

立法會
Legislative Council

LC Paper No. CB(1)1725/09-10

(These minutes have been seen
by the Administration)

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Panel on Financial Affairs

**Minutes of meeting
held on Monday, 1 March 2010 at 10:00 am
in the Chamber of the Legislative Council Building**

Members present : Hon CHAN Kam-lam, SBS, JP (Chairman)
Hon Ronny TONG Ka-wah, SC (Deputy Chairman)
Hon Albert HO Chun-yan
Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP
Dr Hon David LI Kwok-po, GBM, GBS, JP
Hon James TO Kun-sun
Hon Emily LAU Wai-hing, JP
Hon Abraham SHEK Lai-him, SBS, JP
Hon Vincent FANG kang, SBS, JP
Hon Jeffrey LAM Kin-fung, SBS, JP
Hon Andrew LEUNG Kwan-yuen, SBS, JP
Hon WONG Ting-kwong, BBS, JP
Hon KAM Nai-wai, MH
Hon Starry LEE Wai-king
Dr Hon LAM Tai-fai, BBS, JP
Hon Paul CHAN Mo-po, MH, JP
Hon CHAN Kin-por, JP
Hon Mrs Regina IP LAU Suk-ye, GBS, JP

Members absent : Dr Hon Philip WONG Yu-hong, GBS
Hon CHIM Pui-chung

**Public officers
attending** : Agenda Items IV, V and VI

Mr CHENG Yan-chee, JP
Deputy Secretary for Financial Services and the Treasury
(Financial Services)

Agenda Item IV

Prof K C CHAN, SBS, JP
Secretary for Financial Services and the Treasury

Ms Julia LEUNG, JP
Under Secretary for Financial Services and the Treasury

Ms Karen Deborah KEMP
Executive Director (Banking Policy)
Hong Kong Monetary Authority

Agenda Item VII

Mr John LEUNG, JP
Deputy Secretary for Financial Services and the Treasury
(Financial Services)

Miss Grace KWOK
Principal Assistant Secretary for Financial Services and
the Treasury (Financial Services)

Ms Phyllis POON
Assistant Secretary for Financial Services and the
Treasury (Financial Services)

Attendance by invitation : Agenda Item IV

Mrs Ivy LAI
Director, External Relations
Securities and Futures Commission

Agenda Item V

Mr Paul KENNEDY
Executive Director and Chief Operating Officer
Securities and Futures Commission

Agenda Item VI

Mr Keith LUI
Executive Director, Supervision of Markets
Securities and Futures Commission

Mr Rico LEUNG
Senior Director, Supervision of Markets
Securities and Futures Commission

Mr Eric YIP
Head, Cash Market Department
Hong Kong Exchanges and Clearing Limited

Mr Vincent KWAN
Director and General Manager
Hang Seng Indexes Company Limited

Ms Anita MO
Director and Head of Index Business
Hang Seng Indexes Company Limited

Clerk in attendance: Ms Anita SIT
Chief Council Secretary (1)5

Staff in attendance : Mr Noel SUNG
Senior Council Secretary (1)4

Mr Fred PANG
Council Secretary (1)5

Ms Haley CHEUNG
Legislative Assistant (1)8

Action

I Confirmation of minutes of meeting and matters arising

(LC Paper No. CB(1)1151/09-10 — Minutes of the special meeting on
14 December 2009

LC Paper No. CB(1)1152/09-10 — Minutes of the meeting on
4 January 2010)

The minutes of the meetings held on 14 December 2009 and 4 January 2010 were confirmed.

II Information papers issued since the last meeting

(LC Paper No. CB(1)1122/09-10(01) — Hong Kong Mortgage Corporation's presentation materials tabled at the briefing during the visit of the Panel on Financial Affairs on 8 February 2010

LC Paper No. CB(1)1181/09-10(01) — Letter from Hong Kong Unison Limited (HKUL) dated 10 February 2010 expressing concern about ethnic-Pakistani residents being refused to establish bank accounts, with the letters from the organization to the Hong Kong Monetary Authority (HKMA) and the Hang Seng Bank

LC Papers No. CB(1)1181/09-10(02) and (03) — Replies of HKMA and Hang Seng Bank to HKUL's letter dated 10 February 2010)

2. Members noted the information papers issued since the last regular meeting on 1 February 2010.

III Date of next meeting and items for discussion

(LC Paper No. CB(1)1169/09-10(01) — List of outstanding items for discussion

LC Paper No. CB(1)1169/09-10(02) — List of follow-up actions)

Difficulties in opening bank accounts experienced by ethnic minority groups

3. With reference to the letter from the Hong Kong Unison Limited (HKUL)'s concerning the difficulties experienced by ethnic Pakistani residents in opening bank accounts, Ms Emily LAU suggested and members agreed that as the Equal Opportunities Commission (EOC) was investigating into the matter, the Commission should be requested to provide the Panel with a copy of its investigation report when it was available, so that members might decide whether the Panel should

further discuss the issue. The Hong Kong Monetary Authority (HKMA) should also be requested to provide necessary assistance to EOC in its investigation. The relevant bank(s) should be informed that EOC had been requested to keep the Panel informed of the progress of its investigation.

(Post-meeting note: With the concurrence of the Panel Chairman, the Clerk had written to the EOC on 8 March 2010 requesting the Commission to keep the Panel informed of the progress of its investigation into the matter. By copy of the letter, the HKMA was also requested to provide necessary assistance to EOC in its investigation. The HKUL, the Hong Kong Association of Banks and the Hang Seng Bank were informed of the Panel members' concern on the matter. A copy of EOC's reply to the HKUL dated 25 February 2010 was circulated to members vide LC Paper No. CB(1)1326/09-10 on 9 March 2010.)

Hong Kong Mortgage Corporation Limited

4. Referring to the Panel's visit to the Hong Kong Mortgage Corporation (HKMC) on 8 February 2010, Mrs Regina IP said that pursuant to the discussion held during the visit, she would like to request HKMC to furnish the Panel with the following information -

- (a) the business projections for HKMC conducted by the HKMA prior to the establishment of HKMC, and how the actual business situation of HKMC compared with those projections; and
- (b) whether HKMC would consider providing reverse mortgage service, and if so, details of the relevant work plan.

(Post-meeting note: The Administration's response was circulated to members vide LC Paper No. CB(1)1462/09-10(02) on 25 March 2010.)

Legislative proposals to enhance the anti-money laundering regulatory regime in respect of the financial sectors

5. Noting that the Administration had completed the public consultation on the legislative proposals to enhance the anti-money laundering regulatory regime in respect of the financial sectors, Mr Albert HO and Ms Emily LAU proposed that the Panel held a hearing to receive views on the subject. The Chairman said that the Clerk would liaise with the Administration to seek more information on the updated status and work plan regarding the subject so that the Panel could consider the appropriate timing for holding a public hearing.

(Post-meeting note: The Administration had provided relevant information which was issued to members vide LC Paper No. CB(1)1465/09-10(01) on 25 March 2010.

Meeting in April 2010

6. Members agreed to discuss the following items proposed by the Administration for the next regular meeting scheduled for 8 April 2010 –

- (a) Companies Ordinance Rewrite; and
- (b) Briefing on the work of the Financial Reporting Council.

IV Proposed establishment of an Investor Education Council and a Financial Dispute Resolution Centre

(LC Paper No. CB(1)1213/09-10(01) — Administration's paper on proposed establishment of an Investor Education Council and a Financial Dispute Resolution Centre

LC Paper No. CB(1)1127/09-10(01) — Administration's consultation paper on the proposals to establish an Investor Education Council and a Financial Dispute Resolution Centre

IN15/09-10 — Information note on financial ombudsman system in the United Kingdom

IN16/09-10 — Information note on securities arbitration in the United States)

Briefing by the Administration

7. The Secretary for Financial Services and the Treasury (SFST) briefed members, through a Powerpoint presentation, on the proposals for the establishment of an Investor Education Council (IEC) and a Financial Dispute Resolution Centre (FDRC).

(Post-meeting note: The notes of the Powerpoint presentation (LC Paper No. CB(1)1284/09-10(01)) were issued to members vide a Lotus Notes e-mail on 1 March 2010.)

Financial Dispute Resolution Centre

8. Mr KAM Nai-wai opined that the proposed FDRC would not be able to resolve disputes like those arising from the Lehman Brothers Minibonds Incident, as the FDRC would not have any investigation or disciplinary powers, and would only

deal with monetary disputes. He recalled that in its report on the Lehman Brothers Minibonds Incident submitted to the Administration in December 2008, the Securities and Futures Commission (SFC) had recommended that the Commission be empowered to investigate into similar incidents and be given the authority to order payment of compensation to investors by those financial institutions which were found to have breached the relevant regulations. Mr KAM pointed out that out of the over 20 000 complaints relating to the Lehman Brothers Minibonds Incident, only about 80 cases had been resolved by the mediation service provided by the Hong Kong International Arbitration Centre, as the majority of the complainants were concerned that the mediators did not have investigation powers. Mr KAM enquired why, given the experience gained in the Lehman Brothers Minibonds Incident, the Administration did not pursue the recommendation of empowering the regulators to order compensation.

9. SFST responded that both the Hong Kong Monetary Authority (HKMA) and SFC had suggested the Government consider setting up a financial dispute resolution scheme, which could bridge the gap of the existing system. Currently the regulatory regime did not provide for resolution of monetary disputes. Under the proposal, all financial institutions regulated or licensed by HKMA or SFC (i.e. banks, brokers, fund houses, etc.) would be required to join the financial dispute resolution scheme as members. When a monetary dispute arose, upon the claimant's application, the FDRC could require a scheme member to enter into mediation with the claimant concerned and, if mediation was unsuccessful, the FDRC would assist the claimant to bring the case further to arbitration if the claimant so wished. Such an arrangement would bring great improvement to the existing regulatory regime. As regards systemic issues with a scale like the Lehman Brothers Minibonds Incident, the existing legislation had already empowered the regulators to conduct investigation and enter into agreement where it considered appropriate to do so in the interest of the investing public or in the public interest.

10. Mr KAM Nai-wai asked whether the Government would consider empowering the regulatory bodies to impose fines and order compensation. Mr Albert HO shared Mr KAM's concern.

11. SFST responded that the Lehman Brothers Minibonds Incident had demonstrated that the existing legislation had provided adequate powers for HKMA and SFC to deal with systemic issues. Whether the regulatory bodies should be empowered to impose fines and order compensation should be considered carefully, and in the context of the overall regulatory regime for the financial and banking sectors.

12. Mr Albert HO enquired about the difference and working relationship between the proposed FDRC and the existing dispute resolution channels, such as courts and tribunals. Mr HO also asked whether the Administration would consider setting up a financial services ombudsman with the authority to impose penalties and order compensation.

13. SFST responded that the proposed FDRC would be similar in nature as a financial ombudsman scheme in other countries, such as the United Kingdom (UK) and Australia, despite the different names. In essence, a financial ombudsman scheme obligated financial institutions to mediation and, failing which, adjudication. The powers of these overseas ombudsmen were no different from those of the proposed FDRC. For instance, the Financial Ombudsman Service (FOS) in the UK only had the power to collect information but did not have the power to conduct investigation like the UK financial regulator, the Financial Services Authority. SFST stressed that it was necessary to have a clear demarcation between the roles of the regulators and the FDRC, in order to avoid confusion and duplication of work. The existing regulatory bodies, namely the HKMA and SFC, would continue to perform their roles in regulating the financial and banking sectors after the setting up of the FDRC. SFST further said that the FDRC would help to resolve monetary disputes without going through court proceedings which would take time and could be costly, and might not be to the best interest of investors.

14. Mr James TO enquired whether the FDRC would only handle purely monetary disputes, or it would also handle cases involving both monetary disputes and regulatory breaches. He pointed out that based on the experience in the Lehman Brothers Minibonds Incident, most of the monetary disputes involved allegations of regulatory breaches. He doubted, in view of the lack of investigative power of the FDRC and the disparity of the amount of information possessed by the claimant and the financial institution concerned, whether the FDRC could resolve the monetary disputes in a fair manner. He was also concerned that as a result of the mediation/arbitration conducted by the FDRC, many regulatory breach cases would not be revealed.

15. SFST responded that the existing avenues of complaints would continue to be available after the FDRC had come into operation. The claimants might decide whether to request for mediation by the FDRC or lodge a complaint with the regulators, or pursue both courses of action to seek remedy. SFST pointed out that monetary disputes might not necessarily involve breaches of regulations.

16. Given his experience in the mediation project in the insurance field, Mr CHAN Kin-por commented that the proposed establishment of a FDRC was a move in the right direction. Noting that financial institutions had to pay a higher fee than claimants in the mediation/arbitration process, he expressed concern that the service of the FDRC might be abused, as some claimants might seek mediation and/or arbitration even in unjustifiable cases. The financial institutions concerned might incur substantial extra expenses in responding to such unjustifiable cases.

17. SFST responded that under the current proposal, the FDRC service would be offered at a charge to both claimants and financial institutions. While a higher fee would be charged for financial institutions in order to incentivize them to resolve the disputes at an early stage, the claimants would also be required to pay a fee, which should, to a certain extent, prevent abuse on the use of the FDRC service. The intake

officers of the FDRC would conduct initial assessment and would have the discretion not to process a case where the claim appeared to be frivolous and vexatious.

18. While supporting in principle the establishment of the FDRC, Mr Paul CHAN opined that the maximum claimable amount under the financial dispute resolution scheme should be set at a considerably higher level than \$500,000, as many investors with investments under dispute way above \$500,000 would still find the costs of litigation for seeking compensation from financial institutions too high and disproportionate to their investments.

19. In response, SFST said that the FDRC was meant to provide a speedy, simple and affordable way to resolve monetary disputes, and the proposed maximum claimable amount of \$500,000 was set having regard to the fact that it was expected to cover more than 80% of the monetary disputes received by HKMA. Disputes involving more substantive claim amounts might not be appropriate to be processed by the relatively simple procedure of the FDRC.

20. Mr Paul CHAN maintained that the proposed maximum claimable amount of \$500,000 was too low to cater for the need of many investors for an alternative dispute resolution channel other than the traditional court adjudication. He suggested that a higher fee could be charged on claimants with claimable amounts above \$500,000. SFST responded that the FDRC might review the ceiling of \$500,000 after it had operated for some time. The Chairman said that as the proposal was still under public consultation, the Administration should consider whether a higher maximum claimable amount should be adopted when FDRC started operation instead of only undertaking to consider the issue in a future review.

21. Ms Starry LEE opined that the scope of the proposed financial dispute resolution scheme was too limited, as it covered only the financial institutions which were licensed or regulated by HKMA and SFC. She asked whether the licence of a financial institution would be affected if the institution was involved in many monetary disputes.

22. SFST responded that the FDRC and the regulatory authorities would enter into Memoranda of Understanding to clearly spell out their working relationship. For instance, the FDRC might, based on its handling of different types of monetary disputes, make recommendations and transfer information to the regulatory bodies for the latter to enhance regulation.

Investor Education Council

23. Mrs Regina IP was of the view that public officers had not been clearly articulating the risks associated with structured products. She expressed concern whether, in view of the close relationship between the IEC and SFC and/or the relevant government Bureau, the IEC would be able to provide clear and concrete advice to investors regarding structured products. Mrs IP was also concerned that

after the IEC had been established, HKMA, SFC and the financial institutions concerned would shirk their responsibility of offering advice to investors on the risks of the financial products offered in the market, and refer all enquiries to the IEC. Mrs IP opined that if the IEC would not render advice on the risk involved in individual financial products, it would not be performing its function in assisting the investing public in better understanding the risks involved in their investments.

24. SFST responded that the relevant financial regulators and the financial institutions concerned would still have to shoulder their responsibility for educating or alerting investors the risks involved in financial products, even after the establishment of the IEC. HKMA and SFC had been taking steps to improve the regulation of the sale of retail investment products, and SFC had also stepped up its efforts on investor education. That said, SFST stressed that given the development of the financial market and the emergence of new and varied financial products, the Government considered it appropriate to establish the IEC to holistically oversee the needs of investor education and delivery of related initiatives, covering subjects such as enhancing general financial literacy and investors' awareness of risk management. The IEC would not offer investment advice regarding individual financial products. The financial institutions concerned would still be responsible for explaining to their customers regarding the risks of the financial products. Investors might also seek advice from their personal financial advisers regarding the investment in particular financial products. SFST said that the IEC Board would be chaired by a Non-Executive Director of SFC and comprise representatives from and experts in the relevant fields.

25. Dr LAM Tai-fai remarked that the majority of Hong Kong people had participated in the investment market, including extremely experienced or totally inexperienced investors, and there was a wide variety of investment products in the market. He enquired about the target group(s) of investors for the investor education or advice provided by the proposed IEC and expressed concern that such education would be too superficial or over-simplified to meet the genuine needs of investors.

26. SFST responded that the IEC would aim to improve the financial literacy and capability of the general public and at the same time offer tailor-made programmes to suit the needs of different communities. The Director, External Relations, SFC (D(ER)/SFC) supplemented that the IEC would conduct a survey to gauge the financial literacy of the general public. Different strategies would be pursued to improve the financial literacy of different groups of investors, including regular and mass media campaigns to reach large audiences, sustainable and tailored outreach programmes for different sectors of the community, and a website for the young, more educated and independent investors to get access to comprehensive and impartial investor education information. The IEC would target general retail investors in its work rather than institutional investors. SFST added that in proposing the establishment of the IEC, the Government had made reference to the relevant arrangements in overseas countries; the IEC would also adjust its strategy where necessary after gaining more implementation experience.

27. While supporting in principle the establishment of the IEC and noting that the Chairman of the IEC Board would be a non-executive director of SFC, Mr Paul CHAN asked whether the chairman of the IEC Board would be an independent director, and whether the IEC Board would include a representative of the Consumer Council as its member.

28. SFST responded that the SFC Board would recommend to the Financial Secretary an independent non-executive director of SFC as the Chairman of the IEC Board. Membership of the IEC Board would comprise representatives from the regulators. Representative(s) of the Consumer Council and independent experts in the relevant fields would serve on the advisory groups of the Board.

29. Mr WONG Ting-kwong doubted the need of establishing a separate body to take charge of investor education. As SFC had all along been carrying out investor education work, he considered it more appropriate to set up a separate department within SFC to continue the work. The Lehman Brothers Minibonds Incident revealed that the crux of the problem lied in the malpractices of financial institutions in their sale of structured products. He was of the view that the Government and the regulators should step up measures against mis-selling of structured products rather than setting up a new IEC. Where necessary, the Securities and Futures Ordinance (Cap. 571) could be amended to enable SFC to take up all the work related to investor education, so that the regulatory structure would not become too cumbersome.

30. In response, SFST remarked that the Government and the regulators had been stepping up regulation of the sale of retail investment products. On investor education, SFC under the Securities and Futures Ordinance (Cap. 571) could cover the securities and futures sector only. In the light of market development and for investor protection, the Government considered it necessary to set up an IEC to holistically oversee the work of investor education. The IEC would focus on enhancing investors' capability in risk management in investing, rather than advising investors on the selection of financial products for investment. The IEC would be staffed by 10-odd staff only.

31. The Chairman requested and the Administration agreed to revert to the Panel on the outcome of the public consultation and the finalized proposals in due course.

V. Budget of the Securities and Futures Commission for the financial year of 2010-2011

(LC Paper No. CB(1)1213/09-10(02) — Administration's paper on Securities and Futures Commission Budget for the Financial Year 2010-11

LC Paper No. CB(1)1225/09-10 — Background brief on the annual budgets of the Securities and Futures Commission prepared by the Legislative Council Secretariat)

Declaration of interest

32. The Chairman declared interest that he was a non-executive director of the SFC.

Briefing by the Administration

33. The Deputy Secretary for Financial Services and the Treasury (Financial Services), (DS(FS)) briefed members on the budget of SFC for 2010-11 by highlighting the salient points in the paper.

Reserves and investment

34. Mrs Regina IP expressed concern that the reserves of SFC had reached about \$6 billion as at end of 2009, and the investment return of the reserves was only about 2%. She enquired whether SFC would review the investment strategy for its reserves. Mr CHAN Kin-por shared Mrs IP's concern and asked whether, similar to the arrangement for the investment of the fiscal reserves, HKMA would be asked to manage the investment of SFC's reserves and make a fee payment to SFC each year.

35. Mr Paul Kennedy, the Executive Director and Chief Operating Officer, Securities and Futures Commission (ED&COO/SFC) responded that the reserves had been accumulated over a long period of time and every year SFC would discuss with the Financial Services and the Treasury Bureau (FSTB) regarding the size of the reserves and whether there was a need to adjust the transaction levy. Having regard to the size of the reserves, SFC proposed a 25% reduction in levy rates with effect from 1 October 2010, and would continue to review the arrangement every year. As regards the investment strategy for the reserves, SFC regularly reviewed the options for the investment and usage of the reserves. Part of the reserves had been used to finance the Investor Compensation Fund, and would be used to fund the proposed Investor Education Council and Financial Dispute Resolution Centre. The possibility of using the reserves to make investments in property was also being considered. Based on an agreement reached with the Government more than 10 years ago, SFC could only invest in securities with high credit rating. SFC was discussing with FSTB regarding the investment arrangements for the reserves. Since SFC was an independent statutory body, the option of placing investments with HKMA was not open to it.

Staff and operating expenses

36. Noting that there was a 13.4% (\$74.88 million) increase in personnel expenses and a 9.1% (\$7.54 million) increase in premises expenses for 2010-2011,

Ms Emily LAU said that SFC should provide justifications for the increases. She enquired whether the proposed increase of 51 posts would enhance the corporate governance of SFC, and would help improve the efficiency in the investigation of the complaints relating to the Lehman Brothers-related minibonds. Ms LAU also enquired whether the inclusion of a provision of \$2.5 million as a "strategic adjustment" provision had been endorsed by the Board of SFC.

37. In response, ED&COO/SFC explained that the SFC budget had been vetted by the relevant committees and endorsed by the Board of SFC. SFC had experienced difficulties in recruiting suitable candidates to fill the existing 41 vacancies. 50% of the new recruits in 2009 had a pay cut, and another 10% of the new recruits had their salaries frozen. There was a 21% decline rate in SFC's recruitment exercises in 2009. The average lead time of 4.7 months (6.2 months in 2008) for filling vacancies at the executive level was still long, and in some areas the lead time for filling the vacancies was as long as seven to nine months. The current staff turnover rate was about 6% and the rate had once reached as high as 11% during the prime years. Even when the new 51 posts were approved, SFC might have difficulty in recruiting staff. According to an independent consultant report presented to the Remuneration Committee of SFC, there were a significant number of high performing staff in SFC who were remunerated well below or just at market rate. He had great reservations that SFC would be able to recruit suitable staff to fill all the existing vacancies, projected vacancies resulting from staff turnover and the proposed new posts (a total of 138 posts) in 2010-11. ED&COO/SFC further pointed out that out of the 51 posts proposed for 2010-11, 41% were at the junior levels, as SFC continued its long-term strategy of trying to reshape the staffing structure and increase the relative percentage of junior staff. This strategy was necessary for several reasons, including the development of an in-house pipeline of staff to fill senior vacancies as they arose, provision of a structured career path for SFC staff, as well as development of process efficiencies enabling senior personnel, where appropriate, to delegate more tasks to junior personnel. While there was an increase of 9% in headcount for 2010-2011, the increase in personnel expenses was only about 8%.

38. Mr CHAN Kin-por queried that if there were posts not filled for more than a year and the work had been absorbed by other officers, such vacant posts might not be necessary and thus could be deleted. He enquired about the procedures for assessing the manpower requirements of SFC and the need for the proposed additional headcount.

39. ED&COO/SFC responded that the vacant posts arose in different divisions at different times, and since there was a long lead time for recruitment of staff to fill the posts, the overall vacancy situation remained serious. The posts could not be deleted as they were required for SFC to perform its statutory functions. The overall manpower arrangement of SFC was subject to scrutiny by an external auditor. SFC's internal audit also reviewed expenditure based on a three year rotation audit programme, and the auditing work was overseen by the Audit Committee. DS(FS) supplemented that under section 13(2) of the Securities and Futures Ordinance (Cap. 571) (SFO), SFC was required to submit the estimates of its income and expenditure

(the budget) for each financial year to the Chief Executive for approval. The Chief Executive had delegated the authority to the Financial Secretary. FSTB had examined SFC's proposed budget for 2010-2011 and accepted the justifications for the proposals. Subject to members' views, the budget would be submitted to the Financial Secretary for approval. The Administration noted the vacancy situation of SFC and its difficulty in recruitment of staff, especially when the economy had gradually recovered. Efforts would be made by SFC to fill the vacancies.

40. Noting that SFC had difficulty in recruitment of staff, Mrs Regina IP asked about the types of posts involved. She remarked that since many investment banks had laid off their staff during the global financial crisis, SFC should not have encountered much difficulty in filling the staff vacancies, especially if the vacancies were of the junior ranks.

41. Ms Emily LAU opined that SFC should enjoy an edge over the private sector in recruitment of staff, as SFC provided greater job security. She asked whether SFC had reviewed its personnel management strategy with a view to retaining and recruiting the most suitable personnel to perform its functions.

42. ED&COO/SFC responded that most of the laid off banking staff were traders who were not the type of staff sought after by SFC. As the economy started to pick up and the financial sector started to recruit staff again focusing on regulatory compliance and regulatory changes, SFC had to compete with the relevant financial institutions for personnel with experience in financial regulatory work. Most vacancies of SFC occurred at the manager and senior manager levels, and SFC's strategy was to build up a bigger pipeline of the junior managerial grade staff in order to meet the manpower requirements at the middle management level. SFC had an effective performance appraisal and performance related remuneration system to ensure that capable staff were suitably rewarded and retained. The Board of SFC was closely monitoring the manpower situation and the remuneration packages for staff at different levels. The proposed budget, including the staffing proposals, had been vetted and endorsed by the relevant committees and the Board of SFC.

Variable pay

43. Mr Albert HO enquired about the ratio of the variable pay to the fixed pay for the senior executives of SFC, the criteria for granting variable pay to senior executives of SFC, whether there was any benchmark for assessing the performance of staff, and who was responsible for assessing the performance of the divisional heads and the Executive Director. Mr HO further asked whether other statutory bodies adopted the same system in assessing staff performance and the granting of variable pay.

44. ED&COO/SFC responded that the arrangement of splitting the remuneration of SFC staff into two components, i.e. fixed pay and variable pay, was a human resource management tool to drive staff performance, as the variable pay component was performance related. Hence staff in the same salary band might receive different variable pay, depending on their performance. The variable pay component constituted about 9% to 25% of the pay packages for junior and senior staff respectively. The staff's performance was assessed by their immediate supervisors based on a five-grade assessment system, and the performance of the Chief Executive Officer was assessed by the Remuneration Committee based on a self-assessment report prepared by the officer concerned. The Chairman added that some statutory bodies, such as the Urban Renewal Authority, also adopted a similar performance appraisal and variable pay system.

Staff attachment arrangements

45. Mrs Regina IP opined that arrangements should be made for officers of FSTB to be attached to SFC, in order to enhance the government officers' experience in market regulatory work.

46. ED&COO/SFC responded that arrangements had been made for a Senior Manager of SFC to be seconded to FSTB on a rotation basis so as to enhance co-operation between SFC and the Bureau. Consideration was being given to arranging an Administrative Officer to be seconded to SFC, although the officer might not necessarily come from FSTB.

Derivative actions

47. At the request of Mr Albert HO, ED&COO/SFC would provide information as to whether SFC had the power to initiate a derivative action on behalf of a company, and if so, whether there were such cases, the amount of relevant expenditure incurred in the past and the provision for derivative actions in 2010-11.

(Post-meeting note: The Administration's response was circulated to members vide LC Paper No. CB(1)1462/09-10(01) on 25 March 2010.)

VI Suspension of dissemination of Hang Seng family of indexes on 22 January 2010

(LC Paper No. CB(1)1153/09-10(01) — Securities and Futures Commission's paper on suspension of dissemination of Hang Seng family of indices on 22 January 2010)

48. Mr Keith LUI, Executive Director, Supervision of Markets, Securities and Futures Commission (ED(SM)/SFC) briefed members on the incident on suspension of dissemination of Hang Seng family of indexes on 22 January 2010, and the contingency measures taken on the day concerned. Mr Vincent KWAN, Director and General Manager, Hang Seng Indexes Company Limited (D&GM/HSIL) further briefed members on the investigation and remedial actions taken after the incident, by highlighting the salient points in the paper.

49. Mr James TO declared interest that he was holding a small number of shares of Hang Seng Bank. He asked whether similar incidents had occurred before in Hong Kong. Mr Jeffrey LAM enquired whether similar suspension of services had occurred in other overseas markets, and the remedial actions taken to rectify the systems. Given the rapid development of technology and the need to protect the integrity of the Hang Seng Index system, Mr LAM further asked about the measures taken to prevent hacking of the real time index (RTI) system, and whether an overall review of the system would be conducted on a regularly basis. Mr Andrew LEUNG echoed Mr LAM's concern and enquired whether HSIL had information about the number of hacking attempts on the Hang Seng Index system in the past, and whether HSIL was confident that its anti-hacking measures were adequate and effective to guard against attempts to hack the Hang Seng Index system.

50. D&GM/HSIL responded that the incident on 22 January 2010 was caused by a rare incoming message sequence which the system application, using a parallel handling process, had not previously encountered or foreseen. After matching with the HKEx's transaction data, HSIL found that the "out-of-sequence (OFS) event" occurred on 22 January 2010 was not caused by erroneous data being fed into the system, or intrusion by hackers. D&GM/HSIL stressed that the RTI system was protected with firewalls against hacking, based on the latest safety technology, although no information was available as to whether and how many times the system had been attacked by hackers. He further emphasized that over the years, HSIL had provided reliable and accurate services in dissemination of the Hang Seng family of indexes. After the incident on 22 January 2010, HSIL had undertaken a comprehensive review of the system and had taken immediate remedial actions to improve the system to prevent recurrences of the incident. A working group had been set up within HSIL to regularly review and improve the installations and procedures so as to ensure the reliability and accuracy of the system. D&GM/HSIL also pointed out that for the sake of protecting the integrity of their relevant index

systems, overseas stock markets might not be prepared to provide detailed information about their systems.

51. Mr James TO referred to paragraph 4 of the Incident Report provided by HSIL regarding the root cause of the incident, and raised queries on whether there was the possibility that the incident on 22 January 2010 could be attributable to malicious human acts, such as inputting erroneous data into the system, by a begrudged HKEx or HSIL staff member. He requested HSIL to investigate the incident in this direction. D&GM/HSIL responded that immediately after the incident on 22 January 2010, HSIL had conducted a comprehensive checking and review of the RTI system and the contingency arrangements. The "matching indicator" was found to operate normally on the day of the incident. Mr James TO requested the Administration and HSIL to provide a written confirmation to address his concern after the meeting.

(Post-meeting note: The Administration's response was circulated to members vide LC Paper No. CB(1)1462/09-10(01) on 25 March 2010.)

52. Mr James TO further asked whether the RTI system could be improved so that even when an OFS event occurred, the programme would continue to function by "by-passing" the OFS event, and process the data delivered to HSIL after the OFS event through the Market Data Feed (MDF).

53. D&GM/HSIL responded that measures had been taken to further improve the system and contingency arrangements, including the provision of an additional back-up facility to the system so as to prevent future occurrences of service interruption. Consideration would also be given to further improving the RTI system so that it could continue to function despite the occurrence of an OFS event, and keep on updating the price table of the Hang Seng family of indexes at 15-second intervals based on the transaction data delivered through MDF. While pointing out that the process for collecting and sorting the transaction data for updating the price table for all constituent stocks was complex, involving huge amount of data and screening of dubious data, he assured members that HSIL would continue to do its best to ensure reliability of its services.

54. Mrs Regina IP remarked that based on the advice of some information technology (IT) experts, including university lecturers in the relevant field, the failure of the computer system to disseminate the Hang Seng Index information on 22 January 2010 for about 30 minutes was unacceptable. Mrs IP opined that SFC, the Hong Kong Exchanges and Clearing Limited (HKEx) and HSIL should liaise with the experts who were willing to offer free advice on measures to improve the system and prevent recurrences of service interruption. Mr James TO echoed Mrs IP's view. The Chairman shared Mrs IP and Mr TO's view and remarked that HSIL should liaise with Mrs Regina IP and Mr James TO to arrange meetings with their contacts in the IT field, with a view to drawing up measures to further improve the RTI system and prevent the recurrence of the OFS event.

VII Review of the Trustee Ordinance and related matters

(LC Paper No. CB(1)1213/09-10(03) — Administration's consultation conclusions on review of the Trustee Ordinance and related matters

LC Paper No. CB(1)1226/09-10 — Background brief on review of the Trustee Ordinance and related matters prepared by the Legislative Council Secretariat)

55. At the invitation of the Chairman, Deputy Secretary for Financial Services and the Treasury (Financial Services) (DS/FSTB) advised that the Administration conducted a public consultation between June and September 2009 on the reform proposals made in the review of the Trustee Ordinance (Cap. 29) and received 36 submissions of views. Most of the proposals received support from respondents. The Administration would incorporate the proposals into an amendment bill for introduction into LegCo in 2011. He then highlighted the following consultation conclusions -

- (a) With the support of most respondents, the Administration proposed that the list of authorized investments specified in the Second Schedule to the Trustee Ordinance be retained subject to necessary review and updates. The list would serve as a reference of prudential investment for some inexperienced trustees including those of charitable trusts. Settlers could provide trustees with wider investment powers in the trust instruments. The Administration would liaise with relevant financial regulators, professionals and market participants to review the list of authorized investments in the Schedule, and if necessary, to propose amendments to keep it in tandem with market conditions. Such amendments could be made by the Financial Secretary by order published in the Gazette.
- (b) Based on the views of the majority of respondents, the Administration proposed the abolition of the rule against perpetuities and the rule against excessive accumulations of income with an exceptional arrangement that allowed charitable trusts to accumulate its income up to 21 years.
- (c) The Administration accepted some respondents' suggestions of amending sections 8, 11, 12 and 34 of the Trustee Ordinance regarding the default administrative powers of trustees to enhance their clarity.
- (d) The Administration had considered the views of the Deputy Chairman expressed at the meeting on 6 July 2009 that the subject matter about

beneficiaries' right to disclosure of trust information was highly complex and technical, and thus had invited the Law Reform Commission (LRC) to consider conducting a study on the subject matter. LRC's reply was pending and it was premature for the Administration to form a decision on the subject matter.

- (e) There were differing views on the proposal of creating non-charitable purpose trusts. Some respondents to the consultation opined that the Administration should introduce non-charitable purpose trusts to enhance Hong Kong's competitiveness because such trusts already existed in some offshore jurisdictions. Some respondents however expressed concern about the possible abuse of such trusts for tax evasion or other illegal purposes. Nonetheless, a separate bill would be required to legislate for the subject matter. The Administration needed to conduct a further study on the subject matter before considering whether and, if so, how to take the matter forward.

Development of trust law in Hong Kong

56. Mrs Regina IP opined that there were three main types of trust, namely charitable trusts, trust services provided by financial institutions and family trust services provided by private banks. She queried how the trust law reform would facilitate the development of wealth management business in Hong Kong, as mentioned in the Administration's paper. Noting that some multi-national banks set up offshore trusts for some wealthy families for tax avoidance, Mrs IP queried whether the reform could help the local trust service industry to compete with these banks. DS/FSTB advised that, according to the opinions given by trustee associations and professional trustees, many potential settlors did not consider creating trusts in Hong Kong mainly because Hong Kong's trust law was outdated. The purpose of the reform was to enhance the trust law regime of Hong Kong and keep it up with the trust law development in other comparable jurisdictions such as Singapore. DS/FSTB further advised that, besides the trust law reform, other policies were required to support the development of wealth management in Hong Kong such as the abolition of the estate duty and other initiatives to enhance Hong Kong's position as an asset management centre as set out in the Financial Secretary's budget. These policies were an integral part of the Government's overall strategy of attracting settlors to set up family trusts in Hong Kong and to choose Hong Kong trust law as the governing law for their trusts, which in turn would generate more business opportunities for local trust service professionals.

57. Mrs Regina IP further enquired how the trust law reform would help Hong Kong to keep up with the trust law development in Singapore. DS/FSTB advised that the trust law reform addressed the limitations of the current trust law including the trustees' powers to take out insurance, to employ nominees and custodians. The reform also followed the practice in Singapore to provide reserved powers for settlors to make investment and perform asset management without invalidating the

trust and to clarify that the forced heirship rules adopted in other countries like Europe and Japan would not affect the validity of the trusts in Hong Kong.

Beneficiaries' rights to information

58. The Deputy Chairman referred to the list of respondents to the consultation provided in the Administration's paper and pointed out that most respondents were professional trustees, who understandably were concerned their own rights and interests only. None of the respondents including the Consumer Council could represent the interests of individual beneficiaries. Individual beneficiaries were usually reluctant to initiate legal actions to seek disclosure of information because the cost involved was considerable. Trustees had an advantage over beneficiaries in legal proceedings because trustees were financially backed up by the trusts to bear the litigation costs. There was also no guarantee that the beneficiaries would be awarded the costs, despite that the court might rule in favour of them. The Deputy Chairman opined that the Administration should legislate to provide for basic rules on disclosure of information to beneficiaries so that some guidelines would be in place to protect beneficiaries' interests and to discourage professional trustees from contravening principles of the common law in this area or committing illegal practices. The Administration's initial proposal had merits and had gained support from some respondents. He expressed disappointment that the Administration decided not to pursue the proposal.

59. Mr Albert HO remarked that the Joint Committee on Trust Law Reform was mainly composed of professional trustees and conceivably, their views aligned with those of the Administration and were inclined to place emphasis on the trade's interests. Mr HO said that he supported the comprehensive review of the Trustee Ordinance and had no objection to the purposes of the review. But he shared the views of the Deputy Chairman that the Administration should place the same emphasis on the interests of beneficiaries and legislate to provide for the basic rules on disclosure of information to beneficiaries. Since the law relevant to the subject matter of the proposal would take long to evolve, the Administration should make sure legislation was in place to intervene in the administration of trusts to strike a balance between the interests of beneficiaries and the interests of other parties. One case in point was discretionary trusts which could involve a significant amount of trust assets and number of beneficiaries. If a discretionary trust was managed solely by a professional trustee after the settlor passed away, it could be difficult for the beneficiaries to obtain the trust-related information from the trustee under the existing law.

60. DS/FSTB advised that the Administration decided not to legislate for the beneficiaries' rights to information for the time being mainly because respondents' views on the proposal were diverse and the case law about the subject matter was still evolving. In view of the complexity of the subject matter, the Administration had requested LRC to consider conducting a further study on it. It was premature for the Administration to incorporate the proposal into an amendment bill.

61. The Deputy Chairman opined that the complexity of the issue of the beneficiaries' rights to trust information was caused by the contradictions between common law cases. The ambiguity in the law not only made it difficult for beneficiaries to obtain accurate legal advice about the issue, but also provided trustees with an excuse to keep beneficiaries unaware of the information they were supposed to know. Even worse, some trustees could choose not to inform beneficiaries that they were beneficiaries of a trust. It was the responsibility of the Administration to resolve the ambiguity and define clearly the scope of beneficiaries' right to trust information. He queried whether it was because of the objection raised by professional trustees that the Administration did not pursue the proposal. If this was the case, he doubted whether the objection constituted a conflict of interest. DS/FSTB advised that the Administration needed to do some checking to find out the type of respondents who disagreed with the proposal. But, besides professional trustees, at least some scholars had opined that it was premature to codify the relevant common law principles when the relevant case law was still in evolution. The two options proposed by the Administration for the proposal would provide different levels of protection for beneficiaries' rights. Due to the complexity of the subject matter, the Administration was not ready to decide which option to pursue. The Administration would check with LRC to see if the Commission agreed to conduct a study on the subject matter.

62. The Chairman said that as the bill was scheduled to be introduced into LegCo in 2011, the Administration should arrange further discussion with members on the subject matter before a final decision was made. The Deputy Chairman also opined that the Administration should not adopt an all-or-nothing approach. The legislation should at least ensure that the beneficiaries knew they were beneficiaries of a trust so that they could supervise the trustees and ensure the trustees fulfilled their responsibilities.

Trustee's exemption clauses

63. Mr Albert HO enquired and DS/FSTB clarified that the Administration proposed to subject trustee's exemption clauses to statutory control by following the Jersey approach which provided that nothing in the terms of a trust shall relieve, release or exonerate a trustee from the liability for breach of trust arising from the trustee's own fraud, wilful misconduct or gross negligence. Mr HO pointed out that it was usually difficult for a plaintiff to prove whether an act constituted gross negligence, fraud or wilful misconduct. In most lawsuits, the plaintiff was only required to prove that an act constituted ordinary negligence. Mr HO queried why the Administration proposed that trustees were liable for breach of trust only when their conduct constituted gross negligence instead of ordinary negligence. He opined that the Administration should strike a balance between trustees' interests and beneficiaries' in the review. Mr HO also remarked that the promulgation of a code of practice in relation to the inclusion of trustee exemption clauses could not help tightening the control on trustees.

64. DS/FSTB advised that proposed statutory control would impose tighter control on the application of exemption clauses than that under the common law because under the common law, the trustee was liable to breach of trust arising from the trustee's fraud only. The proposal also introduced a statutory duty of care on professional trustees. Mr HO opined that the common law duty of care was already in place and the proposed statutory control would not make any difference to the common law control on trustees. Instead, the Administration should eliminate the ambiguities about their duties and responsibilities defined in the existing legislation. The Chairman shared members' concern about the importance of balancing the interests of the relevant parties. He also encouraged members to provide more comments on the Administration's proposals before the relevant amendment bill was introduced into LegCo in 2011.

Cost afforded by beneficiaries

65. Mrs Regina IP expressed concern about the high level of trustee fees including the hidden cost of creating a trust and the cost of the legal procedures required for beneficiaries to break a trust. She queried whether the Administration would handle this issue. DS/FSTB advised that the trust law reform proposed a default charging clause to give professional trustees a right to receive remuneration, subject to any contrary intention in trust instruments. It also proposed to enable the beneficiaries who were of full age and vested in interest to remove the trustee by a court-free route, provided that the specified requirements such as unanimous consent among the beneficiaries were met. These proposals should help reducing the cost of the legal procedures involved.

Roles of trustee and custodian

66. Mrs Regina IP said that beneficiaries were not just limited to those under charitable or family trusts but should include the general public who might be holders of structured products under a trust arrangement. Using the Lehman-Brothers Minibonds incident as an example, Mrs IP enquired about the difference between trustee and custodian and queried how the Administration would enhance public understanding of their rights as a beneficiary and the trustee's duties and responsibilities. She also queried whether a company which acted as both a trustee and a custodian constituted a conflict of interest. DS/FSTB advised that the trust law reform included a proposal to provide trustee with the power to employ custodians to perform certain designated functions. The reform did not include a proposal to define in what situation a conflict of interest existed in a trust. The Assistant Secretary for Financial Services and the Treasury said that trust assets such as securities were kept by custodians for the convenience of trading those assets. Under the reform proposals, the power of a trustee to appoint custodians would be governed by the statutory duty of care. The trustee was also required to review the performance of the custodians. Noting that DS/FSTB was not familiar with the trust arrangement for the Lehman-Brothers Minibonds, Mrs IP said that she would write to the Administration to follow up her queries about the arrangement.

Non-charitable purpose trust

67. The Deputy Chairman opined that non-charitable purpose trust had its functions in society. For example, a charitable trust could not support the development of a political party in Hong Kong. As such, the development of non-charitable purpose trusts should be enabled by statutes. The Deputy Chairman queried whether the Administration had sought or would seek the advice of LRC on the subject matter. DS/FSTB advised that non-charitable purpose trust was allowed in some offshore jurisdictions. The respondents' views on the proposal were diverse. Some respondents welcomed it for commercial purposes and some opined that safeguards were required for enforcing this kind of trusts to avoid conferring excessive rights to trustees. The Administration needed to conduct further study on the subject matter. On the Deputy Chairman's further enquiry, DS/FSTB said that the Administration would request LRC to consider conducting a study on the subject matter. The Deputy Chairman further opined that, despite that misuse of this type of trusts was found in other countries, the Administration should work out a better framework to allow the creation of this type of trusts for genuine lawful purposes. DS/FSTB responded that the Administration would further study the subject matter including identifying suitable legal safeguards.

Role of LRC in the review

68. Mr Albert HO enquired why the Administration sought LRC's advice for those trust law reform proposals suggested by members but not for those proposals initiated by the trust industry. DS/FSTB said that the Administration had accepted the advice of the Department of Justice to conduct the trust law review by making reference to the studies conducted by other common law jurisdictions such as United Kingdom on the same subject matter. The Administration would seek LRC's advice only for those subject matters that had not been studied in depth in these jurisdictions, such as non-charitable purpose trust and beneficiaries' right to information. The Chairman also requested the Administration to actively follow up the issues raised by members and seek LRC's advice where appropriate with a view to resolving them before the relevant bill was introduced into LegCo in 2011.

VIII Any other business

69. There being no other business, the meeting ended at 12:54 pm.