

立法會
Legislative Council

LC Paper No. CB(1)2659/10-11
(These minutes have been seen
by the Administration)

Ref : CB1/SS/9/10/2

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

Second meeting on
Thursday, 17 March 2011, at 4:30 pm
in Conference Room B of the Legislative Council Building

Members present : Hon James TO Kun-sun (Chairman)
Hon CHAN Kam-lam, SBS, JP
Hon Audrey EU Yuet-mee, SC, JP
Hon WONG Ting-kwong, BBS, JP
Hon CHIM Pui-chung

Public officers attending : Financial Services and the Treasury Bureau

Ms Mandy WONG
Principal Assistant Secretary (Financial Services)

Mr Bernard LO
Assistant Secretary (Financial Services)

Department of Justice

Ms Carmen CHU
Senior Government Counsel

Attendance by invitation : Securities and Futures Commission

Mr Stephen TISDALL
Senior Director of
Intermediaries Licensing and Conduct

Mr Wilson LO
Director of Licensing

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

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

Mr Hugo CHIU
Council Secretary (1)5

Ms Clara LO
Legislative Assistant (1)10

I Meeting with the Administration

(LC Paper No. CB(1)1613/10-11(01) — The Administration's response to issues raised at the Subcommittee meeting held on 8 March 2011

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

Discussion

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

Admin Follow-up actions to be taken by the Administration

2. The Administration was requested to take the following actions:
- (a) In relation to the sanctions applicable to credit rating agencies (CRAs) under the proposed regulatory regime, to advise the Subcommittee of –
- (i) whether the term "misconduct" is defined in the Securities and Futures Ordinance (Cap. 571) (SFO) or illustrated in any rule/code/guideline of the SFO regulatory regime;
 - (ii) on what ground(s) the Securities and Futures Commission (SFC) would decide to take a disciplinary action against a regulated person for misconduct or being not fit and proper to remain a regulated person, and what rules or guidelines SFC would follow in making determinations in disciplinary proceedings;

- (iii) whether the scope of misconduct only covers acts or omissions that are related to the regulated activity of providing credit rating services; if not, what other types of acts and omissions would also be covered and why; and
 - (iv) any precedents of disciplinary cases that can illustrate how a regulated person could be found guilty of misconduct or being not fit and proper to remain a regulated person.
- (b) To relay to the Board of Directors of SFC and the Secretary for Financial Services and the Treasury the Subcommittee's request that the term "misconduct" should be properly defined for the purpose of the SFO regulatory regime.
 - (c) To research into the regulatory regimes of comparable jurisdictions to ascertain whether under any of those regimes, there are any provisions in the relevant legislation specifying criminal or civil liability on CRAs for improper conducts performed in relation to the regulated activity of providing credit rating services.
 - (d) In relation to "private rating", to consider either (i) prohibiting the activity; or (ii) allowing the activity but requiring CRAs to include in the service agreement a provision to prohibit their clients from disseminating the rating result and information to the public.
 - (e) In relation to the phrase "with a reasonable expectation that they [i.e. credit ratings] will be so disseminated" in the definition of "providing credit rating services", to clarify whether the court is expected to apply an objective test in determining the existence of such reasonable expectation; and to consider revising the phrase to "with a reasonable **probability** (or **likelihood**) that they will be so disseminated" so as to filter out the possible dispute in relation to the term "expectation", which would involve a subjective element.
 - (f) To rewrite paragraphs 30-32 of the paper of LC Paper No. CB(1)1613/10-11(01) in a more precise manner.

(Post-meeting note: The Administration's response was circulated to members vide LC Paper No. CB(1)1676/10-11(01) on 23 March 2011.)

II Any other business

Date of next meeting

3. There being no other business, the meeting ended at 6:41 pm.

Council Business Division 1
Legislative Council Secretariat
5 July 2011

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

**Proceedings of the meeting on Thursday, 17 March 2011, at 4:30 pm
in Conference Room B of the Legislative Council Building**

Time Marker	Speaker	Subject(s)	Action Required
000608 000623	– Chairman	Opening remark	
000624 001805	– Administration Mr WONG Ting-kwong SFC	<p>The Administration briefed members on the paper "The Administration's response to issues raised at the Subcommittee meeting held on 8 March 2011" (LC Paper No. CB(1) 1613/10-11(01)) ("the paper").</p> <p>Mr WONG requested the Administration to clarify what constituted "misconduct or not fit and proper to remain a regulated person". The Securities and Futures Commission ("SFC") provided a number of examples to illustrate the terms "misconduct" and "fitness and properness".</p>	
001806 004133	– Chairman SFC Administration Mr WONG Ting-kwong Mr CHIM Pui-chung	<p>The Chairman asked whether the term "misconduct" was defined properly and clearly under the proposed regulatory regime.</p> <p>SFC replied that it would be impossible to define the term "misconduct" in a prescriptive manner. The usual approach adopted by the regulators in other developed markets was to examine the issue on a case-by-case basis having regard to the circumstances.</p> <p>The Chairman opined that if the term "misconduct" was not properly defined, the determinations of SFC in this regard would not be able to withstand judicial review.</p> <p>Noting the Administration's advice that the Securities and Futures Appeals Tribunal served as an appeal channel, the Chairman stated that misconduct should be defined precisely and in detail even if an appeal channel was present.</p> <p>The Chairman also opined that the sanctions under the proposed regulatory regime should be applied only to "misconduct" committed pursuant to the performance of the regulated activity, and</p>	The Administration to take action as per

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		<p>person for misconduct or being not fit and proper to remain a regulated person, and if there are any internal rules or guidelines for SFC to follow when making determination in disciplinary proceedings;</p> <p>(c) whether the scope of misconduct only covered acts or omissions that were related to the regulated activity of providing credit rating services; if not, what other types of act and omission that would also be also covered by the scope of misconduct and why; and</p> <p>(d) any precedents of the disciplinary cases that could illustrate how a regulated person could be found guilty of misconduct or being not fit and proper to remain a regulated person.</p>	
004134 – 005244	Administration Chairman	<p>The Administration pointed out a translation error in paragraph 8 of the Chinese version of the paper and clarified that there was no specific provision on the civil and/or criminal liabilities of CRAs and analysts under the proposed regulatory regime.</p> <p>The Chairman enquired whether there were specific provisions on the civil and/or criminal liabilities of CRAs in other jurisdictions. The Administration remarked that their understanding was that there were no such provisions.</p> <p>The Chairman remarked that a number of other ordinances providing for regulatory systems contained provisions specifying a number of improper acts or omissions that would bear civil and/or criminal liabilities. He was of the view that the way forward was either (i) add provisions to specify the improper conducts that would give rise to civil and/or criminal liabilities for Type 10 regulated activity at this stage; or (ii) withholding the addition of such provisions for the time being and conduct a holistic review on all ten types of regulated activities under SFO at a later time. To facilitate the Subcommittee's further consideration of the issue, the Chairman requested the Administration and SFC to research into the regulatory regimes of comparable jurisdictions to ascertain whether under any of those regimes, there are any provisions in the relevant legislation specify criminal or civil liability on CRAs for</p>	The Administration to take action as per paragraph 2 of

Time Marker	Speaker	Subject(s)	Action Required
		improper conducts performed in relation to the regulated activity of providing credit rating services.	the minutes.
005243 011337	– Administration SFC Chairman Mr CHAN Kam-lam	<p>The Administration and SFC briefly highlighted the relevant clauses in the "Code of Conduct for Persons Providing Credit Rating Services" ("CRA Code") to tackle the issue of conflict of interests.</p> <p>At the Chairman's request, SFC clarified the meaning of the sentence "<i>A CRA should also define what it considers to be an ancillary business and why it cannot reasonably be considered to have the potential to give rise to any conflict of interest with the CRA's credit rating business</i>" in paragraph 30 of the CRA Code. The Chairman sought clarification on the duty of the CRA as specified in this sentence, and remarked that a CRA might deliberately adopt a narrow definition. As such, he suggested using the wording "properly define" instead. SFC explained that it would examine the definition made by a CRA to ensure that the definition was proper and the relevant ancillary business would not lead to conflict of interests with the CRA's credit rating business.</p> <p>Referring to a question on conflict of interests raised by Ms Audrey EU at the last meeting, the Chairman enquired whether the relevant code/guideline could prevent CRAs from adopting a relaxed approach in making credit rating in order to attract business. Mr CHAN considered that such scenario would not happen because (i) CRA were required to use objective data in making credit rating; and (ii) other CRAs might provide credit rating on the same financial product/institution and recurrent deviations of the credit rating made by a CRA would draw the attention of SFC. The Chairman enquired whether SFC would be concerned with such scenario. SFC responded that while credit rating was an expression of opinion and SFC could not determine whether the credit rating made by a CRA was right or wrong, the CRA Code had specified a number of requirements to ensure that CRAs would conduct credit rating in an objective manner.</p>	

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011338 – 011848	Administration	The Administration explained the financial resource requirements on CRAs as per paragraphs 13-17 of the paper. Members raised no questions.	
011849 – 012501	Administration Chairman	<p>SFC took members through those sections of the draft CRA Code with substantive difference from the international standards. They included paragraphs 6, 34(b) and 71 of the Code.</p> <p>The Chairman asked whether the draft CRA Code contained any provisions that were more relaxed than the international standards. SFC replied in the negative.</p>	
012502 – 013400	ALA8 Administration SFC Chairman	<p>ALA8 enquired why paragraphs 38 to 40 of the draft CRA Code enclosed to SFC's consultation document had been deleted in the current draft. SFC explained that those paragraphs were included in the previous draft CRA Code because the relevant requirements were then being proposed by the US regulatory authority. However, those requirements were eventually neither adopted by the EU nor included in the international standards like the revised Code of Conduct Fundamentals for Credit Rating Agencies issued by the International Organisation of Securities Commissions in May 2008 ("IOSCO Code"), and thus SFC had decided to remove the relevant paragraphs from the CRA Code.</p> <p>In reply to the Chairman, SFC confirmed that the requirements set out in the current draft CRA Code were generally more stringent than those based on the international standards.</p>	
013401 – 013620	Chairman Administration	<p>In relation to paragraph 18 of the paper, the Chairman expressed concern that SFC had conducted public consultation on the CRA Code before the relevant legislation had been enacted by the Legislative Council.</p> <p>The Administration responded that since Hong Kong currently did not have a regulatory regime for CRAs, market practitioners, when being consulted on the proposed regulatory framework, would be keen to know the applicable regulatory standards and requirements. Besides, as the CRA Code had to be effective when the enacted legislation commence operation, the present</p>	

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		<p>arrangement would enable early implementation of the proposed regulatory regime.</p> <p>The Chairman did not entirely agree with the Administration's explanation and considered that more preferable arrangements like the publication of a White Bill could have been made instead.</p>	
013621 014223	– Administration Chairman SFC	<p>The Administration took members through paragraphs 21-24 of the paper regarding the suggestion of requiring CRAs to take out indemnity insurance.</p> <p>The Chairman sought confirmation on whether CRAs would be expected to take out insurance, and enquired whether professional negligence would be covered by the insurance taken out by CRAs. SFC replied that operational risks covered professional negligence. Since CRAs would take out insurance on operational risks, professional negligence would also be covered.</p>	
014224 015008	– Administration Chairman SFC	<p>The Administration briefed members on paragraph 25 of the paper on measures to prevent product issuers from hiding the (previous) unfavorable credit ratings.</p> <p>The Chairman remarked that the measures only imposed obligations on CRAs but not their clients. SFC explained that clauses 18, 47 and 52 of the CRA Code would ensure that issued rating could not be concealed.</p>	
015009 015849	– Administration Chairman SFC	<p>The Administration briefed members on paragraphs 26-29 of the paper regarding potential loophole created by (i) the definition of "providing credit rating services" and (ii) possible overlap between Type 4 regulated activity and Type 10 regulated activity.</p> <p>The Chairman clarified his concern. He stated that paragraph 4 of the Legislative Council Brief provided by the Administration set out a number of scenarios not covered by Type 10 regulated activity. In this connection, a client might ask a CRA to conduct private rating for it and then unilaterally disclosed the credit rating. As a result, such private rating might circumvent the regulation of Type 10 regulated activity. He further considered that the Administration might</p>	

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		<p>need to eliminate the loophole by making amendments to Type 4 regulated activity, and/or that the service agreements must include provisions prohibiting clients from disseminating the advice received (including rating results) to the public.</p> <p>SFC responded that private rating was beyond the scope of Type 4 regulated activity. SFC also remarked that while in practice, a CRA would usually enter into a contract with its client restricting the dissemination of credit rating information to the public, SFC could not control the action of the client.</p> <p>In view of SFC's explanation, the Chairman suggested that in relation to "private rating", the Administration consider either (i) prohibiting the activity; or (ii) allowing the activity but requiring CRAs to include in the service agreement a provision to prohibit their clients from disseminating the rating result and information to the public. SFC remarked that it might tackle the issue by refining paragraph 19 of the CRA Code.</p>	<p>The Administration to take action as per paragraph 2 of the minutes.</p>
<p>015850 – 020538</p>	<p>ALA8 Chairman Administration SFC</p>	<p>With respect to the phrase "with a reasonable expectation that they [i.e. credit ratings] will be so disseminated" in the definition of "providing credit rating services", ALA8 suggested that the Administration clarify whether the court is expected to apply an objective test in determining the existence of such reasonable expectation; and to consider revising the phrase to "with a reasonable probability (or likelihood) that they will be so disseminated" so as to filter out the possible dispute in relation to the term "expectation", which would involve a subjective element. SFC undertook to study the issue.</p>	<p>The Administration to take action as per paragraph 2 of the minutes.</p>
<p>020539 – 020935</p>	<p>Administration Chairman SFC</p>	<p>The Administration briefed members on paragraphs 30-32 of the paper which sought to address the concern raised by members in the last meeting regarding (i) any financial product that was regulated by credit rating requirements before such product was offered to the public; and (b) any regulatory requirement regarding the standard of credit rating applicable to regulated financial products.</p>	

Time Marker	Speaker	Subject(s)	Action Required
		SFC suggested that paragraphs 30 and 31 could benefit from being made clearer. In view of this, the Chairman requested the Administration and SFC to rewrite paragraphs 30-32 of the paper in a more precise manner.	The Administration to take action as per paragraph 2 of the minutes.
020936 – 021004	Chairman	The Chairman said that the Clerk would liaise with the Administration regarding the date of next meeting.	

Council Business Division 1
Legislative Council Secretariat
5 July 2011