立法會
Legislative Council

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Subcommittee on Securities and Futures Ordinance (Amendment of Schedule 5) Notice 2011 and Securities and Futures (Financial Resources)(Amendment) Rules 2011

First meeting on
Tuesday, 8 March 2011, at 2:30 pm
in Conference Room B of the Legislative Council Building

Members present	**:**	Hon James TO Kun-sun (Chairman) Hon Audrey EU Yuet-mee, SC, JP Hon WONG Ting-kwong, BBS, JP Hon CHIM Pui-chung
Member absent	**:**	Hon CHAN Kam-lam, SBS, JP
Public officers attending	**:**	Ms Mandy WONG Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) Mr Bernard LO Assistant Secretary for Financial Services and the Treasury (Financial Services) Ms Carmen CHU Senior Government Counsel Department of Justice

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

Mr Wilson LO
Director of Licensing
Securities and Futures Commission

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

Staff in attendance : Ms YICK Wing-kin
Assistant Legal Adviser 8

Mr Hugo CHIU
Council Secretary (1)5

Ms Clara LO
Legislative Assistant (1)10

Action

I Election of Chairman

Mr James TO was elected Chairman of the Subcommittee.

II Meeting with the Administration

L.N. 28 of 2011	— Securities and Futures Ordinance (Amendment of Schedule 5) Notice 2011
L.N. 29 of 2011	— Securities and Futures (Financial Resources) (Amendment) Rules 2011
SUB/14/1/5 (2010)	— Legislative Council Brief on Securities and Futures Ordinance (Amendment of Schedule 5) Notice 2011 and Securities and Futures (Financial Resources) (Amendment) Rules 2011 issued by the Financial Services and the Treasury Bureau

LC Paper No. LS29/10-11	— Legal Service Division report on subsidiary legislation gazetted on 18 February 2011
LC Paper No. CB(1)1499/10-11(01)	— Marked-up copy of the Securities and Futures Ordinance (Amendment of Schedule 5) Notice 2011 (L.N. 28 of 2011) prepared by the Legal Service Division
LC Paper No. CB(1)1499/10-11(02)	— Marked-up copy of the Securities and Futures (Financial Resources) (Amendment) Rules 2011 (L.N. 29 of 2011) prepared by the Legal Service Division
LC Paper No. CB(1)1497/10-11	— Background brief on Securities and Future Ordinance (Amendment of Schedule 5) Notice 2011 and Securities and Futures (Financial Resources) (Amendment) Rules 2011 prepared by the Legislative Council Secretariat)

2. The Subcommittee deliberated (Index of proceedings attached at **Appendix**).

Admin Follow-up actions to be taken by the Administration

3. The Administration was requested to take the following follow-up actions:

(a) To provide details of the proposed regulatory regime for credit rating agencies (CRAs), including but not limited to –

(i) eligibility criteria for licensing CRA firms and individuals;

(ii) sanctions for breach of relevant legislative requirements or "Code of Conduct for Persons Providing Credit Rating Services" ("Code of Conduct");

(iii) criminal and/or civil liabilities for problematic credit ratings; and

(iv) measures to prevent/avoid conflict of interests

(b) To provide the latest version of the draft "Code of Conduct", with remarks on any substantive deviations from the Code of Conduct Fundamentals for Credit Rating Agencies issued by the International Organization of Securities Commissions.

(c) To consider requiring CRAs to take out indemnity insurance as an investor protection measure, and provide information on any comparable arrangements in overseas major financial markets.

(d) To consider requiring CRAs or their clients to disclose all credit ratings that have been made on a financial product or issuer under certain circumstances so as to prevent the product issuers hiding the (previous) unfavourable credit ratings.

(e) In relation to the definition of "providing credit rating services", to review whether the present construction of the definition, particularly the phrase "with a reasonable expectation that they will be so distributed", may create a loophole.

(f) To review whether Type 4 regulated activity is actually distinct from the proposed Type 10 regulated activity, and whether the respective (proposed) scopes of the two regulated activities would create loophole or overlap in the regulatory regime under the Securities and Futures Ordinance (Cap. 571).

(g) To advise the Subcommittee of (a) any financial product that is regulated by credit rating requirements before such product is offered to the public; and (b) any regulatory requirement regarding the standard of credit rating applicable to regulated financial products.

III Any other business

4. Members agreed that as more time was required to scrutinize the subsidiary legislation, the Chairman of the Subcommittee would move a motion at the Council meeting on 16 March 2011 to extend the scrutiny period to 13 April 2011.

5. There being no other business, the meeting ended at 4:10 pm.

Council Business Division 1
Legislative Council Secretariat
14 April 2011

Appendix

Proceedings of the Subcommittee on Securities and Futures Ordinance (Amendment of Schedule 5) Notice 2011 and Securities and Futures (Financial Resources)(Amendment) Rules 2011
First meeting on Tuesday, 8 March 2011, at 2:30 pm in Conference Room B of the Legislative Council Building

Time Marker	Speaker	Subject(s)	Action Required
000506 – 000535	Mr James TO Ms Audrey EU CHIM Pui-chung	Election of Chairman	
000536 – 001224	Chairman Administration	Briefing by the Administration on the subsidiary legislation.	
001225 – 001827	Chairman SFC	Referring to paragraph 4 of the Legislative Council (LegCo) Brief provided by the Administration, the Chairman enquired whether the proposed regulatory regime was intended to cover credit rating information not intended for dissemination to the public and a third party utilizing credit rating information not intended for dissemination to the public. The Securities and Futures Commission (SFC) responded that the excluded activities set out in the subsidiary legislation were decided after consultation with relevant market stakeholders and, in particular, with regulatory bodies in other jurisdictions. The scenarios mentioned by the Chairman would be excluded because it would not be practical for the regulatory regime to cover all scenarios and potentially raise the number of Type 10 licensees to unmanageable levels. In practice, a credit rating agency (CRA) would enter into a contract with its client restricting the dissemination of credit rating information to the public. In any case, the CRA had to demonstrate that it/he had observed the relevant guidelines and taken reasonable steps to prevent such incidents.	
001828 – 003320	Ms Audrey EU SFC Chairman	Ms Audrey EU asked the following questions: (a) what type of persons would have to obtain a licence for Type 10 regulated activity and whether they had been subject to regulation before;	

Time Marker	Speaker	Subject(s)	Action Required
		(b) the qualification(s) required for obtaining a licence for Type 10 regulated activity; (c) whether a uniform rating standard existed and adopted by CRAs; and (d) given that credit rating information not intended for dissemination to the public would not be regulated, what the consequences would be if such information was released into the public arena. SFC replied as follows: (a) Credit rating activities had not been subject to regulation before and it was anticipated that seven CRAs including the "Big Three" would apply for a licence under the proposed new regulatory regime. They would wish to be licensed before 1 June 2011 as a regulation in the European Union (EU) prohibiting the use of credit ratings from a place not having aligned its regulatory regime with that of the EU would come into force on 7 June 2011. (b) The qualification requirements would be similar to those for other financial intermediaries, e.g. a relevant degree and possession of local knowledge. (c) While different CRAs utilized different rating systems, all CRAs in applying for the licence would be required to publish the details of their rating system to fulfill the transparency requirements. (d) Regarding the consequences of the release, by a client of a CRA, of credit rating information not intended to be disseminated into the public arena, it would be difficult for the subsidiary legislation to regulate the conduct of a client, who was not a SFC licensee.	

Time Marker	Speaker	Subject(s)	Action Required
		Ms EU requested the Administration/SFC to provide a paper setting out: (a) details of the Administration's regulatory regime for CRAs, particularly control over conflict of interests under the scenario that a CRA conducted credit rating on a company which was the CRA's major source of funding; and (b) what regulatory powers SFC would have to ensure that CRAs would observe the relevant requirements/rules/codes.	The Administration to take action as per paragraph 3 of the minutes.
003321 – 003750	Chairman Administration	The Chairman remarked that even the Big Three of CRAs made mistakes on credit rating during the financial tsunami, and the Government and the regulatory authority would bear a greater responsibility upon regulating CRAs. He enquired whether the Government or SFC would be held responsible if a licensed CRA committed mistakes in performing its credit rating activities. The Administration replied that CRAs would be subject to the same mode of regulation as currently applied to the nine types of regulated activities under the Securities and Futures Ordinance (SFO) and had to observe the Code of Conduct for Persons Providing Credit Rating Services (CRA Code) to be promulgated by SFC. CRAs in contravention of the CRA Code would be subject to disciplinary actions including fines and revocation of licence.	
003751 – 005230	Mr CHIM Pui-chung Administration SFC	Mr CHIM enquired about the following: (a) objectives of the proposed subsidiary legislation; (b) the number of complaints received from investors against CRAs; (c) whether there would be any punishment on CRAs for providing false or misleading credit rating information;	

Time Marker	Speaker	Subject(s)	Action Required
		(d) whether the activities of CRAs in Hong Kong were so important that licensing was necessary; (e) how were investors protected from the malpractices of CRAs; and (f) whether the huge reserve of SFC was one of the reasons for SFC to regulate CRAs. Mr CHIM considered that the primary objective of the subsidiary legislation should be affording protection for investors. The Administration and SFC replied that the objective of the subsidiary legislation was to create a regulatory regime for a segment of the market, i.e. CRAs, which were not subject to regulation before. SFC further added that following the financial tsunami, the G20 had reached consensus on the need to subject CRAs to a regulatory oversight regime. Responses to SFC's consultation revealed general support for such regulation. SFC would promulgate the CRA Code, which would be consistent with the revised Code of Conduct Fundamentals for Credit Rating Agencies issued by the International Organization of Securities Commissions published in May 2008 (IOSCO Code). The IOSCO Code was adopted by other jurisdictions like the US, the EU, Australia and Japan in formulating their regulatory regime over CRAs. In this way, Hong Kong could align its regulatory regime on CRAs with international standards so that credit ratings prepared by CRAs in Hong Kong would be serviceable in other jurisdictions. Otherwise, CRAs in Hong Kong might relocate their business to other jurisdictions. SFC also remarked that through the CRA Code, SFC would impose minimum conduct standards on CRAs. As such, the proposed regulatory regime would enhance the transparency of CRAs and help ensure fair and reliable credit ratings by CRAs. While the CRA Code did not explicitly specify punishments, CRAs violating the Code	

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		would be subject to serious consequences including fines and revocation of licence.	
005231 – 005431	Chairman SFC	The Chairman asked whether a CRA which had followed the CRA Code yet its credit ratings had caused huge losses to investors would be subject to any consequences and whether SFC would be responsible for punishing them. SFC replied that the CRA concerned would not be made specifically liable under the regime proposed for the regulation of CRAs. SFC could not take regulatory responsibility for ensuring the reliability of ratings, but CRAs would have regulatory obligations which should encourage this. This was the usual practice of the regulatory regimes of other financial markets.	
005432 – 011830	Chairman Administration SFC	The Chairman remarked that the minimum amount of required liquid capital ($100,000) was small and disproportionate to the risks that investors of relevant financial products were exposed to. In response, SFC remarked that the financial resources requirements for CRAs had been considered carefully. It was important to maintain consistency among the 10 regulated activities under SFO. Besides, there were no capital requirements on CRAs in other regions like the US. The Chairman asked whether CRAs were required to take out indemnity insurance. Noting SFC's reply in the negative, the Chairman remarked that some professionals like lawyers were required to take out indemnity insurance and CRAs should not be exempted from this. He considered that the credit ratings given by CRAs might affect large amounts of investments and there should be proper risk management in this regard. The Administration remarked that consistency of approach should be maintained in the regulatory regime under SFO. If CRAs were required to obtain indemnity insurance coverage, the	

Time Marker	Speaker	Subject(s)	Action Required
		licensees of the remaining nine types of regulated activities under SFO would also have to be subject to the same requirement. The Chairman remarked that the Administration might review the regulatory system to see whether it would be necessary to require licensees of all or some of the other types of regulated activities under SFO to take out indemnity insurance. Given the very low capital requirement on CRAs, he considered it necessary to study whether CRAs should be required to take out indemnity insurance. SFC replied that the aim of the IOSCO Code was to standardize the regulatory regimes of various jurisdictions in the world and there were no capital requirements for CRAs in the US and the EU. The requirement on indemnity insurance might incur significant cost on CRAs causing them to relocate their business to other regions. The Chairman asked the Administration to study the feasibility of requiring CRAs to take out indemnity insurance as an investor protection measure, and provide information on any comparable arrangements in overseas major financial markets.	The Administration to take action as per paragraph 3 of the minutes.
011831 – 012648	Ms Audrey EU SFC	On Ms Audrey EU's concern about the regulation on regarding conflict of interests, SFC advised that relevant concrete requirements were set out in the draft CRA Code. At the request of Ms Audrey EU and the Chairman, SFC undertook to provide the latest version of the draft Code for the Subcommittee and highlight those parts where there was any substantive difference with the IOSCO Code.	The Administration to take action as per paragraph 3 of the minutes.
012649 – 013120	The Chairman SFC	The Chairman asked, if a client commissioned a CRA to rate its credit rating and received an unfavourable rating, whether the CRA Code required the client or the CRA concerned to disclose such information under certain situations for investor protection purpose.	

Time Marker	Speaker	Subject(s)	Action Required
		SFC remarked that while there was no requirement identical to the one mentioned by the Chairman, the CRA Code required a client seeking credit rating service from a CRA to disclose its past credit ratings made by other CRAs, if any, to the CRA. SFC undertook to provide relevant information on this issue.	The Administration to take action as per paragraph 3 of the minutes.
013121 – 013726	The Chairman Administration	The Chairman requested the Administration/SFC to provide information on the following two issues: (a) in relation to the definition of "providing credit rating services", to review whether the present construction of the definition, particularly the phrase "with a reasonable expectation that they will be so distributed", may create a loophole; and (b) to review whether Type 4 regulated activity is actually distinct from the proposed Type 10 regulated activity, and whether the respective (proposed) scopes of the two regulated activities would create to a loophole in the regulatory regime under SFO.	The Administration to take action as per paragraph 3 of the minutes.
013727 – 013952	Mr CHIM Pui-chung Administration Chairman	Mr CHIM Pui-chung and the Chairman requested the Administration to advise the Subcommittee of (a) any regulated financial products the offer of which to the public was subject to credit rating requirements; and (b) any statutory/regulatory requirement regarding the standard of credit rating applicable to regulated financial products.	The Administration to take action as per paragraph 3 of the minutes.
013953 – 014104	Chairman	Members agreed to extend the scrutiny period for the subsidiary legislation to 13 April 2011.	

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