it assumed new regulatory functions. The implementation of the proposal to introduce legislative changes later in 2006-07 to give statutory backing to the more important requirements in the Listing Rules would also have implications on SFC's staff establishment in future years.

(d) With the projected budget surplus and a reasonable size of reserves, SFC had for the fourteenth consecutive year not requested for any appropriation from LegCo. SFC would continue to tightly control its expenditure in 2006-07. If required, additional resources would be allocated to areas which were considered necessary to improve the quality of the market or to enhance Hong Kong's status as a preferred fund raising centre in the region.

Discussion

Attendance of SFC Chairman at meetings of the Panel

9. Pointing out that the former Chairman of SFC had attended meetings of the Panel to brief members on the annual budgets of SFC, Ms Emily LAU was gravely concerned why the new Chairman had not attended this meeting. Given that the new Chairman had not attended any meetings of the Panel since his appointment in September 2005, Ms LAU urged that the new Chairman should attend meetings of the Panel to exchange views with members on issues related to SFC.

10. In response, Mr Peter AU-YANG explained that as the annual budget of SFC was under the charge of the Chief Operating Officer (COO), it was the practice of the last two years for the COO to brief the FA Panel on the annual budget. However, before the creation of the COO post, the former SFC Chairman had attended meetings of the Panel to brief members on the annual budgets. At the request of
SFC Ms Emily LAU, Mr AU-YANG undertook to convey her views mentioned in paragraph 9 above to the new Chairman of SFC.

Provision for FRC

11. Noting the provision of $5 million in 2006-07 for contribution to the reserve and operating fund of FRC, Ms Emily LAU pointed out that the Bills Committee on FRC Bill had requested the Administration to discuss with SFC and other parties concerned on the need to increase the amount of their contribution to ensure the effective operation of FRC. She enquired whether SFC had already taken into account the views of the Bills Committee in making the provision for 2006-07.

12. Mr Peter AU-YANG confirmed that the Administration had discussed with SFC on the Bills Committee's request for additional provision for FRC, and that SFC would give due consideration to the request. The Deputy Secretary for Financial Services and the Treasury (Financial Services) added that the Administration was

consulting the parties concerned on the level of contribution to the reserve and operating fund of FRC, and would revert to the Bills Committee on the outcome in due course.

Fees and charges of SFC

13. Given that SFC had not requested any appropriation from LegCo in the past 14 years and that it had a reasonable size of reserves, Mr CHIM Pui-chung urged SFC to consider reducing the licensing fees so as to promote market participation. In reply, Mr Peter AU-YANG advised that in collecting fees and charges for services provided to the market, such as licensing and authorization of investment products, SFC adopted the "users pay" principle to recover the costs of services. Given that the costs involved in licensing services had not been fully recovered, there was no room for reduction at the present stage. Nevertheless, Mr AU-YANG said that SFC would consider Mr CHIM's suggestion upon achievement of full cost recovery in the licensing services.

14. Mr Peter AU-YANG also pointed out that according to section 396 of the Securities and Futures Ordinance (SFO) (Cap. 571), SFC should consult the Financial Secretary with a view to recommending to the Chief Executive in Council that the rate of levy be reduced if the reserves of SFC had reached a level more than twice its estimated operating expenses for that financial year. In addition to this statutory requirement, SFC had to balance the interests of the investing public and the market participants when examining the proposal of reducing licensing fees instead of the rate of levy under the circumstances where SFC's reserves exceeded its estimated operating expenses.

15. Noting the increase of SFC's reserves from about $1,024 million in the end of October 2005 to an estimated $1,081 million in March 2006, Mr SIN Chung-kai enquired whether the current level of reserves had reached the historic peak; and if not, what was the peak level and when it was reached. Mr Peter AU-YANG advised that the reserves of SFC had reached the highest level of about 2.9 times of its operating expenses in 1993-94 to 1994-95. Given the unfavourable economic climate and the drop in market activities in 2001-02 to 2002-03, the reserves of SFC had dropped to only 1.4 times of its operating expenses. He assured members that as a responsible market regulator, SFC would closely monitor its reserves level and take necessary actions in collaboration with the Administration for reducing the rate of levy in accordance with section 396 of SFO. Responding to Mr SIN's further enquiry, Mr AU-YANG explained that there was no restriction on the timing for making recommendation on reduction of the rate of levy and hence, the reduction could be implemented at any time during a financial year.

Manpower provision and staff turnover

16. Mr CHIM Pui-chung was of the view that SFC should strike a balance among its various functions, including market supervision, investor education and market development, taking into account the interests of stakeholders including local and overseas intermediaries as well as the investing public. In this connection, Mr CHIM enquired whether SFC had, in working out the proposed establishment of 427 for 2006-07, put more emphasis on market supervision than its other functions. He was of the view that more resources should be provided for market development so that all market participants could benefit from the increased business opportunities.

17. In response, Mr Peter AU-YANG pointed out that SFC had struck a balance among its various functions and made manpower provisions for its different divisions to meet the operational needs for performance of their functions. For example, the Corporate Affairs Division was responsible for investor education and communications, and the Corporate Finance Division was responsible for, among other things, projects concerning market development and expansion, such as conducting consultation on the proposed amendments to the Companies Ordinance (Cap. 32).

18. Noting the high staff turnover rate of SFC in 2005, in particular the turnover rate for Manager and Assistant Manager ranks, Ms Emily LAU was concerned whether the measures proposed by SFC (such as pay increase and award of variable pay) could adequately address the problem of loss of talent. Miss TAM Heung-man expressed similar concern. Miss TAM was particularly concerned whether timely and suitable replacements could be found to prevent succession problems in any of the divisions of SFC.

19. In response, Mr Peter AU-YANG advised that SFC had attempted to tackle the problem of high staff turnover rate with a three-pronged approach. These included: proposing an average fixed pay adjustment of 3% to bring the pay package in line with the market trends; including a provision for the award of variable pay in the budget for 2006-07; and increasing the provision for staff training and development to provide more intensive training activities to upgrade the skills and competence of staff as well as promote their sense of belonging to the Commission. It was expected that the above measures would effectively attract and retain talents for SFC. Mr AU-YANG also pointed out that while some experienced staff had left SFC for employment with other companies, there were new recruits joining the Commission from time to time. As such, SFC did not anticipate any succession problem in the coming years. While the 14% average staff turnover rate of SFC was higher than the 11% turnover rate for all sectors of Hong Kong, Mr AU-YANG informed members that the rate was still lower than that of the financial sector as a whole, which was 17%.

20. The Chairman opined that the interflow of talents among different organizations in the financial sector might facilitate the exchange of professional knowledge and expertise within the sector to a certain extent. He sought the view of

SFC on the pros and cons of such exchange of talents between SFC as the regulator and other companies in the financial sector. In response, Mr Peter AU-YANG agreed that to a certain extent, the interflow of talents would facilitate the industry's comprehension of the regulatory requirements and keep the regulator abreast of the latest development and practices in the market. He reiterated that the staff turnover of SFC was more significant for the middle executive ranks and the turnover rate for senior executives was smaller than the average of 14%, as more private companies were in demand of middle management staff to assist them in compliance with the regulatory requirements.

Policy governing post-termination employment of senior executives of SFC

21. Given the high staff turnover rate of SFC, Ms Emily LAU was concerned whether adequate safeguards were in place to prevent conflict of interests in the post-termination employment of senior executives of SFC. Miss TAM Heung-man expressed similar concern and enquired about the measures in place to prevent disclosure of confidential information by former SFC staff to companies regulated by SFC.

22. In reply, Mr Peter AU-YANG advised that all SFC employees were bound by the statutory provisions on secrecy and conflict of interest under sections 378 and 379 of SFO. Non-compliance with these statutory provisions would constitute criminal offences. Responding to Ms Emily LAU's enquiry on the restrictions imposed on post-termination employment of senior executives of SFC, Mr AU-YANG said that the objective of the relevant policy was to prevent conflict of interest between the prospective employment of the staff concerned and his previous service with SFC. Hence, the current rules mainly stipulated certain requirements for senior executives if the activities of their new employment had been the subject of any of the statutory functions of SFC. As to the details of the current requirements, members noted that SFC would, in response to the Panel's earlier invitation, provide the relevant information in the end of March. To provide the Panel with a clearer picture on the post-termination employment taken up by senior executives of SFC, Mr SIN Chung-kai requested SFC to provide in its written response information on the number of relevant cases for the Executive Directors and for each tier of the senior executives in each of the past three years. Ms Emily LAU supported Mr SIN's request. She also requested SFC to provide the following details on each of the cases:

(a) Whether a sanitization period had been imposed; and if so, the length of the period;

(b) The dates on which the officers concerned had ceased service with SFC; and

(c) The dates on which the officers concerned had subsequently taken up employment with other corporations, and the nature of the new employment.

23. As the Panel had also requested HKMA to provide information on its policy on post-termination employment of senior executives, members agreed that HKMA be invited to provide details on cases of such employment as stipulated in paragraph 22 above.

(*Post-meeting note*: The letters dated 7 March 2006 from the Clerk to Panel to HKMA and SFC and the written responses dated 27 March 2006 from the two regulators were circulated to members vide LC Paper Nos. CB(1)1183/05-06(01) and (02) and CB(1)1186/05-06(02) and (03) on 28 March 2006.)

Increase in insurance expenses

24. Referring to paragraph 42 of the Annex to the paper provided by SFC, the Chairman enquired about the reasons for additional expenses for insurance coverage for the World Trade Organization 6th Ministerial Conference held in December 2005. In reply, Mr Leo LEE, Director, Finance and Administration of SFC explained that SFC had decided to take out additional insurance for the event given that the original insurance policy did not cover the risks of riots during the international event. Mr LEE also informed members that as the additional insurance coverage would be valid for 12 months, the risks arising from the upcoming 31st Annual Conference of IOSCO to be held in June 2006 would also be covered under the policy.

V. Outcome of consultation on the new structure for listing decision-making — Composition changes to the Listing Committee

(LC Paper No. CB(1)997/05-06(04) — Paper provided by the Hong Kong Exchanges and Clearing Limited (HKEx)

(***Appendix 1***: HKEx's Consultation Paper on New Structure for Listing Decision-making issued in February 2005

Appendix 2: Current Main Board Listing Rule 2A.25 and Growth Enterprise Market Listing Rule 3.26

Appendix 3: HKEx's press release issued on 3 February 2006)

LC Paper No. CB(1)997/05-06(05) — Background brief prepared by the Legislative Council Secretariat)

Briefing by HKEx

25. At the Chairman's invitation, Mr Richard WILLIAMS, Head of Listing of HKEx briefed members on the status of policy development relating to a new structure for listing decision-making and the related amendments to the Main Board and the Growth Enterprise Market (GEM) Listing Rules (the Rules), including those in relation to term limits of Listing Committee members. Mr WILLIAMS highlighted the following salient points in the paper provided by HKEx:

(a) A majority of the responses to the consultation paper published in February 2005 on a new structure for listing decision-making were supportive of some or all of the consultation proposals. However, in considering the way forward, the Listing Committee was mindful of a number of current uncertainties that might have impact on its operations and the decisions SEHK was required to make. Specifically, uncertainties relating to the continuing consideration regarding which of the obligations in the Rules should be given statutory backing, the manner of such statutory backing and the likely implementation timetable, as well as a continuing judicial review concerning the procedures of the Listing (Disciplinary) Committee (L(D)C). Given such uncertainties, the Listing Committee resolved in October 2005 to address the proposals set out in the consultation paper in two phases.

(b) The first phase, which would become effective in May 2006, involved a number of Rule amendments aimed at addressing the most significant concerns raised by respondents, namely the size and composition of the Listing Committee. Most notably the Rules had been amended:

(i) to expand the Listing Committee to 28 members or such greater number of members as the SEHK Board might from time to time agree (increased from the current membership of 25 for the Listing Committee and 21 for the GEM Listing Committee);

(ii) to change the composition of the Listing Committee to include at least eight investor representatives, the Chief Executive of HKEx and, otherwise, a suitable balance of representatives of listed issuers and market practitioners including lawyers, accountants, corporate finance advisers and participants of SEHK (Exchange Participants) or officers of Exchange Participants;

(iii) to extend the maximum term for Listing Committee members to six years. The current Rules (Main Board Rule 2A.25 and GEM Rule 3.26) provided that members of the Listing Committee might only remain in office for a maximum of three consecutive years or, for a person who served as chairman or deputy chairman of the Committee, four years (the Current Term). A member who had served the maximum term was not eligible for re-appointment for two years after vacating office, subject to Listing Nominating Committee (LNC)'s discretion for exceptional circumstances. The amended Rules would extend the Current Term to six years for all Committee members and the current LNC discretion would be retained. Providing for a maximum term of six years did not mean that all members would be appointed for six years. Rather, it gave LNC the flexibility to manage the Listing Committee composition from year to year; and

(iv) to change the composition of LNC. Before the Rule amendments became effective, LNC comprised the Chief Executive of SEHK and two members of the HKEx Board as well as the Chairman and two Executive Directors of SFC. The effect of the Rule amendments is to change the HKEx representatives to three non-executive members of the HKEx Board. This change was intended to make LNC even more independent and reduce the perceived influence of the SEHK executive on the nomination process.

(c) The second phase for consideration of the consultation proposals would commence once the relevant judicial review (mentioned in item (a) above) was resolved and further progress was made in deciding which of the Rules would be given statutory backing.

Discussion

Judicial review concerning the procedures of the Listing (Disciplinary) Committee

26. Mr CHIM Pui-chung was concerned why the continuing judicial review on the procedures of L(D)C would have impact on the development of a new structure for listing decision-making. Mr Richard WILLIAMS explained that the major issue involved was whether company directors should have an absolute right of legal representation in appearing before L(D)C hearings. The decision of the Court of Final Appeal might have an impact on the manner in which disciplinary hearings and other hearings would be held in future and the procedures to be adopted by SEHK.

Independence of the Listing Committee

27. Mr SIN Chung-kai pointed out that all along, HKEx had stressed the importance of its minimal involvement in the work of the Listing Committee. In this connection, Mr SIN was concerned whether the proposed new structure would

strengthen the participation of HKEx in LNC and the Listing Committee and if so, what were the justifications for such a change.

28. Mr Richard WILLIAMS clarified that as far as the process of nominating and appointing members to the Listing Committee was concerned, no change was introduced under the current proposal. LNC would continue to comprise three representatives each from SFC and HKEx. The effect of the proposed change to the composition of LNC was to change the HKEx representatives to three non-executive members of the HKEx Board (instead of the Chief Executive of SEHK and two members of the HKEx Board under the current membership), thus separating the executives of SEHK from the nominating process and making the process even more independent.

29. Mr SIN Chung-kai enquired about the role of the Chief Executive of HKEx in the Listing Committee. Mr Richard WILLIAMS advised that the Chief Executive of HKEx was an ex-officio member of the Listing Committee. His role was limited to dealing with new listing applications and participating in policy discussions. He was not involved in any of the reviews of listing decisions or disciplinary hearings.

Proposed expansion in membership of the Listing Committee

30. Noting that the SEHK Board might from time to time agree to expand the membership of the Listing Committee to 28 members or more, Mr Jeffrey LAM enquired about the circumstances under which the SEHK Board would expand the membership and whether there was a cap on the number of members of the Listing Committee. Mr Richard WILLIAMS responded that the SEHK Board would consider expanding the membership of the Listing Committee on the basis of the recommendation of LNC. He assured members that should the SEHK Board decide to expand the membership of the Listing Committee to more than 28 members, the additional members would be in the investor category.

Composition of the Listing Committee

31. Mr CHIM Pui-chung was of the view that there was an imbalance in the composition of the Listing Committee with decreasing number of Exchange Participants, i.e. the securities intermediaries. He considered this unreasonable as the securities intermediaries played a significant role in the market and they should be well represented on the Listing Committee. Mr Richard WILLIAMS pointed out that there were a number of brokers on the Listing Committee. As regards the number of Exchange Participants to be appointed to the Listing Committee in future, it would be a matter for LNC to decide.

32. Noting that the revised composition of the Listing Committee would include at least eight investor representatives, Mr Jeffrey LAM was concerned about the broad coverage of the term "investor representatives" and whether HKEx would give a more refined definition on the different categories of investors to be represented.

Mr Richard WILLIAMS advised that HKEx had deliberately not attempted to define the term "investor representatives" so as to allow flexibility for LNC to nominate suitable candidates who could represent the investing community, including different categories of investors such as small investors and institutional investors, by referring to the credentials of individual representatives rather than setting artificial barriers on the sub-categories of investors to be considered by LNC. Mr LAM was concerned that the absence of a clear definition of "investor representatives" might give rise to disputes. Mr WILLIAMS said that he believed that LNC, which comprised three members of SFC and three non-executive members of the HKEx Board, would carefully examine in detail the credentials of every individual before putting forward its nominations.

Maximum term for Listing Committee members

33. Mr CHIM Pui-chung, Mr Ronny TONG, Ms Emily LAU and Mr Albert CHENG queried the justifications for extending the maximum term for Listing Committee members to six years. Mr CHIM considered it unfair to allow such a long-term appointment. Mr TONG, Ms LAU and Mr CHENG were gravely concerned that the repeated re-appointment of a small pool of candidates to the Listing Committee might turn it into a private club of restricted membership, thus undermining the credibility of the Committee. Referring to the submission dated 14 May 2005 from Mr David WEBB, they were concerned that the term of some serving members of the Listing Committee had been repeatedly extended under the discretion of LNC and the Chairman of the Listing Committee had remained in office for nine years. They queried why the maximum term permitted by the current Listing Rules (i.e. three years for members and four years for the Chairman or Deputy Chairman of the Listing Committee) had been exceeded in a number of cases. Mr TONG was also concerned that the flexibility allowed for LNC to manage the Listing Committee composition might undermine the independence of the Listing Committee.

34. Mr Richard WILLIAMS pointed out that HKEx had considered the arguments for a period shorter or longer than six years as the maximum term for Listing Committee members, and came to the view that it was appropriate to provide for a maximum term of six years. However, this did not mean that all members would be appointed for six years. LNC would be given the flexibility to manage the Listing Committee composition from year to year so that the Listing Committee would have a suitable mix of experienced members and new members for its smooth operation. The re-appointment or otherwise of serving members and/or the nomination of new members would be a matter for LNC to consider having regard to the circumstances prevailing at the time it made the decision. Mr WILLIAMS also pointed out that there had been a significant change in the membership of the Listing Committee in 2003 when nearly half of the serving members were replaced by new members. Following the publication of the "Consultation Paper on New Structure for Listing Decision-making" in February 2005, it was suggested by the Chairman of SFC and agreed by LNC that some serving members of the Listing Committee should be

re-appointed in May 2005 to provide continuity in the period up to the introduction of the new structure.

35. Ms Emily LAU enquired about the reasons for SFC to support the re-appointment of some serving members of the Listing Committee in May 2005. Mr Peter AU-YANG advised that as review of the structure for listing decision-making was underway in May 2005, SFC considered it desirable for any changes to the composition of the Listing Committee to be deferred until the completion of the review. Nevertheless, as HKEx had subsequently decided to implement the proposals under the new structure in two phases and the extension of the maximum term of Listing Committee members would be implemented in the first phase, Mr AU-YANG believed that LNC would take into full consideration the Rule amendment on the maximum term in nominating members for re-appointment upon the expiry of their current term in May 2006.

36. Ms Emily LAU opined that repeated re-appointment of members to the Listing Committee should be avoided and more "fresh blood" should be brought in so that its membership would not be restricted to a small group of persons. Mr Richard WILLIAMS stressed that in exercising its discretion to nominate re-appointment of members to the Listing Committee beyond the maximum term, LNC would take into consideration the need to have a suitable rotation in membership to ensure the smooth transition and continuity of the Listing Committee's work as well as to maintain a balanced composition with representatives from different groups of stakeholders. The re-appointment or otherwise of Listing Committee members would be considered by LNC in the light of the extended maximum term of six years during the next appointment exercise in May 2006. In this connection, Mr WILLIAMS informed members that when the appointment issue was discussed at the meeting of the Listing Nominating Committee in May 2005, it was agreed that the decision not to apply the rules limiting the term of appointment for members (including the Chairman) should not be extended beyond the current period of appointment (that was the period ordinarily ending in May 2006).

37. Mr WONG Ting-kwong said that the LegCo Members of the Democratic Alliance for the Betterment and Progress of Hong Kong were concerned about the extension of the maximum term for Listing Committee members. In this connection, Mr WONG enquired whether HKEx and SFC had made reference to practices adopted by overseas listing regimes in working out the current proposals, such as the practices of the Financial Services Authority (FSA) in the United Kingdom (UK).

38. In reply, Mr Richard WILLIAMS explained that FSA had a separate listing authority advisory committee which gave advice on policy matters in respect of listing but was not involved in making decisions on individual cases. The nomination and appointment process in UK was not quite similar to those in Hong Kong. The FSA Board made many appointments to its advisory panels on the basis of nominations from the industry and institutional investing bodies. Whether

nominations for the Listing Committee would be invited from the market/industry would be subject to the decision of LNC.

39. Responding to Mr WONG Ting-kwong's further enquiry, Mr Peter AU-YANG said that the amendments to the Main Board and GEM Listing Rules, including the extension of the maximum term for Listing Committee members, had been discussed and endorsed by the SFC Board.

40. Given the rapid changes in the international market, Mr Jeffrey LAM considered the proposed extension of the maximum term for Listing Committee members to six years acceptable as this would provide greater flexibility in the appointment of suitable persons to facilitate the accumulation of experience and skills.

41. Responding to Mr Albert CHENG's enquiry, Mr Peter AU-YANG advised that previous years of service on the Listing Committee would be counted towards the maximum term of six years when the amended Rules came into effect, but it would be for LNC to decide whether those members who had served for six years or more would be re-appointed in May 2006. Mr Richard WILLIAMS also advised that in making nominations, LNC would take into account members' previous years of service on the Listing Committee and consider whether it was appropriate to re-appoint those members who had served for six years or more. Mr Albert CHENG urged for a clear and definite reply that those members who had served for six years or more would not be re-appointed to the Listing Committee. Mr WILLIAMS explained that he was not in a position to give such a reply as it was a matter for LNC to consider in due course.

42. Mr Albert CHENG stated that he would object to the re-appointment of any members exceeding the maximum term of six years under the amended Rules. He also expressed his concern about the lack of transparency in the nomination of members to the Listing Committee as well as the factors for consideration and the exceptional circumstances under which LNC might exercise discretion for re-appointment of those members who had already served the maximum term. Ms Emily LAU shared Mr CHENG's concern.

43. Mr Ronny TONG urged SFC and HKEx to give due consideration to the views expressed by members of the Panel. Mr TONG, Ms Emily LAU and Mr Albert CHENG urged that those members of the Listing Committee who had remained in office for six years or more should not be re-appointed when their current term expired in May 2006.

44. Mr SIN Chung-kai suggested and members agreed that HKEx be requested to provide the Panel with the following information after the next annual appointment of Listing Committee members in May 2006:

(a) Membership list of the Listing Committee;

(b) Number of years served by the Chairman, Deputy Chairman and each member on the Listing Committee; and

(c) If any of the members had remained in office for six years or more, the factors considered by LNC in exercising its discretion to re-appoint the members to the Listing Committee.

HKEx

45. Mr Richard WILLIAMS undertook to convey members' concerns to LNC and provide the required information in paragraph 44 above to the Panel after the appointment of Listing Committee members for the new term commencing May 2006.

46. Ms Emily LAU suggested that in case those members of the Listing Committee who had remained in office for six years or more were re-appointed in May 2006, representatives of LNC should be invited to attend a meeting of the Panel to explain their decisions. Members agreed that the Panel would consider the need for further discussion of the subject upon receipt of the written information provided by HKEx.

VI. Progress on the implementation of the Deposit Protection Scheme

(LC Paper No. CB(1)997/05-06(06) — Paper provided by the Hong Kong Deposit Protection Board

LC Paper No. CB(1)997/05-06(07) — Background brief prepared by the Legislative Council Secretariat)

Briefing by the Hong Kong Deposit Protection Board (HKDPB)

47. At the invitation of the Chairman, the Chief Executive Officer, Hong Kong Deposit Protection Board (CEO/HKDPB) gave a power-point presentation on the progress made by HKDPB in its preparation for the launch of the Deposit Protection Scheme (DPS). He highlighted progress made in the following major preparatory tasks:

(a) System for assessment of contributions

- HKDPB had developed a system for assessing the amount of annual contributions payable by a member of DPS with reference to the amount of relevant deposits held by the member and its supervisory rating assigned by HKMA.
- DPS members had submitted the first return of relevant deposits to HKDPB, and HKMA had also provided the relevant supervisory ratings of DPS members. With these information, HKDPB was ready to assess the amount of contributions payable by DPS members in 2006.

(b) Development of rules and guidelines governing the operation of DPS

- HKDPB and the Monetary Authority (MA) were empowered under the DPS Ordinance to make rules governing the operation of DPS. The two sets of rules to be issued by HKDPB were rules on payment of contributions and rules on representations. The asset maintenance rules would be issued by MA. These rules would be promulgated in the form of subsidiary legislation which was subject to the negative vetting of LegCo.
- Apart from the rules, HKDPB had also issued an information system guideline in February 2006. The guideline required DPS members to keep and provide information to HKDPB in specified formats so as to ensure that HKDPB could determine entitlement to compensation and arrange payment to eligible depositors in a speedy manner.

(c) Payout infrastructure

- The development of the payout system was progressing well and the user-acceptance tests were now underway.
- The payout procedures were being written in the form of a comprehensive manual, which would set out the key payout processes and various payout activities.

(d) Publicity campaign

- The effectiveness of DPS to contribute to banking stability hinged on the level of public confidence in DPS. In this connection, promotional activities would start shortly before the official launch of DPS, such as TV and radio commercials, information leaflets distributed through the branch networks of DPS members, and exhibitions at major shopping malls and MTR stations.
- HKDPB would develop an on-going strategy for maintaining a high level of public awareness of DPS.

(e) Others

- HKDPB proposed to amend Schedule 1 to the DPS Ordinance to exclude all structured products from DPS protection initially. It had also established a set of quantitative benchmarks for triggering a review of this matter and would reverse the exclusion if the review showed that the exclusion would materially affect the effectiveness of DPS.
- HKDPB also proposed to amend Schedule 1 and 4 to the DPS Ordinance to allow DPS members not to exclude deposits held by certain excluded persons in the assessment of contributions; to clarify that contributions for the first year would be assessed on a time pro-rata basis; and to specify that DPS members should report their deposit positions on the preceding day if 20 October of the year was a general holiday.

48. On the way forward, CEO/HKDPB advised that the remaining tasks were expected to be completed in the next six months and, if everything went smoothly, DPS would commence in the second half of 2006.

Discussion

Transfer of costs to customers

49. Noting that the DPS Fund would be established by means of contributions from member banks, Mr Ronny TONG was concerned whether the banks would try to recoup cost for the implementation of DPS from customers through fee increases. In this connection, Mr TONG enquired whether measures and guidelines would be in place to ensure that banks would not transfer the costs for DPS to their clients. Ms Emily LAU shared his concern.

50. In response, CEO/HKDPB advised that how banks charged their clients was a commercial decision and it was inappropriate for HKDPB or HKMA to interfere with such decisions. However, he pointed out that the cost implications on member banks would not be significant given the low average rate of contribution payable by the banks at only 0.08% of the protected deposits per annum during the fund built-up period, which was expected to take approximately five years, with reduction of the rate to 0.01% thereafter. Furthermore, it was envisaged that after the implementation of DPS, banks would tend to be more active in competing for small deposits. As such, market competition would exert pressure on banks to refrain from transferring the costs. The Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)5 added that the Administration had been actively involved in the preparatory work for DPS through the representation of the Permanent Secretary for Financial Services and the Treasury (Financial Services) on HKDPB as an ex-officio member. She advised that the Administration shared CEO/HKDPB's view that it would be unlikely for banks to transfer their costs for DPS to customers.

Management of the DPS Fund

51. Ms Emily LAU expressed concern about the management of the DPS Fund. In particular, she was concerned how the operating cost of DPS would be covered, how the investment strategy of the Fund would be determined, and who would be responsible for undertaking the investment activities.

52. In response, CEO/HKDPB advised that the DPS Fund would be managed by HKDPB. With the proposed target fund size at 0.3% of the banking sector's total amount of protected deposits (which was equivalent to approximately $1.6 billion based on the level of protected deposits as at August 2002), it was expected that the investment return of the Fund would be adequate to cover the operating cost of DPS. An investment committee under HKDPB would be responsible for the investment arrangement for the Fund. He also advised that the range of investment products was governed by the relevant provisions in the DPS Ordinance, such as investment in deposits with the Exchange Fund, Exchange Fund Bills, US Treasury Bills and exchange rate and interest rate contracts. In the event that the investment returns were inadequate to cover the operating cost, the contributions made by DPS members would make up the difference.

Amount of deposit protection and payment of compensation

53. Ms Emily LAU and Mr Ronny TONG expressed concern about the amount of deposit protection under DPS. Noting the coverage limit of $100,000 per depositor per bank, Ms LAU was concerned whether the protection offered under DPS was comparable to similar schemes in overseas jurisdictions. In reply, CEO/HKDPB advised that the coverage limit of $100,000 was considered acceptable since 84% of depositors would have their total deposits fully protected in the event of a bank failure.

54. Ms Emily LAU also expressed concern over the time required for making compensation payments to depositors in the event of a bank failure. She was of the view that expeditious payout under DPS was important for restoring depositors' confidence in the banking system. CEO/HKDPB advised that the actual time required would vary according to the quality of the information system and comprehensiveness of the database of the bank concerned, which would have impact on HKDPB's assessment of depositors' claims. The target of HKDPB was to provide an interim payment of up to 25% of the depositors' entitlements within two weeks, with full entitlements paid out within six weeks after the collapse of a bank. He pointed out that these timeframes for payment were targets instead of performance pledges of HKDPB.

Exemption from DPS

55. In response to the Chairman's concern about exemption of overseas incorporated banks from DPS, CEO/HKDPB explained that participation by licensed banks in DPS was mandatory. However, an overseas incorporated bank could apply for exemption from participating in DPS if the deposits taken by the bank's Hong Kong offices were protected by a scheme in the bank's home jurisdiction and the scope and level of protection afforded by that scheme were not less than those offered to such deposits by DPS in Hong Kong. He however envisaged that few overseas banks operating in Hong Kong would be eligible for exemption from DPS.

56. On the requirement of displaying the DPS membership sign in member banks' local branches, Ms Emily LAU was concerned about the possible confusion of the public that their deposits in banks exempted from DPS would have no protection at all. CEO/HKDPB advised that exempted banks were required to inform their depositors or prospective depositors that they were not members of DPS and to provide details of the protection offered by their home jurisdiction scheme including the level of protection and the types of deposits protected.

Complaint/Appeal mechanism

57. Miss TAM Heung-man enquired about the mechanisms under DPS for handling complaints and/or appeals from small depositors. CEO/HKDPB responded that depositors might lodge complaints on scheme members directly to HKDPB. Moreover, depositors and member banks might appeal to an independent Deposit Protection Appeals Tribunal (the Tribunal) for review of the decisions made by HKDPB. The Deputy Chief Executive Officer (Operations), HKDPB supplemented that the Tribunal was established in January 2005 with a former Vice-President of the Court of Appeal of the High Court appointed as the Chairman and a panel of six persons coming from different professions from which the Financial Secretary might appoint as members of the Tribunal.

Conclusion

58. There being no further questions from members, the Chairman concluded the discussion. He said that the Panel supported in principle the proposed rules governing the operation of DPS and the proposed amendments to Schedules 1 and 4 to the DPS Ordinance. On the timing for tabling the three sets of rules before LegCo for negative vetting, members noted that HKDPB aimed at proceeding with the legislative procedures as soon as practicable.

VII. Any other business

59. There being no other business, the meeting ended at 12:35 pm.

Council Business Division 1
Legislative Council Secretariat
3 May 2006