

立法會
Legislative Council

LC Paper No. CB(1)1609/05-06
(These minutes have been seen
by the Administration)

Ref : CB1/PL/FA/1

Panel on Financial Affairs

Minutes of meeting
held on Monday, 3 April 2006 at 10:45 am
in Conference Room A of the Legislative Council Building

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

Member attending : Hon Albert HO Chun-yan

Member absent : Hon Andrew LEUNG Kwan-yuen, SBS, JP

**Public officers
attending**

: Agenda Item IV

Mr Kenneth MAK, JP
Deputy Director (Corporate Services)
Housing Department

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

**Attendance by
invitation**

: Agenda Item IV

Ms Alice LAW
Director of Licensing
Securities and Futures Commission

Ms Doris PAK
Commission Secretary
Securities and Futures Commission

Mr Peter CURLEY
Senior Vice President (Listing Division)
Hong Kong Exchanges and Clearing Limited

Mr Simon HO
Compliance Manager
The Link Management Limited

Ms Phoebe LAM
Legal Counsel and Company Secretary
The Link Management Limited

Agenda Item V

Mr Alan LINNING
Executive Director (Enforcement)
Securities and Futures Commission

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 meetings

(LC Paper No. CB(1)1177/05-06 — Minutes of meeting on 5 January 2006

LC Paper No. CB(1)1178/05-06 — Minutes of meeting on 6 February 2006)

The minutes of the meetings held on 5 January and 6 February 2006 were confirmed.

II. Information paper issued since the last meeting

2. Members noted that an information paper on “Mandatory Provident Fund Schemes Statistical Digest — December 2005” (LC Paper No. CB(1)1053/05-06) had been issued since the last regular meeting held on 6 March 2006.

III. Date of next meeting and items for discussion

(LC Paper No. CB(1)1179/05-06(01) — List of outstanding items for discussion

LC Paper No. CB(1)1223/05-06(01) — Letter dated 31 March 2006 from Hon SIN Chung-kai

LC Paper No. CB(1)1179/05-06(02) — List of follow-up actions)

Discussion items for the meeting on 4 May 2006

3. The Chairman reminded members that as the first Monday of May fell on a public holiday, the next regular meeting of the Panel had been scheduled to be held on Thursday, 4 May 2006. The following four items were proposed for discussion at the next regular meeting:

Items proposed by the Administration

- (a) Briefing on the work of the Hong Kong Monetary Authority (HKMA) and its 2005 Annual Report;
- (b) Briefing on the development of capital and disclosure rules to be made under the Banking (Amendment) Ordinance 2005;

Items proposed by members

- (c) Members' proposal for the Administration to brief the Panel on the annual budget of HKMA; and
- (d) Policies on remuneration for and post-termination employment of senior executives of HKMA and the Securities and Futures Commission (SFC).

4. On paragraph 3(a) above, the Chairman advised that the Chief Executive/HKMA (CE/HKMA) would brief the Panel on the work of HKMA and its 2005 Annual Report. On paragraph 3(b), the Administration would brief the Panel on the progress of developing the capital and disclosure rules, which would have the status of subsidiary legislation subject to negative vetting of the Legislative Council (LegCo).

5. On paragraph 3(c) above, the Chairman pointed out that LegCo Members had, on a number of previous occasions, expressed their concern about the existing practice where HKMA, as an integral part of the Government, was not subject to the resource allocation mechanism applicable to other government departments. Members considered the current arrangement for HKMA to disclose its administrative budget for the current financial year in the Annual Report far from satisfactory because the disclosure was confined to very brief information about the administrative expenditure and was only made after the approval of HKMA's annual budget. They considered that the Administration should reconsider the request previously raised by Members that in line with the practice of SFC, HKMA should brief the Panel on its annual budget before the commencement of each financial year. Members reiterated the same concern and request when examining the Estimates of Expenditure 2006-07 at the special meeting of the Finance Committee on 13 March 2006. The subject was then referred by the Finance Committee to the Panel for follow-up action. On paragraph 3(d), the Chairman said that some members, having noted the information provided by HKMA, the Governance Sub-Committee (GSC) of the Exchange Fund Advisory Committee, and SFC in March 2006 on the policies on remuneration for and

post-termination employment of senior executives of HKMA and SFC, considered it necessary for the subjects to be discussed at a meeting of the Panel.

6. Members agreed that the four items in paragraph 3 above be placed on the agenda for the meeting on 4 May 2006, and that the Financial Secretary (FS), the Chairman of GSC, CE/HKMA and the Chairman of SFC be invited to the meeting. Given the number and complexity of the discussion items, members also agreed that the meeting be held from 8:30 am to 12:45 pm.

Other discussion item

7. The Chairman said that at the last Panel meeting held on 6 March 2006, some members had suggested that the subject on “Impact of branch closure by banks on the public” be scheduled for discussion at the Panel meeting on 4 May 2006. The Chairman informed members that the Hong Kong Association of Banks (HKAB) had recently advised that its working group established for the purpose of exploring ways to alleviate the effects of branch closure needed more time to look into the subject and it aimed to discuss the subject with the Panel in July. In the light of HKAB’s advice, members agreed that the subject be scheduled for discussion at the meeting on 3 July 2006. Mr SIN Chung-kai suggested and other members agreed that all non-Panel Members should be invited to join the discussion of the subject.

IV. Conflict of interest issue and other financial issues involved in and after the listing of The Link Real Estate Investment Trust

(LC Paper No. CB(1)1152/05-06(01) — List of questions previously raised by Members

LC Paper No. CB(1)1152/05-06(02) — Reply dated 22 March 2006 from the Chairman of the Board of Directors, The Link Management Limited

LC Paper No. CB(1)1179/05-06(03) — Paper provided by the Housing, Planning and Lands Bureau

LC Paper No. CB(1)1179/05-06(04) — Paper provided by the Securities and Futures Commission

LC Paper No. CB(1)1179/05-06(05) — Background brief prepared by the Legislative Council Secretariat

LC Paper No. CB(1)514/05-06(01) — Paper provided by the Housing, Planning and Lands Bureau

- LC Paper No. CB(1)514/05-06(02) — Paper provided by the Securities and Futures Commission
- LC Paper No. CB(1)514/05-06(03) — Letter dated 12 December 2005 from the Chairman of the Board of Directors, The Link Management Limited, including:
Annex 1: Appendix 4 of the Company's Corporate Governance Policy
Annex 2: Press statement issued by The Link Management Limited on 9 December 2005
Annex 3: Press statement issued by Deutsche Bank on 9 December 2005
- LC Paper No. CB(1)532/05-06(01) — Letter dated 13 December 2005 from the Chairman of the Board of Directors, The Link Management Limited
- LC Paper No. CB(1)514/05-06(04) — Extracts from the Securities and Futures Commission's Code on Real Estate Investment Trusts (June 2005), including:
— Explanatory notes
— General principles
— Effect of breach of the Code
— Chapters 8, 9 and 10
— Appendices B and D
- LC Paper No. CB(1)996/05-06 — Minutes of the special meeting on 14 December 2005)

8. The Chairman welcomed representatives of The Link Management Limited (The Link), Housing, Planning and Lands Bureau (HPLB), Financial Services and the Treasury Bureau, SFC, and Hong Kong Exchanges and Clearing Limited (HKEx) to the meeting.

9. The Chairman drew Members' attention that in response to the Panel's invitation in January 2006, Mr Paul CHENG, Chairman of the Board of Directors of The Link Management Limited (The Link), indicated in his reply dated 22 March 2006 that due to other commitments, he was unable to attend today's meeting.

However, Mr CHENG had provided written response to the questions raised by Members at the special meeting of the Panel on 14 December 2005, and two other representatives of The Link attended today's meeting. The Chairman reminded the representatives of The Link that when addressing the Panel, they would not be covered by the protection and immunity provided under the Legislative Council (Power and Privileges) Ordinance (Cap. 382), and the papers provided by The Link would also not be covered by the Ordinance.

10. The Chairman reminded Members that in accordance with Rule 83A of the Rules of Procedure of the Legislative Council (LegCo), a Member should not move any motion relating to or speak on a matter in which he had a pecuniary interest, whether direct or indirect, except where he had disclosed the nature of that interest.

Discussion

Meeting arrangements

11. Mr James TO expressed his grave concern that despite the Panel's invitations for Mr Paul CHENG to attend the meeting on 14 December 2005 and today's meeting and the fact that the second invitation was issued three months before today's meeting, Mr CHENG did not attend the two meetings. Given that the agenda item was an issue of public concern involving Mr CHENG himself, Mr TO considered that the Panel should follow up the issue with Mr CHENG. As Mr CHENG indicated that he was unable to attend the meetings due to other commitments, Mr TO suggested that the Panel should schedule another meeting for Mr CHENG to attend so as to address the concerns about the conflict of interest issue and other financial issues involved in and after the listing of The Link Real Estate Investment Trust (The Link REIT).

12. Given that Mr Paul CHENG had provided written response to Members' questions and representatives of the relevant parties were present at today's meeting, the Chairman suggested that the Panel should discuss the agenda item as scheduled and decide after the discussion how the matter should be taken forward. Other members supported the Chairman's suggestion.

Mr Paul CHENG's role as the Senior Advisor to Deutsche Bank

13. Mr James TO pointed out that according to the press statement issued by Deutsche Bank on 9 December 2005, Mr Paul CHENG's role as the Senior Advisor to the Bank "extends to providing guidance and counsel to Deutsche Bank management on the general business and commercial environment in Hong Kong and Asia; its overall business development in Asia ...", etc. Mr TO also noted that Mr CHENG had, in his reply dated 22 March 2006, stated that he was not involved with nor had given any advice on Deutsche Bank's investment strategies and Deutsche Bank had not consulted or informed him in regard to its acquisition of the units of The Link REIT. In this connection, Mr TO was concerned how Mr CHENG, in his capacity as the Senior Advisor to Deutsche Bank, interpreted his role in providing guidance and

counsel to Deutsche Bank management on “overall business development in Asia”, and interpreted “investment strategies”.

14. Mr Simon HO, Compliance Manager, The Link advised that as Mr James TO’s questions involved Mr Paul CHENG’s own interpretation, he was not in a position to respond on behalf of Mr CHENG. Mr HO however pointed out that according to the letter issued by Deutsche Bank to the Board of Directors of The Link on 6 January 2006 (Annex to Mr CHENG’s reply dated 22 March 2006), Mr CHENG’s advisory role “has not involved, and will not involve, participation in day-to-day operations of the Bank, nor any discussions or decisions in relation to the Bank’s investment and trading activities either for its asset management business or on behalf of DB’s clients. With respect to property related and/or real estate investment trust related matters, Mr Cheng has not had any role in advising the Bank, nor will he have going forward as our advisor ...”. Hence, Mr CHENG’s advisory role with Deutsche Bank was not related to the performance of executive functions.

15. Mr James TO pointed out that he had already studied Mr Paul CHENG’s reply dated 22 March 2006 and Deutsche Bank’s letter dated 6 January 2006. However, both letters had not addressed the concerns mentioned in paragraph 13 above, i.e. how Mr CHENG interpreted his role in providing guidance and counsel to Deutsche Bank management on “overall business development in Asia”, and interpreted “investment strategies”. In Mr TO’s view, it was essential for Members and the public to know how Mr CHENG interpreted his advisory role and whether providing guidance and counsel on “overall business development in Asia” or “investment strategies” could cover providing advice to Deutsche Bank on The Link REIT, such as the likelihood for the Government to buy back the units of The Link REIT in order to retain control over its management. If it could cover this kind of advice, there would be conflict of interest between Mr CHENG’s advisory role with Deutsche Bank and his role as Chairman of the Board of Directors of The Link. With such advice, Deutsche Bank might take joint actions with some significant holders to acquire additional units of The Link REIT and then force the Government to buy back the units from them at a high price.

16. Mr James TO also noted that Mr Paul CHENG had, in his reply dated 22 March 2006, confirmed that he was remunerated for the position as the Senior Advisor to Deutsche Bank. In this connection, Mr TO was concerned whether Mr CHENG’s remuneration was linked to his performance as the Senior Advisor and/or the advice given by him, and whether Mr CHENG had, before accepting the appointment as the Senior Advisor to Deutsche Bank, informed the Bank that he was going to be appointed as the Chairman of the Board of Directors of The Link and made it clear that he, when appointed as the Senior Advisor to the Bank, should not be involved in any strategies or matters related to The Link or The Link REIT. Given that all the questions mentioned in paragraphs 15 and 16 could only be answered by Mr CHENG himself, Mr TO considered that the Panel should invite Mr CHENG again to attend a meeting of the Panel.

Non-disclosure of Mr Paul CHENG's advisory role with Deutsche Bank during the meeting on 19 November 2005 to decide the pricing and allocations to investors for The Link REIT Initial Public Offering (IPO)

17. Mr James TO expressed concern on whether Mr Paul CHENG had been involved in the preparation of the tentative lists of individual investors set out in the appendix to the discussion paper prepared by the Joint Global Coordinators (JGCs) for consideration at the meeting of The Link's Board of Directors on 19 November 2005. In particular, he was concerned whether the JGCs had any form of discussions with Mr CHENG on the tentative lists of individual investors before tabling the lists at that meeting.

18. The Deputy Director (Corporate Services) of Housing Department (DD(CS)/HD) said that the tentative lists of individual investors were prepared and tabled by the JGCs at the meeting on 19 November 2005. Referring to Annex A to the paper provided by HPLB for the Panel meeting on 14 December 2005, DD(CS)/HD pointed out that in the tentative lists, individual investors were classified under different tiers on the basis of the categorization criteria proposed by the JGCs. During the meeting on 19 November 2005, The Link's Board of Directors formally approved the allocation of units as between the International Offering (IO) and the Hong Kong Public Offering and the objective criteria for allocation to individual investors under the IO. However, the meeting did not go over the tentative lists set out in the appendix to the paper. The detailed categorization of individual investors and the actual allocations to them were left to the professional judgment of the JGCs and the Financial Adviser of the Housing Authority (HA) after the meeting. DD(CS)/HD stressed that the actual allocations were decided by the JGCs according to the objective criteria agreed jointly by the HA's Supervisory Group on Divestment and The Link's Board of Directors, and the Financial Adviser of HA had checked whether the actual allocations were made according to the objective criteria. DD(CS)/HD said that he had confirmed with the JGCs that they had not discussed with Mr Paul CHENG on the tentative lists of individual investors before the meeting on 19 November 2005. At the request of Mr James TO, DD(CS)/HD undertook to reconfirm with the JGCs on whether they had had any form of discussions with Mr CHENG on the tentative lists of individual investors before tabling the lists at the meeting.

(Post-meeting note: The Administration's written response to the request in paragraph 18 above was circulated to members vide LC Paper No. CB(1)1352/05-06(01) on 24 April 2006.)

Whether Mr Paul CHENG had contravened any relevant rules and regulations

19. The Chairman invited the parties present to comment on whether Mr Paul CHENG had contravened any rules and regulations of The Link, SFC and HKEx relating to declaration of interest and avoidance of conflict of interest.

20. Mr Simon HO said that having examined the matter, including Mr Paul CHENG's advisory role with Deutsche Bank, the terms of reference of his position as a Senior Advisor to the Bank and the remuneration for the position, the Board of Directors of The Link affirmed at a meeting that there was no conflict of interest between Mr CHENG's advisory position with Deutsche Bank and his duties as Chairman of the Board of Directors of The Link. As regards the allocation of the units of The Link REIT, Mr HO advised that according to the Offering Circular of The Link REIT dated 14 November 2005, allocation of units pursuant to the IO would be determined by the JGC. During the meeting on 19 November 2005 for deciding the pricing and allocations to investors for The Link REIT IPO, the Board of Directors had not discussed nor reviewed the tentative lists of individual investors and hence, there was no question of conflict of interest.

21. DD(CS)/HD advised that as stated in the paper provided by HPLB for the Panel meeting on 14 December 2005, HPLB had carefully examined the matter and was satisfied that in the circumstances of the case, allocations to all investors under the IO had been made objectively and impartially, and the "non-declaration" by Mr Paul CHENG did not have any impact on the outcome of the allocations.

22. Mr Peter CURLEY, Senior Vice President (Listing Division), HKEx advised that with respect to REITs, the primary regulator was SFC which was more involved in the review of all the materials. As regards the case of The Link REIT, the Listing Division of HKEx was satisfied that The Link had complied with all the listing rules at the time of listing.

23. Ms Alice LAW, Director of Licensing, SFC advised that SFC was not in a position to provide specific information on individual cases given the statutory confidentiality obligation imposed on SFC. She pointed out that in general, the REIT Manager, which was a licensee under SFO, was subject to the regulation of the REIT Code and the relevant codes of conduct and guidelines. SFC would not hesitate to take actions against a licensee if the conduct of the licensee cast doubt on its overall fitness and properness. Ms LAW also pointed out that SFC was transparent in enforcement of the laws and regulations. Should there be a final decision against a licensee, it would be made known to public and the relevant information would be put on SFC's website.

24. While the Board of Directors of The Link affirmed at a meeting that there was no conflict of interest between Mr Paul CHENG's advisory position with Deutsche Bank and his duties as Chairman of the Board of Directors of The Link,

Mr WONG Ting-kwong was concerned that potential conflict of interest might be involved, such as in the situation quoted in item 1(c) of the “List of questions previously raised by Members”, i.e. if Deutsche Bank joined with some significant unit-holders to propose replacing the Board of The Link or selling the Link REIT’s assets, what position Mr CHENG would take in serving as the Senior Advisor to the Bank as well as the Chairman of the Board of Directors of The Link. However, Mr CHENG had not directly responded to this question in his reply dated 22 March 2006. He only remarked that such situation would not arise as he was not renewing his advisory position with Deutsche Bank on expiry of the term on 31 March 2006. In this connection, Mr WONG enquired whether The Link considered that there would be any real, potential or perceived conflict of interest involved if such situation did arise and what actions would be taken to avoid conflict of interest.

25. In response, Mr Simon HO said that since Mr Paul CHENG no longer served as the Senior Advisor to Deutsche Bank on expiry of the term on 31 March 2006, the situation quoted in item 1(c) of the “List of questions previously raised by Members” would not arise. Mr HO added that as Mr CHENG had pointed out in his reply dated 22 March 2006, The Link had in place internal governance policies requiring its Directors to, where a potential or perceived conflict of interest arose, declare any interest they might have and if considered necessary, abstain from any discussions and decisions at meetings. In such circumstances, the relevant papers would not be circulated to the Directors concerned.

26. Mr CHAN Kam-lam considered that in examining whether there was any conflict of interest between Mr Paul CHENG’s advisory position with Deutsche Bank and his duties as Chairman of the Board of Directors of The Link, two major questions needed to be addressed: first, whether Mr CHENG had been involved in Deutsche Bank’s decision-making process in respect of the Bank’s acquisition of The Link REIT’s units; and second, whether Mr CHENG, as the Chairman of the Board of Directors of The Link, had been involved in the decision on the pricing and allocation of The Link REIT’s units to Deutsche Bank. On the first question, Mr CHENG clarified in his reply dated 22 March 2006 that Deutsche Bank had not consulted or informed him in regard to its acquisition of The Link REIT’s units, and the Bank clarified in its letter dated 6 January 2006 that Mr CHENG did not have any role in advising Deutsche Bank on property related and/or REIT related matters. As regards the second question, both Mr CHENG and HPLB confirmed that the tentative lists of individual investors had not been discussed nor reviewed at the meeting on 19 November 2005 and the final allocations for institutional investors were made by the JGCs and HA’s Financial Adviser. Moreover, HPLB was satisfied that the allocations to all investors under the IO had been made objectively and impartially, and the “non-declaration” by Mr CHENG did not have any impact on the outcome of the allocations. Mr CHAN therefore considered that no conflict of interest was involved.

27. Mr Jeffrey LAM noted Mr Paul CHENG’s written response given in his reply dated 22 March 2006, and that the Board of Directors of The Link had affirmed that

there was no conflict of interest between Mr CHENG's advisory position with Deutsche Bank and his duties as Chairman of the Board. Mr LAM pointed out that as an international financial centre, Hong Kong had put in place a robust and effective financial services system. He believed that SFC and HKEx would take appropriate actions should there be any conflict of interest involved in the listing of The Link REIT.

Way forward

28. Mr James TO proposed that the Panel should invite Mr Paul CHENG again to attend a meeting of the Panel for discussion on the conflict of interest issue and other financial issues involved in and after the listing of The Link REIT. Responding to Mr Abraham SHEK, Mr TO indicated that the scope of discussion would cover the questions he had raised at today's meeting. The Chairman invited members' views on Mr TO's proposal.

29. Given the written responses provided by Mr Paul CHENG and the relevant parties in December 2005 and March 2006 and the information provided by the relevant parties at today's meeting, Mr Jeffrey LAM did not consider it necessary for the Panel to discuss the subject further or invite Mr CHENG again to attend a meeting of the Panel.

30. Mr James TO pointed out that a number of questions he raised at today's meeting were left unanswered, such as the question of how Mr Paul CHENG interpreted his advisory role with Deutsche Bank. As pointed out by Mr Simon HO, he was not in a position to respond to such questions on behalf of Mr CHENG. Hence, it was necessary to invite Mr CHENG again to attend a meeting of the Panel to clarify in person all the questions on the conflict of interest issue and other financial issues involved in and after the listing of The Link REIT.

31. Mr Abraham SHEK was of the view that how Mr Paul CHENG interpreted his advisory role with Deutsche Bank was not the crux of the matter. Mr SHEK believed that SFC and The Link would act in accordance with the relevant rules and regulations to guard against any conflict of interest involved in the listing of The Link REIT and operation of The Link. He did not appreciate the need for the Panel to insist on inviting Mr CHENG to attend a meeting of the Panel on the subject. Mr SHEK proposed that if individual members had any outstanding questions, they might set out the questions for Mr CHENG to respond in writing. The Panel might, after receiving Mr CHENG's written response, consider how the matter should be taken forward.

32. Ir Dr Raymond HO pointed out that in respect of Mr Paul CHENG's advisory role with Deutsche Bank, Mr CHENG clarified in his reply dated 22 March 2006 that Deutsche Bank had not consulted or informed him in regard to its acquisition of The Link REIT's units, and the Bank clarified in its letter dated 6 January 2006 that Mr CHENG did not have any role in advising Deutsche Bank on property related and/or REIT related matters. Ir Dr HO supported Mr Abraham SHEK's proposal

mentioned in paragraph 31 above. Mr James TIEN also supported Mr SHEK's proposal.

33. Mr James TO pointed out that despite the written responses provided by Mr Paul CHENG in December 2005 and March 2006, some questions on the conflict of interest issue still remained unanswered. Hence, the Panel should invite Mr CHENG again to attend a meeting of the Panel to clarify the questions in person. As Mr CHENG indicated in his reply dated 22 March 2006 that he was unable to attend today's meeting due to other commitments, another meeting should be scheduled for the Panel to follow up the issues concerned with Mr CHENG.

34. The Chairman suggested and members agreed that Mr James TO's proposal mentioned in paragraph 28 above be put to vote. Of the eleven members present, five members voted for and six members voted against the proposal. The Chairman declared that the proposal was not endorsed by the Panel.

35. Mr James TIEN considered that in line with Mr Abraham SHEK's proposal mentioned in paragraph 31 above, the Panel should follow up the subject by inviting Mr Paul CHENG to provide written response to any further questions from members. Mr CHENG's written response would then be issued to members for consideration on the need or otherwise for the Panel to have further discussion on the subject.

36. The Chairman suggested and members agreed that Mr James TIEN's proposal mentioned in paragraph 35 above be put to vote. Of the eleven members present, ten members voted for the proposal and one member abstained. The Chairman declared that the proposal was endorsed by the Panel. He concluded that members who had any questions for Mr Paul CHENG to respond in writing should forward the questions to the Clerk to Panel.

(Post-meeting note: The two letters dated 2 May 2006 from Mr James TO, one for Mr Paul CHENG and the other for HPLB and The Link to respond in writing, were forwarded to the parties concerned on 8 May 2006. The written responses from the three parties concerned together with Mr James TO's letters were circulated to members vide LC Paper No. CB(1)1627/05-06 on 30 May 2006.)

V. Regulation of market misconduct

(LC Paper No. CB(1)1179/05-06(06) — Letter dated 9 March 2006 from Hon SIN Chung-kai

LC Paper No. CB(1)1179/05-06(07) — Paper provided by the Securities and Futures Commission

LC Paper No. CB(1)1179/05-06(08) — Background brief prepared by the Legislative Council Secretariat)

Cases of alleged market misconduct under section 277 of the Securities and Futures Ordinance (SFO) (Cap. 571)

37. Mr SIN Chung-kai referred to two cases of public concern, one relating to a misleading statement made by the then Chairman of Melco International Development Limited in November 2004 resulting in fluctuations in the share price of the company and another relating to the error made by Pacific Century Insurance Holdings Limited in reporting its profits made for the first three quarters of 2005. Given the impact of such cases involving the announcements of incorrect or misleading information by listed companies on the public in particular the small investors, Mr SIN considered that SFC should disclose its follow-up actions and/or enforcement actions taken on such cases. Whilst appreciating that SFC and its employees were bound by the provision under section 378 of the SFO to preserve secrecy of any matters coming to their knowledge in performing the functions of SFC, Mr SIN considered that the transparency of SFC in the performance of its regulatory functions should be enhanced so as to enable LegCo Members and the public to monitor the work of SFC in handling cases of alleged market misconduct.

38. Mr Albert HO shared Mr SIN Chung-kai's views and concerns. Given that the two cases quoted by Mr SIN had aroused considerable public concern, SFC should disclose what actions it had taken on the cases so as to address the concern. Otherwise, the public would never know whether justice had been done in respect of the cases and other cases of alleged market misconduct. In this connection, Mr HO pointed out that while it was an established policy for the Administration not to disclose detailed reasons for prosecution decisions, the Secretary for Justice had in recent years briefed the LegCo on prosecution decisions on some cases of public concern. For example, the Secretary had briefed the LegCo Panel on Administration of Justice and Legal Services at its meeting on 3 February 2006 on the decision not to prosecute Mr Michael WONG Kin-chow, a retired High Court judge. Mr HO urged SFC to enhance the transparency of the actions it had taken and ensure the protection of the interests of small investors.

39. In reply, Mr Alan LINNING, the Executive Director (Enforcement) of SFC said that he was bound by the secrecy provision under section 378 of SFO not to comment on or disclose details of individual cases. Nevertheless, he assured members that SFC attached great importance to investor protection. Referring to the statistics

on the number of investigations conducted by SFC into possible cases of market misconduct set out in SFC's written reply to question 2 raised by Mr SIN Chung-kai before the meeting (LC Paper No. CB(1)1179/05-06(07)), Mr LINNING stressed that SFC would follow up alleged cases of market misconduct, irrespective of the persons/companies involved, and exercise its statutory powers to investigate the cases and/or take enforcement actions if there was sufficient evidence.

40. Noting the civil regime under section 277 of SFO on disclosure of false or misleading information inducing transactions, Mr James TIEN was concerned that the directors/spokepersons of listed companies might face a dilemma where they, after disclosing preliminary business information which was subject to confirmation according to the requirements under the listing rules, might be held liable under the civil regime under section 277 for any subsequent changes to the details of the information disclosed. In this connection, Mr TIEN enquired whether and how SFC, in conducting investigations and taking enforcement actions against possible breaches of section 277, could strike a proper balance between the need to protect the interests of the investing community, to facilitate the healthy development of the market as well as to relieve the concerns of directors/spokepersons of listed companies about their civil liability for disclosure of preliminary business information.

41. In response, Mr Alan LINNING pointed out that SFC had all along struck a balance between the relevant factors in exercising its investigatory and enforcement powers. Indeed, a high threshold had been set under SFO for instituting any civil or criminal proceedings. For the purpose of section 277 of SFO, it was necessary to prove that the information disclosed was likely to induce another person to subscribe for or buy or sell securities, which was in practice onerous to prove and might require expert evidence that could be challenged or contradicted at trial or in a Market Misconduct Tribunal (MMT) hearing. As far as he was aware, there was one single case of suspected market misconduct involving disclosure of false or misleading information which SFC had referred to FS for consideration of whether proceedings before MMT should be instituted. Responding to Mr James TIEN's further enquiry on the case involving a misleading statement made by the then Chairman of Melco International Development Limited in November 2004, Mr LINNING reiterated that he was bound by section 378 of SFO not to disclose information on the details of individual cases. He advised that in general, SFC would examine the relevant statements carefully in such cases.

42. Mr CHAN Kam-lam did not consider it desirable or appropriate for SFC to disclose information on individual cases of alleged market misconduct to the public during the investigation stage, as the disclosure might subject the parties being complained or investigated to public criticisms on unsubstantiated grounds.

Checks and balances mechanism

43. Noting that SFC's internal procedures were subject to the review and advice of the Process Review Panel (PRP), Mr SIN Chung-kai sought information on the terms of reference and operation of PRP, in particular, whether it had the power to review all enforcement or complaint cases handled by SFC.

44. Mr Alan LINNING explained that PRP was an independent, non-statutory panel established by the Chief Executive (CE) in November 2000 to review the internal operational procedures of SFC to ensure that the procedures were fair and reasonable, and to determine whether SFC had followed its internal procedures, including enforcement procedures. There was no restriction on the number and types of cases which PRP could review or give advice on. PRP might select any completed SFC cases for review. PRP comprised twelve members including nine members from the financial sector, academia, and the legal and accountancy professions, and three ex-officio members including the SFC Chairman, a non-executive director of SFC and a representative of the Secretary for Justice. PRP members met with representatives from the securities and futures industries, and received views and referrals from the industries on cases for review. Mr LINNING also pointed out that PRP was established to improve the transparency of SFC and to increase public confidence in the consistency and fairness in its work. Indeed, PRP operated with high degree of transparency. It reported to FS annually and those reports were made available to the public. In monitoring SFC's investigation work, PRP took into account the rights and interests of the parties concerned, including the parties under investigation and the public. Moreover, SFC's work was also subject to the scrutiny of the Independent Commission Against Corruption (ICAC) under the Prevention of Bribery Ordinance (Cap.201). ICAC regularly audited the work of SFC's divisions, including the Enforcement Division.

45. As a former member of PRP, the Chairman advised that PRP would consider the requests and referrals from the industries in selecting cases for review. However, PRP would not review cases being handled or investigated by SFC.

46. Mr Albert HO enquired whether SFC and its staff were bound by the secrecy provision under section 378 of SFO not to reveal details of individual cases to PRP; if not, whether PRP was permitted under the law to disclose the information obtained from SFC to the complainants and/or any interested members of the public. Mr HO was of the view that if PRP was not allowed to disclose information on cases it had reviewed to the complainants and the public, it could hardly serve the purpose of enhancing the transparency and accountability of SFC.

47. Mr Alan LINNING explained that while SFC and its staff could provide information on cases to PRP to facilitate its review, PRP could not readily divulge all the information to the public. In general, PRP could refer to the cases in its reports,

except details or facts of the cases, such as names of individuals or the companies concerned.

48. Referring to SFC's written reply to question 6 raised by Mr SIN Chung-kai before the meeting (LC Paper No. CB(1)1179/05-06(07)), Mr Abraham SHEK was concerned whether PRP had reviewed those cases which SFC had decided not to take any follow-up actions, investigations and/or enforcement actions; and if not, there was no way to ensure that complaints from small investors or the public had been handled by SFC properly and fairly.

49. Mr Alan LINNING said that PRP might review all completed cases involving the exercise of statutory powers of investigation, inquiry and prosecution for the purpose of verifying that the actions taken and decisions made in relation to the cases were consistent with the relevant internal procedures and operational guidelines. All external complaints were considered by the Complaints Control Committee (CCC) which decided whether or how a complaint should be dealt with, including whether there was prima facie evidence for the case, and whether it should be further examined or be discontinued. CCC was chaired by a senior member of SFC and comprised representatives of all operational divisions. SFC kept proper records of the minutes of CCC meetings and decisions made at these meetings were subject to review by PRP. The Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)¹ (PAS/FS1) explained that while PRP would not review cases in which actions were still in progress, it could review any completed or discontinued cases. Members of the public who wished to make suggestions to PRP on the cases to be reviewed might give their views to the Secretariat of PRP.

50. Mr Abraham SHEK requested the Administration and SFC to confirm in writing on whether PRP had the power to review the cases which SFC had decided not to take any follow-up actions, investigations and/or enforcement actions; if it had, to provide the number of such cases reviewed by PRP since its establishment in November 2000; and if not, to provide information on which party was responsible for reviewing SFC's decision on such cases.

51. Mr Albert HO and Mr SIN Chung-kai considered that the public concern on whether SFC had properly discharged its regulatory functions needed to be addressed. Mr HO said that he was not requesting SFC to disclose information on all cases at the initial stage of investigation. His major concern was to ensure adequate monitoring of SFC's investigation and enforcement work to inspire public confidence in SFC as an effective regulator. Referring to the error made by Pacific Century Insurance Holdings Limited in reporting its profits made for the first three quarters of 2005, Mr HO was gravely concerned that members of the public had no idea of whether and what investigation or enforcement actions had been taken by SFC, thus giving rise to queries on the impartiality and credibility of SFC. To enhance the transparency of SFC's decisions on not taking any follow-up actions, investigations and/or enforcement actions on certain cases of alleged market misconduct and to ensure the impartiality and credibility of such decisions, Mr HO requested the Administration to

improve the existing checks and balances mechanism by requiring all such cases be reviewed by an independent committee (e.g. PRP). He also suggested that the Administration should make reference to the Operations Review Committee appointed by CE to oversee the work of the investigative arm of ICAC.

52. Mr SIN Chung-kai supported Mr Albert HO's request and suggestion. He recalled that LegCo Members had raised similar concern during the scrutiny of the Securities and Futures Bill and at that time, representatives of the Administration had advised that the checks and balances mechanism could be reviewed in the light of the operational experience of PRP. Given that PRP had operated for a few years and that the public was concerned on whether and what actions had been taken on cases of alleged market misconduct, Mr SIN urged that the Administration should examine measures to improve the existing mechanism. The Chairman shared Mr SIN's view and requested the Administration to provide written response to the Panel on the suggestions of Mr HO and Mr SIN.

53. PAS/FS1 pointed out that PRP was tasked to review and advise SFC on the adequacy of the SFC's internal procedures and operational guidelines governing the actions taken and operational decisions made by SFC and its staff in the performance of its regulatory functions. PRP was empowered to review all completed or discontinued cases and complaints received or referred to SFC, including cases which SFC had decided not to take further actions on. Nevertheless, she noted members' concerns and undertook to provide written responses to the Panel as requested.

(Post-meeting note: The written response of the Administration and SFC on members' requests mentioned in paragraphs 50, 51 and 52 above was circulated to members vide LC Paper No. CB(1)1376/05-06(01) on 2 May 2006.)

Communication with complainants

54. Mr CHAN Kam-lam was of the view that SFC should inform the complainants of whether and what actions had been taken in respect of their complaints, including the cases where CCC had decided not to deal with the complaints. In this connection, Mr CHAN enquired whether SFC would approach the complainants for further information or evidence relating to the subjects of complaints and whether the complainants would be informed of the actions taken by SFC.

55. Mr Alan LINNING assured members that there were well-established procedures for SFC to follow in handling complaints, including guidelines on providing timely and regular updates to complainants on the progress of their complaints. These internal procedures of SFC were also subject to review and advice of PRP. In fact, PRP had commented that the incorporation of procedures for communication with complainants was a good practice for SFC to uphold. Mr LINNING also advised that it was quite common for the operational divisions of

SFC to communicate with the complainants for clarification or further information on the subjects of complaints.

Investors' claim for compensation

56. Mr Albert HO expressed concern about the assistance available to small investors to claim compensation for loss incurred from transactions induced by false or misleading information. Miss TAM Heung-man expressed similar concern. In this connection, Miss TAM enquired whether the Administration would consider putting in place a mechanism to provide financial assistance to small investors in taking collective litigation to seek remedies from any wrongdoers in cases of market misconduct.

57. Mr Alan LINNING said that small investors could take some form of derivative actions under the law provided that there was substantiated evidence for their cases. PAS/FS1 advised that the relevant provisions in the Companies (Amendment) Ordinance 2004 had significantly enhanced shareholders' remedies, including allowing minority shareholders to bring statutory derivative actions on behalf of the company against wrongdoers in relation to the company. She also pointed out that the Administration and the SFC had previously conducted public consultation on the proposal for empowering SFC to initiate, out of its own resources, a derivative action on behalf of shareholders. Nevertheless, public views were divided on whether it was appropriate to expand public resources on private commercial disputes. The proposal had therefore not been pursued after the public consultation. However, the Administration would be prepared to keep the issue under review in the light of the enhanced remedies available under the Companies (Amendment) Ordinance 2004, where necessary.

Conclusion

58. Mr SIN Chung-kai remained concerned about the need for SFC to disclose information of its actions taken on cases of alleged market misconduct. Whilst appreciating the purpose of the secrecy provision under section 378 of SFO, Mr SIN pointed out that the lack of transparency in SFC's decisions and follow-up actions had aroused considerable public concern, resulting in queries on whether SFC had discharged its regulatory functions in a proper and fair manner. Mr SIN suggested that the Panel might refer the two cases mentioned in paragraph 37 above to PRP for review. Given the small number of members present at that point in time, the Chairman suggested that Mr SIN might refer the two cases to PRP in his personal capacity. Mr SIN agreed to consider the suggestion.

VI. Any other business

59. There being no other business, the meeting ended at 1:05 pm.

Council Business Division 1
Legislative Council Secretariat
2 June 2006