

立法會
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Panel on Financial Affairs

**Minutes of special meeting
held on Monday, 19 July 2010 at 10:45 am
in Conference Room A 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
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 Jeffrey LAM Kin-fung, SBS, JP
Hon Andrew LEUNG Kwan-yuen, GBS, JP
Hon WONG Ting-kwong, BBS, JP
Hon CHIM Pui-chung
Hon KAM Nai-wai, MH
Hon Starry LEE Wai-king, JP
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** : Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP
Dr Hon Philip WONG Yu-hong, GBS
Hon Vincent FANG kang, SBS, JP
- Public officers attending** : Agenda Item I
Prof K C CHAN, SBS, JP
Secretary for Financial Services and the Treasury

Miss AU King-chi, JP
Permanent Secretary for Financial Services and the
Treasury (Financial Services)

Ms Annie CHOI, JP
Commissioner of Insurance

Mr Patrick HO, JP
Deputy Secretary for Financial Services and the Treasury
(Financial Services)²

Agenda Item II

Mr John LEUNG, JP
Deputy Secretary for Financial Services and the Treasury
(Financial Services)³

Mr E T O'CONNELL, JP
Official Receiver

Ms May LEE
Assistant Official Receiver (Legal Services)²

Agenda Item III

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

Ms Mandy WONG
Principal Assistant Secretary for Financial Services and
the Treasury (Financial Services)

Mr Stephen TISDALL
Senior Director of Intermediaries Licensing and Conduct
Securities and Futures Commission

Mr Wilson LO
Director of Licensing
Securities and Futures Commission

Ms Carolyn CHIU
Manager of Licensing
Securities and Futures Commission

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

Staff in attendance : Mr KAU Kin-wah
Assistant Legal Adviser 6

Mr Noel SUNG
Senior Council Secretary (1)4

Ms Haley CHEUNG
Legislative Assistant (1)8

Action

I Proposed establishment of an independent Insurance Authority

(LC Paper No. CB(1)2525/09-10(01) — Administration's paper on "Proposed establishment of an independent Insurance Authority"

LC Paper No. CB(1)2525/09-10(02) — Administration's consultation paper on "Proposed establishment of an independent Insurance Authority"

LC Paper No. CB(1)2522/09-10 — Background brief on proposed establishment of an independent Insurance Authority prepared by the Legislative Council Secretariat)

Briefing by the Administration

The Secretary for Financial Services and the Treasury (SFST) briefed members, through a Powerpoint presentation, the proposals for the establishment of an independent Insurance Authority (IIA).

(Post-meeting note: The notes of the Powerpoint presentation were issued to members vide a Lotus Notes e-mail on 19 July 2010.)

Structure of the proposed regulatory regime

2. Mr KAM Nai-wai said that he supported in principle the establishment of an IIA as recent incidents in the travel industry showed that self-regulation was not an effective way for regulating an industry. Mr KAM enquired whether the IIA would have the authority to order compensation, in addition to the power to impose supervisory sanctions such as reprimands and fines. Noting that the Hong Kong Monetary Authority (HKMA) would be empowered to regulate banks and their employees in selling insurance products in banks, Mr KAM expressed grave concern

that this would give rise to the problem of inconsistency in the enforcement standards and practices between IIA and HKMA. In this connection, he pointed out that the arrangement for regulating the sale of structured financial products in banks by both the HKMA and the Securities and Futures Commission (SFC) in the Lehman Brothers Minibonds Incident had caused wide public concern.

3. The Deputy Chairman expressed a similar concern and enquired why it was necessary to separately empower the HKMA to regulate the sale of insurance products in banks.

4. The Chairman enquired about the international practice in the regulation of the insurance industry, and whether the Government had taken into consideration the local circumstances in proposing the establishment of the IIA. He questioned whether consistent standards and actions would be applied if the IIA and HKMA were concurrently given the responsibility for regulating insurance intermediaries.

5. SFST responded that at present, the Insurance Claims Complaints Bureau (ICCB) was responsible for investigating complaints relating to the terms of insurance policies and where appropriate, determine on the claims settlement. Another three self-regulatory organizations (SROs) were responsible for supervising the conduct of intermediaries. Under the current proposal, the existing ICCB mechanism would continue to operate after the establishment of the IIA. However, the proposed IIA would take up the responsibilities of these SROs in investigating complaints, and where appropriate impose sanctions against insurance intermediaries. A unified appeal mechanism would be set up to deal with appeals. The IIA would also be responsible for licensing insurers and insurance intermediaries, and drawing up the codes of practice for the insurance industry. SFST said that the Government supported the principle of establishing a single authority to regulate a particular industry. However, having regard to banks' client profile and the sale environment in banks, the Government considered it more appropriate that HKMA be given powers similar to those of IIA for the regulation of bank employees selling insurance products, and to impose additional conduct requirements specific to banks, on top of those set by IIA, if necessary. SFST stressed that the regulatory regime would be highly transparent and consistent standards would be adopted by the regulatory bodies.

6. Mr James TO also expressed concern about possible duplication of work and functions between the HKMA and the proposed IIA in regulation of the insurance industry. He also enquired about the control of investment linked insurance products, and queried why, in respect of those products, there was a disparity between the regulatory arrangements for the insurance industry and the securities sector.

7. SFST responded that the SFC was responsible for authorization of the sale of investment linked insurance products, and the IIA would regulate insurers and insurance intermediaries. HKMA would be given the powers similar to those of IIA for the regulation of the sale of insurance products in banks, and where appropriate would conduct investigation and/or impose sanctions on the banks and/or employees concerned. An independent appeals tribunal would be established to handle all appeals from insurers and intermediaries, including banks and their employees, against the decisions of the IIA and the HKMA. SFST explained that the regulatory arrangements for the insurance and securities sectors had to take into account the specific characteristics of the sectors and relevant products.

8. Mr Albert HO expressed concern that the banking, securities and insurance sectors were separately regulated by three different regulatory bodies, namely the HKMA, SFC and the Insurance Authority, and the HKMA, being empowered to supervise banks in conducting various activities including the sale of securities and insurance products, appeared to have most extensive powers. Mr HO was of the view that the proposal for establishing a single regulatory authority to oversee the financial sectors should be further explored.

9. The Deputy Chairman pointed out that the Legislative Council had passed a motion urging the Administration to set up a single regulatory authority to regulate the financial services sectors, and asked whether the Administration had explored this arrangement.

10. Mr Paul CHAN enquired whether the Administration had decided to continue with the existing arrangements, whereby different financial services sectors were regulated by different regulators, or the Administration would consider alternative approaches such as setting up a single financial services authority.

11. SFST responded that different regulatory regimes for the financial services sectors were adopted in different countries. The idea of setting up a single overarching financial services authority in Hong Kong needed to be carefully considered, in view of the risks involved and doubtful efficacy of such an arrangement. Based on the experiences of other countries, an overarching regulatory authority might not be able to effectively deal with specific issues in different financial service sectors, and in result designated regulatory bodies had to be set up to regulate specific sectors. Currently the Government was adopting a dual approach, namely "institutional and functional regulation", in regulating the financial services sectors, and would continue to refine the existing regulatory regimes with a view to maintaining the stability of the financial markets and enhancing the competitiveness of the financial sectors. In regulating banks in the sale of securities and insurance products, HKMA had to follow the relevant ordinances, and where necessary, issue additional guidelines on top of those set by the IIA for compliance by authorized institutions (AIs), having regard to the specific client profile and sale environment of AIs.

12. Mr CHIM Pui-chung opined that the Government had not learned from the Lehman Brothers Minibonds Incident in proposing to regulate the insurance industry through three regulatory bodies, namely the SFC to control the issue of investment linked insurance products, the IIA to regulate the insurers and insurance intermediaries, and the HKMA to oversee the operation of banks and their employees in the sale of insurance products. Mr CHIM was of the view that HKMA had been given excessive regulatory powers, but had failed to perform its duties in regulating the banks in the Lehman Brothers Minibonds Incident. Mr CHIM asked whether the Government would consider setting up a Monetary Development Authority to supervise the work of the HKMA, SFC and IIA. Mr CHIM also enquired about the respective roles and responsibilities of the FSTB and the IIA/HKMA in the regulation of the insurance industry.

13. SFST reiterated that the Administration did not consider that it was suitable under the present situation to set up an overarching authority to oversee the financial services sectors, in view of the risks involved and the doubtful efficacy of the arrangement. The relevant regulatory authorities in the world also held divergent views on the proposal. An appropriate regulatory regime had to be established to suit the needs of the local market. Subsequent to the Lehman Brothers Minibonds Incident, co-ordination among the regulatory bodies had been enhanced, and additional measures had been introduced to strengthen the control on the sale of structured financial products. SFST stated that while the FSTB was responsible for the formulation of policy for the development of the financial market, the regulatory bodies would draw up detailed regulations and guidelines to regulate the relevant industries.

Involvement of the insurance industry

14. Noting that the proposed IIA would be responsible for the licensing and regulation of insurance intermediaries, and would take over the investigation and disciplinary functions from the three SROs, the Deputy Chairman asked whether representatives of the insurance companies and intermediaries would be allowed to participate in the formulation of the codes of practice, and investigation and disciplinary functions of the IIA. The Deputy Chairman pointed out that the Hong Kong Bar Association, the Law Society of Hong Kong and the Hong Kong Institute of Certified Public Accountants drew up the code of practice for their respective sectors and had the power to investigate complaints and discipline their members. The Deputy Chairman further enquired about the working relationship between the proposed IIA and the Financial Reporting Council (FRC).

15. Mr CHAN Kin-por said that he supported the establishment of a single regulatory body for the insurance industry. The existing self-regulatory regime had so far worked well and he would support the merger of the three SROs to enhance consistency. Nevertheless, Mr CHAN remained open as to whether insurance intermediaries should be directly regulated by the IIA or remain self-regulated through merger of the three SROs, and remarked that the views of the industry and the public should be sought.

16. SFST responded that the insurance industry would be invited to participate in the formulation of policy for the future development of the insurance market. The views of the insurance industry would also be taken into account in the setting up of the IIA, which would operate as an independent body in the regulation of the industry, including the imposition of sanctions if and when appropriate. The IIA would also be involved in market development, in addition to its regulatory functions. Representatives of the insurance industry would be appointed as members of the advisory committee of the IIA to advise on issues affecting the industry. SFST stated that the proposed IIA and the FRC were two independent organizations responsible for regulation of the insurance industry and monitoring the financial reporting arrangements of listed companies respectively.

Role and functions of the proposed IIA

17. Mr Albert HO was concerned that similar to the arrangement for HKMA and SFC, the investigations to be carried out by the proposed IIA would be kept confidential, and the public would not be able to monitor the investigation work of the IIA.

18. SFST responded that a balance had to be struck between transparency and fairness as it would be unfair to the subject of investigation if a regulatory body disclosed the identity of the subject before completion of its investigation. The international practice was that a financial regulatory organization would abide by the confidentiality principle when it conducted investigation.

19. Mr Albert HO opined that the Financial Services and the Treasury Bureau (FSTB), rather than the IIA, should be responsible for the development of the insurance market and enhancing the competitiveness of the insurance industry.

20. The Chairman pointed out that there were many complaints regarding the payment of compensation by insurance companies, and the proposed IIA's main responsibilities should concentrate on the regulation of the industry. The Chairman also expressed concern that if the IIA was tasked with the responsibility of promoting the development of the insurance market, it might duplicate the work of FSTB and hence waste the valuable resources of IIA. He opined that there should be a clear demarcation of responsibilities between the IIA and FSTB.

21. SFST responded that while the FSTB was responsible for policy initiatives to enhance market development, the relevant regulatory bodies had to draw up the relevant regulatory guidelines/rules correspondingly. Hence there was a division of labour between the Government policy bureau and the relevant regulatory bodies. For instance, when the government promoted the market of renminbi financial products, the relevant regulatory bodies would need to formulate control measures on the transactions of the renminbi financial products.

Funding arrangement

22. Mr CHAN Kin-por opined that the IIA should seek to strike a balance between regulation and market development, and enhance the competitiveness of the insurance industry. He said that the insurance industry was concerned about the size of the proposed IIA which would have 237 staff, as it might incur considerable expenses and result in over-regulation. Mr CHAN pointed out that some people would pay off the insurance premium on a one-off basis, and the 0.1% levy for an insurance policy of \$10 million would amount to as much as \$10,000. Mr CHAN opined that a ceiling should be set for the levy that would be charged on each insurance policy.

23. The Chairman said that the insurance industry was concerned that the imposition of 0.1% levy on insurance policies might increase the financial burden of the insured. The Chairman supported the proposal to set a ceiling on the amount of levy to be charged. The Chairman also expressed concern that the proposed arrangement to charge a variable licence fee on insurance companies based on the liabilities of the company might affect the competitiveness of some insurance companies.

24. SFST responded that the proposed establishment of 237 staff for the IIA was recommended by the independent consultant after examining the workload involved and the manpower of similar establishments in Hong Kong and overseas countries. Measures would be put in place to ensure the cost-effectiveness of the IIA, which would operate in a highly transparent manner, with its work being supervised by a Board of Directors. SFST added that the Government would consider the proposal regarding setting a ceiling on the levy, pending the outcome of the public consultation.

25. Noting that a levy of 0.1% on insurance premiums would be imposed on each insurance policy to support the funding of the proposed IIA, Mr WONG Ting-kwong enquired about the estimated income from the proposed levy, and whether the levy would be refunded to the policyholder when an insurance policy was terminated prematurely. Mr WONG further asked whether the revenue from the levy was sufficient to cover the expenditure of the IIA.

26. Mr Paul CHAN also expressed concern about the cost-effectiveness of the IIA and the financial implication of the levy on the insured. He asked how the proposed 0.1% levy was arrived at.

27. The Commissioner of Insurance (C of I) responded that based on the total premium income received in previous years, the income from the levy was estimated to be about \$180 million per year, which would be about 70% of the annual operating cost of the IIA. The remaining 30% would come from the variable licence and user fees to be imposed on insurers. The detailed arrangement regarding levy refund for prematurely terminated insurance policies would be considered after the completion of the public consultation exercise.

Interim arrangement

28. Mr CHAN Kin-por enquired about the interim arrangement of the OCI as the OCI faced a very heavy workload in the wake of the global financial crisis. Mr CHAN opined that the Government should regularly review the resources requirements of the OCI and ensure adequate resources were allocated to the OCI for meeting its workload.

29. SFST said that the workload of the OCI had been heavy and staff of the office were trying their best to cope with the situation. C of I supplemented that additional resources had been allocated to the OCI in 2009-2010 to hire additional contract staff to cope with the increasing workload in the coming years.

Protection for policyholders' interests

30. Pointing out that an insurance company had paid the Octopus Cards Limited in return for the personal data of Octopus cardholders for promotion of insurance business, Mr WONG Ting-kwong enquired whether guidelines would be drawn up to control the sharing of personal data between insurance companies and other enterprises.

31. In response, C of I said that there were codes stipulating the confidentiality requirements in the insurance industry and all insurance companies / intermediaries were not allowed to disclose any information of policyholders and potential policyholders, except for the administration of the concerned insurance contracts.

32. Mr Albert CHAN enquired whether, apart from setting up the IIA, steps would be taken to enhance control on the sale of investment-linked insurance products, and excessive administration fees charged by the insurers, as there were many complaints relating to the sale of such products.

33. SFST responded that measures had been introduced to enhance the regulation of the sale of investment linked insurance products. For life products, a cooling-off period had long been introduced. Different administration fees were charged on different insurance products, and a regulatory body normally would not lay down rules on the level of administration fees. Nevertheless, the code for investment-linked products had been revised with a view to enhancing transparency of all the fees related to such products. The establishment of the IIA would further enhance the regulation of the insurance industry. C of I supplemented that measures had been introduced recently to enhance the control on the sale of investment-linked insurance products. These included the requirement for the insurance companies to conduct a financial needs analysis of the client, a risk profile questionnaire, the extension of the cooling-off period from 14 days to 21 days, and the carrying out of post-sale confirmation calls for vulnerable clients, i.e. elderlies, clients with low education level and low income. C of I said she would consider the suggestion of providing a copy of the audio record to the clients.

Public hearing

- Clerk 34. The Chairman suggested and members agreed that the Panel would hold a meeting to receive the views of the insurance industry and other relevant parties on the proposed establishment of an IIA.

II Review of corporate rescue procedure legislative proposals

(LC Paper No. CB(1)2525/09-10(03) — Administration's paper on "Review of corporate rescue procedure legislative proposals consultation conclusions"

LC Paper No. CB(1)2523/09-10 — Background brief on review of corporate rescue procedure legislative proposals prepared by the Legislative Council Secretariat)

Briefing by the Administration

35. The Deputy Secretary for Financial Services and the Treasury (Financial Services)3 (DS(FS)3) briefed members on the feedback and conclusions of the public consultation on the corporate rescue procedure legislative proposals, by highlighting the salient points in the paper.

Insolvent trading

36. While pointing out that the legislative proposals had included measures to ensure the payment for employees' outstanding entitlements, Mr Andrew LEUNG said that the Hong Kong Federation of Industries had expressed strong views regarding the legislative proposals on insolvent trading. Mr LEUNG commented that a director would face a dilemma when a limited company became insolvent. If a director declared that his company was insolvent, banks would be reluctant to provide credit facility for the company. If the director did not disclose the insolvency of his company, he would be personally liable for insolvent trading. Mr LEUNG enquired why the Administration proposed to introduce the insolvent trading provisions. Mr Albert HO shared Mr LEUNG's concern and said that the legislative proposals on insolvent trading needed to be carefully considered.

37. Mr Paul CHAN said that while he supported the introduction of the corporate rescue procedure and the proposed insolvent trading provisions with a view to protecting the interest of the creditors, extra care should be taken in drawing up the insolvent trading provisions.

38. DS(FS)3 responded that the insolvent trading provisions were proposed having regard to similar arrangements in other jurisdictions including Australia and the United Kingdom (UK). Directors of an insolvent company had a responsibility

to protect the interests of shareholders and creditors. Apart from initiating the corporate rescue procedure, directors of a company facing financial difficulty might try to come to an arrangement with their creditors by means of non-statutory voluntary workouts or restructuring arrangements under section 166 of the Companies Ordinance (CO) (Cap. 32). Only if the directors continued the business of the company without taking steps to prevent insolvent trading, they would be liable, under civil proceedings, for the debts of the company incurred during the insolvent period. Taking into account the views of the respondents during public consultation, the standard in establishing liability had been modified by dropping the ground of "reasonable grounds for suspecting". Other defence factors for the directors might be considered during the drafting of the legislative provisions and great care would be taken in drawing up the provisions in order to strike a balance between the protection of the interests of the directors and the creditors/employees. The liquidator of a company would consider factors such as the cost involved and the repayment ability of the director(s) before making an application to the court to seek a declaration that a "responsible person" who failed to prevent the insolvent trading was personally liable for the debts. Based on the experience of other jurisdictions such as the UK, the number of directors being sued for insolvent trading was relatively small. DS(FS)3 added that the introduction of insolvent trading provisions would encourage directors to act on insolvency earlier and would enhance corporate governance. The Government would continue to explain the legislative proposals to the Hong Kong Federation of Industries and other stakeholders concerned, and was prepared, where necessary, to make minor amendments to the proposal.

39. In response to Mr Andrew LEUNG's and the Chairman's request, DS(FS)3 undertook to provide details of the views expressed by different parties on the insolvent trading proposals during the public consultation.

(Post-meeting note: The information provided by the Administration was circulated to members vide LC Paper No. CB(1)2719/09-10 on 10 August 2010.)

Provisional supervision

40. The Deputy Chairman opined that some financially troubled companies might not be suitable to pursue the rescue procedure. He enquired whether a threshold would be set for a company to initiate the corporate rescue procedure, such as the need for seeking a court order. The Deputy Chairman also expressed concern whether the provisional supervision arrangement was adequate for protection of creditors' interests, as in the US, a trustee should be appointed to oversee the operation of the company when the corporate rescue procedure was pursued. Mr Albert HO expressed a similar concern and opined that apart from the support of secured creditors, consideration should be given to add the requirement of the support of non-secured creditors for the corporate rescue procedure to continue after initiation, as non-secured creditors would be most affected by the liquidation of the company concerned.

41. Mr Paul CHAN supported the imposition of personal liability on the provisional supervisors for any contracts they had entered into when performing their functions, similar to the relevant arrangement for liquidation of banks, and the arrangement would protect the interests of employees and creditors.

42. DS(FS)3 responded that the proposed corporate rescue procedure was based on the corporate rescue models in the UK and Australia, and the recommendations of the Law Reform Commission, with a view to minimizing court involvement so as to save cost and time. Based on a recommendation of the Law Reform Commission, the corporate rescue procedure could only be continued with the concurrence of the major secured creditors. A meeting of the creditors would be held ten days after the commencement of the corporate rescue procedure to consider the suitability of the appointment of the provisional supervisor. A provisional supervisor would be personally liable for debts and liabilities under certain conditions.

43. Mr Jeffrey LAM expressed concern about the high cost for appointment of the provisional supervisor which might render the corporate rescue procedure impracticable for the small and medium sized enterprises.

44. DS(FS)3 responded that the corporate rescue procedure provided an alternative arrangement to rescue insolvent companies, in addition to the existing non-statutory arrangements. The Government had no intention to set any restriction on the types of companies which might seek to initiate the corporate rescue procedure, except those companies which were subject to other regulatory regimes, e.g. banks.

Employees' outstanding entitlements

45. Mr Albert HO asked whether the latest proposed arrangements for the treatment of employees' outstanding entitlements were supported by the labour associations. Mr Paul CHAN shared Mr HO's concern and said that, if necessary, further discussion on the corporate rescue procedure with the labour associations should be arranged.

46. DS(FS)3 responded that the Labour Advisory Board had been briefed on the latest corporate rescue procedure proposals. The labour associations supported in principle the proposals although some associations had expressed concern about the time taken for the insolvent company to pay back the employees' outstanding entitlements.

Liquidation

47. Mrs Regina IP was concerned that some multi-national corporations facing insolvency might arrange transfer of their capital out of Hong Kong before initiating the corporate rescue procedure.

48. The Official Receiver responded that there was legislation in Hong Kong and other jurisdictions to enable the liquidators to challenge the transfer of property to other overseas branch offices of an insolvent corporation before liquidation i.e. they were called anti-avoidance provisions. With regard to our proposal on insolvent trading, it was also important to have in place provisions to hold those who abused credit and the availability of credit to account. Insolvent trading provisions would assist in this regard..

Consultation

49. Mr Jeffrey LAM was of the view that the paper only provided a broad outline of the legislative proposals. The Government should proactively consult and hold more in-depth discussion with the business sector, the senior management of companies, and the labour associations on the legislative proposals, including the insolvent trading provisions, instead of passively waiting for the stakeholders' submissions.

50. DS(FS)3 responded that the consultation conclusions had been drawn up after extensive consultation with the stakeholders, including the business sector and the labour associations, and further discussion with the relevant parties would be held on the detailed legislative proposals.

Legislative work and timetable

51. The Chairman enquired about the timetable for legislating the corporate rescue procedure, and whether the Panel would be further consulted on the legislative proposals before the relevant Bill was introduced into the Legislative Council. The Chairman said that the Panel should be kept informed of the progress of the consultation and legislative timetable.

52. DS(FS)3 responded that the Administration was drawing up the drafting instructions for the relevant bill, and, subject to the scheduling of other legislative proposals to be put up by the FSTB, the most optimistic timeline was to introduce the bill into the Legislative Council by June/July 2011. Given the complexity of the bill, it might take the Legislative Council about one year to scrutinize the bill. The Administration would consider the need for consulting on the detailed draft provisions, and/or conducting a further consultation exercise on the legislative proposals.

III Regulation of credit rating agencies

(LC Paper No. CB(1)2525/09-10(04) — Administration's paper on "Regulation of credit rating agencies"

LC Paper No. CB(1)2524/09-10

— Background brief on regulation of credit rating agencies prepared by the Legislative Council Secretariat)

Briefing by the Administration

53. The Under Secretary for Financial Services and the Treasury (USFST) briefed members on the proposed regulation of credit rating agencies (CRAs) operating in Hong Kong, by highlighting the salient points in the paper.

Regulation of CRAs

54. Pointing out that many financial institutions had collapsed during the global financial crisis despite their high credit rating, Mr Jeffrey LAM enquired what measures would be taken to ensure that the CRAs would operate properly, and that their credit ratings would be independent, objective and of appropriate quality. Mr LAM also asked whether legislation would be made to hold CRAs liable for errors in their credit ratings, and whether the SFC could order a CRA to make compensation for a breach of the future CRA Code of Conduct.

55. USFST responded that CRAs would be required to comply with the CRA Code of Conduct to be drawn up based on the revised Code of Conduct Fundamentals for CRAs issued by the International Organization for Securities Commissions (IOSCO) in May 2008. The IOSCO standards required credit rating activities to be conducted in accordance with the principles of integrity, independence, transparency and confidentiality. CRAs had to ensure timely review of their credit ratings for individual financial institutions or products arising from certain incidents, and refrain from getting involved in situations that would give rise to a conflict of interests. Under the proposed regulatory system, SFC would monitor the operation of CRAs, and might take disciplinary actions, including the revocation of the CRA's licence, against a CRA which had breached the CRA Code of Conduct. The Senior Director of Intermediaries Licensing and Conduct, SFC (SD(IL&C)/SFC) supplemented that in some circumstances a CRA could be ordered by the SFC to pay a pecuniary penalty (as distinct from compensation), although in practice the risk to a CRA of its licence being revoked for failure to comply with the CRA Code of Conduct, would generally be viewed as a stronger deterrent .

56. Mr James TO opined that the financial market would only accept the credit ratings awarded by reputable CRAs. Mr TO was of the view that apart from the CRA Code of Conduct, an effective regulatory regime for CRAs should include legislation to hold the CRAs liable for problematic credit ratings. Mr TO pointed out that unlike the regulatory regimes in the UK and the United States (US), the Administration's proposal did not include the setting up of a compensation fund, or a fund for class actions. Mr TO said that while he supported the proposal to regulate CRAs operating in Hong Kong, he doubted the effectiveness of the proposed regulatory regime, given the absence of provisions for class actions and order of compensation.

57. USFST responded that as evidenced by the enforcement actions taken by the HKMA and SFC in recent years, the regulators handled regulatory breaches seriously. The proposed regulatory regime for CRAs was in fact more rigorous than those in the UK and the US, as both CRAs and their rating analysts would need to be licensed. Since any disciplinary actions taken by SFC against a CRA would have profound impact on the reputation of the CRA and its business, CRAs would be cautious not to breach the CRA Code of Conduct and relevant legislation.

58. Mr Albert HO was concerned about co-operation among the CRA regulatory bodies in the world. Mr HO was concerned that a rating analyst who was disciplined and/or de-registered in Hong Kong might be allowed to continue to undertake credit rating work in other jurisdictions.

59. USFST responded that a global network of CRA regulatory regimes was being formed as the Code of Conduct Fundamentals for CRAs issued by the IOSCO had been or would be adopted by the regulatory bodies in various jurisdictions. After the implementation of the proposed regulatory regime for CRAs operating in Hong Kong, a Memorandum of Understanding (MOU) would be signed with the European Union (EU) governing the serviceability of CRAs in both Hong Kong and the EU. Under similar MOUs signed between the EU and other jurisdictions, CRAs registered in Hong Kong would be subject to similar regulation in other jurisdictions. SD(IL&C)/SFC added that a rating analyst who had breached the CRA Code of Conduct could be subject to disciplinary proceedings including the ultimate sanction of having his licence revoked in a serious case, and that the regulatory regimes for CRAs in various jurisdictions would be generally based on similar standards.

60. Pointing out that certain CRAs had also been established in the Mainland, Mr WONG Ting-kwong asked whether Mainland CRAs would be allowed to operate in Hong Kong. Mr WONG opined that proactive actions should be taken to invite more renowned CRAs to operate in Hong Kong.

61. USFST responded that all CRAs which met the licensing requirements would be welcomed to operate in Hong Kong, and would be regulated under the same set of standards.

62. Mr James TO pointed out that there was a paradox in the regulatory regime for CRAs in that in assessing the credit rating of a jurisdiction, a CRA was making an assessment of its regulatory oversight body. Mr TO opined that in making sovereign credit rating, a CRA would inevitably need to contact the officials responsible for financial affairs to obtain relevant information, whereas the officials were in close contact with the regulatory bodies for CRAs.

63. USFST responded that in accordance with paragraph 2.10 of the revised Code of Conduct Fundamentals for CRAs issued by IOSCO, in instances where the government was the rated entity and simultaneously was also the body pursuing the oversight function related to the CRA, the CRA should use different employees to conduct its rating actions than those employees involved in its oversight issues. She

also stressed that SFC was an independent statutory body responsible for the regulation of the securities market, including CRAs. SD(IL&C)/SFC supplemented that the purpose of setting up a regulatory regime for CRAs was to ensure that their credit ratings were awarded based on independent, objective and fair assessments. The regulatory bodies in Hong Kong and elsewhere would concentrate on monitoring their conduct in producing credit ratings.

IV Any other business

64. There being no other business, the meeting ended at 1:01 pm.

Council Business Division 1
Legislative Council Secretariat
29 September 2010