

**立法會**  
**Legislative Council**

LC Paper No. CB(1)2028/11-12

(These minutes have been seen  
by the Administration)

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**Panel on Financial Affairs**

**Minutes of meeting**

**held on Monday, 2 April 2012 at 10:45 am  
in Conference Room 3 of the Legislative Council Complex**

**Members present :** Hon CHAN Kam-lam, SBS, JP (Chairman)  
Hon CHAN Kin-por, JP (Deputy Chairman)  
Hon Albert HO Chun-yan  
Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP  
Hon James TO Kun-sun  
Hon Emily LAU Wai-hing, JP  
Hon Abraham SHEK Lai-him, SBS, JP  
Hon Jeffrey LAM Kin-fung, GBS, 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  
Hon Paul CHAN Mo-po, MH, JP  
Hon Mrs Regina IP LAU Suk-ye, GBS, JP

**Members absent :** Dr Hon David LI Kwok-po, GBM, GBS, JP  
Dr Hon Philip WONG Yu-hong, GBS  
Hon LEE Wing-tat  
Hon Ronny TONG Ka-wah, SC

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

Mr Darryl CHAN  
Deputy Secretary for Financial Services and the  
Treasury (Financial Services)

Agenda Item IV

Mr Nick AU YEUNG  
Principal Assistant Secretary for Financial Services  
and the Treasury (Financial Services)

Miss Joey LEE  
Assistant Secretary for Financial Services and the  
Treasury (Financial Services)

Agenda Item V

Ms Sophia KAO  
Chairman  
Financial Reporting Council

Dr KAM Pok-man  
Chief Executive Officer  
Financial Reporting Council

Mr CHAN Tak-shing  
Senior Director, Investigation and Compliance  
Financial Reporting Council

Agenda Item VI

Mr Anthony LI  
Principal Assistant Secretary for  
Financial Services and the Treasury (Financial  
Services) 2

Mr Edmond LAU  
Executive Director, Monetary Management  
Hong Kong Monetary Authority

Mr Daryl HO  
Head, Market Development  
Hong Kong Monetary Authority

**Attendance by invitation :** Agenda Item VI

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

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

Mr Gerald D GREINER  
Chief Operating Officer  
Hong Kong Exchanges and Clearing Limited

Mr Kelvin LEE  
Vice President  
Platform Development and Strategy Department  
Hong Kong Exchanges and Clearing Limited

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

**Staff in attendance :** Mr Noel SUNG  
Senior Council Secretary (1)5

Ms Haley CHEUNG  
Legislative Assistant (1)5

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**I Confirmation of minutes of meetings and matters arising**

(LC Paper No. CB(1)1227/11-12 — Minutes of the meeting on  
15 December 2011

LC Paper No. CB(1)1417/11-12 — Minutes of the meeting on  
6 February 2012)

The minutes of the meetings held on 15 December 2011 and 6 February 2012 were confirmed.

## **II Information paper issued since the last meeting**

(LC Paper No. CB(1)1245/11-12(01) — Administration's information note in response to the letter from Hon Albert CHAN on issue of commemorative banknotes by the Bank of China (Hong Kong) Limited)

2. Members noted the information paper issued since the last regular meeting held on 2 March 2012.

## **III Date of next meeting and items for discussion**

(LC Paper No. CB(1)1411/11-12(01) — List of outstanding items for discussion

LC Paper No. CB(1)1411/11-12(02) — List of follow-up actions

LC Paper No. CB(1)1461/11-12(01) — Letter dated 28 March 2012 from Hon Mrs Regina IP LAU Suk-yee on Hong Kong Mortgage Corporation (English version only)

### Meeting in May 2012

3. The Chairman stated that the Chief Executive, Hong Kong Monetary Authority (HKMA) would be on overseas duty visit in early May 2012 and would not be able to brief the Panel on the work of HKMA at the meeting originally scheduled for 7 May 2012. He suggested and members agreed to defer the meeting to 21 May 2012 to discuss the following items:

- (a) Briefing on the work of HKMA; and
- (b) Electricity charges subsidy.

Members noted that item (b) above was proposed by the Administration.

### The Hong Kong Mortgage Corporation

4. The Chairman remarked that Mrs Regina IP had sent in a letter requesting the Administration to review the role and scope of business of the

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Hong Kong Mortgage Corporation (HKMC). The Chairman pointed out that the Panel had previously discussed the role and operation of HKMC at the meeting on 2 November 2009.

5. Mrs Regina IP remarked that since its incorporation in 1997, HKMC had progressively diversified its business portfolio offering a variety of new financial services which had gone beyond the original business scope of the corporation. Mrs IP opined that given the various changes to HKMC's role and services over the past 15 years, it was about time that the Government should conduct a comprehensive review of HKMC's objects and the parameters of its business.

6. The Chairman suggested and members agreed that the Administration should be requested to give a written response to Mrs IP's letter so that the Panel would consider whether the issue should be discussed by the Panel.

*(Post-meeting Note: The Administration's response to Mrs IP's letter was issued to members vide LC Paper No. CB(1)1870/11-12 on 15 May 2012.)*

#### **IV Consultation on the detailed proposals on trust law reform**

(LC Paper No. CB(1)1411/11-12(03) — Administration's paper on "Consultation on the Detailed Legislative Proposals on Trust Law Reform"

LC Paper No. CB(1)1397/11-12(01) — Administration's consultation paper on "Detailed legislative proposals on trust law reform"

LC Paper No. CB(1)1408/11-12 — Background brief on review of the trust law regime in Hong Kong prepared by the Legislative Council Secretariat)

#### Briefing by the Administration

7. At the invitation of the Chairman, the Deputy Secretary for Financial Services and the Treasury (Financial Services) (DS(FS)) briefed members on the legislative proposals to reform Hong Kong's trust law, by highlighting the salient points in the paper.

## Discussion

8. Mr James TO enquired whether there were any trust laws which had been recently introduced in overseas jurisdictions but were not included in the legislative proposals made by the Administration.

9. DS(FS) responded that in drawing up the detailed legislative proposals, the Financial Services and the Treasury Bureau (FSTB) had consulted and taken into account the views of the trust industry in Hong Kong, represented by the Joint Committee on Trust Law Reform. FSTB had also drawn reference from other comparable common law jurisdictions such as the United Kingdom (UK) and Singapore in formulating the legislative proposals. DS(FS) pointed out that while the legislation of some offshore jurisdictions provided greater flexibility on the rights of settlors and on non-charitable purpose trusts, the Government had to be careful in considering whether such legislative provisions were suitable for adoption in Hong Kong, as the major international regulatory concern was to ensure the transparency of the operation of trusts, and to guard against fraudulent arrangements for tax evasion in the guise of trusts.

10. Mr James TO enquired whether the Government had liaised with the relevant authorities in the Mainland regarding the legislative proposals, e.g. whether the trusts set up in Hong Kong were recognized under the laws in the Mainland, as many customers of trust funds came from the Mainland.

11. DS(FS) responded that trusts adopting Hong Kong law as the governing law were regulated by the laws of Hong Kong. In general, the Hague Convention on the Law Applicable to Trusts and on their Recognition would govern the regulation of trusts in different jurisdictions.

12. In response to the Chairman's enquiry as to why the current proposals did not include provisions against Forced Heirship Rules, DS(FS) responded that while the relevant industry was in favour of introducing provisions against the Forced Heirship Rules in the legislative proposals, research showed that there was a need to further examine the interaction of such provisions with overseas legislation and rules. The Government was conducting further study on this subject having regard to the experience of relevant overseas jurisdictions, and would consider incorporating such provisions in the amendment bill in the light of the study findings.

13. Mr Paul CHAN welcomed the public consultation on the detailed proposals for trust law reform. He enquired whether charitable trusts were covered under the current legislative proposals, and if covered, whether

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provisions would be made to ensure the transparency of charitable trusts, such as the requirements on the trustees to make public the information of the trusts, the financial statements and annual reports of the trusts. Mr CHAN expressed concern that some trustees might not act in the best interest of the beneficiaries, and an effective regulatory system was essential to protect the rights of the beneficiaries, especially when the Administration did not propose to introduce any legislation on beneficiaries' rights to information. Mr CHAN further enquired whether provisions would be made for the regulatory/enforcement bodies to conduct spot checks on the trustees so as to prevent malpractice, and whether the Administration would consider establishing a public register system to publicize the detailed information and financial reports of trusts. The Chairman and the Deputy Chairman shared Mr CHAN's concerns.

14. DS(FS) responded that the proposed amendments to the Trustee Ordinance (Cap. 29) (TO) and the Perpetuities and Accumulations Ordinance (Cap. 257) (PAO) would cover all types of trusts, including charitable trusts. However, given the special nature of charitable trusts, some specific requirements had been included in the legislative proposals for charitable trusts. For example, while the rules against excessive accumulations of income would be abolished for other trusts, the REA would still apply to charitable trusts in order to prevent the undesirable effect of allowing charitable trusts to accumulate income for more than 21 years without applying the income for charitable purposes. DS(FS) pointed out that currently there was not a mandatory registration regime for trusts, and trustees had the discretion whether they preferred to be registered in the form of trust companies under the TO. As the current trust law reform exercise had already reached an advanced stage, any major proposal on the regulatory arrangements for charitable trusts might lead to delay in implementing the legislative proposals and might adversely affect the asset management businesses of Hong Kong. DS(FS) remarked that under a separate context, FSTB liaised with the Law Reform Commission (LRC) on the review of the legal and regulatory framework for charities, and Mr CHAN's concerns could be further considered in that context.

15. At the request of Mr Paul CHAN, DS(FS) agreed to provide a comparison table setting out the latest legislative proposals to reform Hong Kong's trust law regime and the latest trust statutes of some common law and offshore jurisdictions, in order to facilitate interested parties to provide comments on the detailed legislative proposals.

*(Post-meeting note: The information provided by the Administration was issued to members vide LC Paper No. CB(1)1648/11-12 on 20 April 2012.)*

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16. Noting that the Administration proposed to widen the scope of the trustees' power to take out insurance to cover any property against any loss or damage by any event and to remove the insured limit so that the property could be insured up to its market value or full replacement value, the Deputy Chairman was concerned which party/parties, the trustees and/or the beneficiaries, would be empowered to decide the types and scope of insurance to be taken out, and in case of dispute, the arrangements for settling the issue.

17. DS(FS) responded that one of the objectives of the trust law reform was to offer protection and guidance to settlors, trustees and beneficiaries. He said that as trustees had the responsibility to effectively manage the trusts, the trustees would be empowered to decide the types and scope of insurance to be taken out for the trusts. The proposed arrangement was in line with the practice in other common law jurisdictions such as UK and Singapore. In order to protect beneficiaries' interests, provisions were proposed to be made to subject the trustees to certain requirements, including the application of the statutory duty of care, the requirement on the trustees to give the agent a statement on the exercise of asset management functions, and the duty of the trustees to review the arrangements relating to the employment of agents.

18. Mr Albert HO was concerned that many charitable trusts were set up in the form of a company limited by guarantee under the Inland Revenue Ordinance (Cap. 112). He considered that the Government had a responsibility to regulate such charitable trusts. Mr HO remarked that under the "void for uncertainty" principle, a trust could be invalidated if the objectives of the trust were uncertain. Mr HO was concerned that many charitable trusts were set up in overseas countries which might not be regulated under the laws of Hong Kong, although the assets and custodians involved were based in Hong Kong. Mr HO enquired how such overseas trusts could be regulated in Hong Kong.

19. DS(FS) responded that charities established in the form of companies limited by guarantee should be regulated by the Companies Ordinance (Cap. 32). FSTB would liaise with the LRC and relevant Government Bureaux/departments regarding the review on the legal and regulatory framework for charitable organizations. DS(FS) pointed out that the current trust law reform could not codify all the laws relating to trusts under the common law, but aimed primarily to update the relevant legislation in order to meet the need of modern-day trusts, and the request of the trust industry to revise the relevant legislation as soon as possible.

20. DS(FS) advised that the current legislative proposals had made reference to those in comparable jurisdictions such as the UK and Singapore. Although the trust laws in some offshore jurisdictions provided greater



flexibility for the relevant parties in the management of the trusts, such arrangements had aroused the concern of international authorities as to whether the trusts set up in these jurisdictions would become a tax evasion instrument. The Government had to be very careful in considering whether trust laws provisions similar to those in the offshore jurisdictions should be adopted in Hong Kong.

21. Mr Jeffrey LAM was concerned that some wealthy people might use a trust to evade tax payments if a settlor was allowed to decide the types and amounts of investments of the trust funds. Mr LAM enquired whether any safeguards would be put in place to prevent such malpractice. Mr LAM opined that a balance had to be struck between the protection of the interests of the trustees and the beneficiaries in the legislative proposals.

22. DS(FS) responded that the Government had made reference to the trust statute in Singapore in drawing up the proposed provisions for a settlor to retain certain powers in deciding the investments of his trust. The arrangement would not contravene the relevant principle under the common law, and according to the trust industry, would encourage more people to set up their trusts in Hong Kong and adopt Hong Kong laws. He however pointed out that a settlor might face the risk of his trust being ruled as invalid in court if they controlled fully or to a significant extent the investments of the trust.

23. Mr Jeffrey LAM enquired about the arrangements to handle complaints that the trustees charged an unreasonably high management fee for the trusts.

24. DS(FS) responded that although provisions had been made in the legislative proposals that the professional trustees might be entitled to remuneration, they would be subject to reasonable safeguards if the trust instruments did not contain a charging clause. For instance, to guard against any possible abuse by trustees in seeking remuneration, a legislative proposal was made to include provisions for collective scrutiny of trustees' remuneration, i.e. a professional trustee (other than a trust corporation) was entitled to remuneration only if he was not the sole trustee and all other trustees had unanimously agreed that he might be remunerated and the remuneration was "reasonable".

25. Mr Paul CHAN pointed out that in some overseas jurisdictions, the trustees were required to take out professional indemnity insurance. Mr CHAN enquired whether the legislative proposals had included such a requirement, and considered that the relevant industry should be consulted on such an arrangement.

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26. DS(FS) responded that the legislative proposals did not include any clauses to compel trustees to take out insurances, as the trustees, based on their assessment of the risks in the investments of the relevant trusts, might decide whether and what types of insurance coverage should be provided for the trusts. DS(FS) added that a trust company had to meet the statutory requirements for setting up such company, such as the required capital level, and depositing a guarantee with the Government.

27. In response to Mr Paul CHAN's enquiry as to whether the relevant industry had drawn up operation guidelines for trustees, DS(FS) replied that the trust industry was in the process of preparing a code of practice for compliance by the relevant parties.

**V Annual briefing on the work of the Financial Reporting Council**

(LC Paper No. CB(1)1411/11-12(04) — Financial Reporting Council's paper on "Progress Report on the work of the Financial Reporting Council"

LC Paper No. CB(1)1409/11-12 — Background brief on the Work of the Financial Reporting Council prepared by the Legislative Council Secretariat)

Briefing by the Financial Reporting Council

28. The Senior Director, Investigation and Compliance, Financial Reporting Council (SD(IC)/FRC) briefed members, through a Powerpoint presentation, on the work of FRC in the past year.

*(Post-meeting note: The notes of the Powerpoint presentation (LC Paper No. CB(1)1502/11-12(01)) were issued to members vide Lotus Notes e-mail on 2 April 2012.)*

Declaration of interest

29. Mr Paul CHAN declared interest that he represented the accountancy constituency in the Legislative Council, and was a non-executive joint chairman of an accounting firm.

## Discussion

30. Mr Jeffrey LAM expressed concern that when the FRC focused its work on certain industry and accounting themes, it might create an impression that FRC would pay less attention to the financial reporting work in other fields.

31. The Chairman, FRC responded that FRC selected the themes for its risk-based financial statements review programme each year after consultation with other relevant regulatory bodies, which reflected the concerns of market participants over the listed companies in the relevant period. The Chief Executive Officer, FRC (CEO/FRC) supplemented that out of the 70 financial statements reviewed in 2011 under the review programme, only 20 financial statements were selected based on the accounting and industry themes, and the remaining reviews were selected against other risk-based criteria as explained in the presentation.

32. Given that irregularities had been reported by the media or found in the audit reports of certain Hong Kong-listed Mainland private enterprises, and the increasing number of Mainland companies listed in Hong Kong in the past years, Mr Jeffrey LAM enquired what steps had been taken by FRC to enhance the checking of the financial statements of Mainland companies listed in Hong Kong.

33. The Chairman, FRC remarked that in view of media reports on the irregularities of some of the Hong Kong-listed Mainland private enterprises, FRC had maintained a list of these companies for the purpose of continuous monitoring. FRC had discussed with other relevant regulatory bodies on the issues concerned and the appropriate actions required. FRC would review the financial reports of these companies to check against possible auditing or reporting irregularities, and/or possible non-compliance with accounting requirements once they had issued their financial reports. Meanwhile, the Securities and Futures Commission was looking into a number of alleged malpractice cases involving the companies concerned. CEO/FRC added that FRC, the Hong Kong Institute of Certified Public Accountants (HKICPA) and the Hong Kong Exchanges and Clearing Limited (HKEx) had shared the review of all four Hong Kong-listed Mainland companies which opted to appoint Mainland auditors and prepare their 2010 financial statements in accordance with "China Accounting Standards for Business Enterprises". Based on the findings in the reviews, FRC had discussed with the Ministry of Finance regarding the areas of concern, and the Ministry of Finance would in turn discuss the relevant issues with the companies concerned. For the 2011 financial year, the number of such cases increased to 27. FRC, HKICPA and HKEx would continue to share the review of these companies' financial

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statements in their respective financial statements review programmes and discuss the findings with the Ministry of Finance.

34. Mr Paul CHAN expressed support for the work of FRC. He opined that "fair value" should be included as an accounting theme for the risk-based financial statements review programme, as the financial arrangements, including investments and advances, made by holding companies with/for their subsidiaries and/or associated corporations were an area prone to irregularities, particularly at times of adverse economic conditions. Mr CHAN was of the view that the financial statements review programme should cover overseas corporations listed in Hong Kong especially those corporations that were involved in unique businesses such as mining. Mr CHAN also enquired whether FRC would review the Initial Public Offer documents of listed companies.

35. The Chairman, FRC thanked Mr CHAN for his support and responded that the risk-based financial statements review programme already covered the 24 overseas corporations listed in Hong Kong, and so far irregularities had not been found in the relevant financial statements. FRC would take into consideration Mr CHAN's suggestion regarding "fair value" in drawing up the accounting theme in the future risk-based financial statements review programme. The Chairman, FRC remarked that the review of the financial statements of newly listed companies was an integral part of the review programme, and FRC would continue to keep a close watch on the relevant financial statements. CEO/FRC added that the HKICPA had issued a new accounting standard on fair value measurement, and FRC would consider selecting fair value measurement as an accounting theme in the future. The number of reviews under the risk-based financial statements review programme would be increased from 70 to 75 in 2012 as a result of the increase in the number of listed companies in Hong Kong.

36. Mr Paul CHAN opined that information on complaints relating to fraud and false accounting should be included in the report of the FRC. He also suggested that in analyzing the complaints received, FRC should pay attention to the accounting firms involved in the complaints so that enforcement work could be targeted at accounting firms which were the subject of frequent complaints.

37. The Chairman, FRC remarked that FRC would take into consideration Mr CHAN's views in its enforcement work and in preparing future annual reports.

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38. In response to Ir Dr Raymond HO's enquiry regarding the percentage of modified auditors' reports reviewed by FRC and the problems identified in the reviews, the Chairman, FRC remarked that FRC reviewed all modified auditors' reports of listed companies, and had screened 434 modified auditors' reports since the proactive review approach was adopted in July 2008. CEO/FRC added that out of the 131 modified auditors' reports reviewed in 2011, only 71 reports revealed potential non-compliance with accounting requirements, including auditors not being able to obtain sufficient information to substantiate the results of the operations of subsidiaries. The remaining 60 reports only highlighted specific events of the companies, e.g. the involvement of the company in a lawsuit or going concern uncertainties.

39. In response to the concern raised by Ir Dr Raymond HO on the auditing standard adopted in the Mainland, the Chairman, FRC remarked that the auditing standard in the Mainland, as recognized by the European Union, was on a par with the international auditing standard.

40. The Deputy Chairman asked about the actions that might be taken by FRC if and when an independent non-executive director(s) of a listed company resigned. The Chairman, FRC said that FRC paid close attention to such incidents and would take extra care in reviewing the financial reports of the companies concerned.

41. The Deputy Chairman enquired whether any prosecution actions had been taken as a result of the reviews conducted by FRC on the financial reports of listed companies.

42. The Chairman, FRC responded that FRC had completed the investigation of 12 cases relating to possible auditing or reporting irregularities in the past years. As FRC was not empowered to impose sanctions on the parties concerned, FRC had referred 11 cases to the HKICPA for consideration of disciplinary actions. Out of the 11 referral cases, the HKICPA had issued disapproval letters to the accounting firms concerned in two cases. The disciplinary committee of HKICPA was currently handling two cases, whereas the remaining seven cases were still being considered by HKICPA. As regards the six completed enquiry cases undertaken by FRC, four listed companies had rectified their financial reports as a result of FRC's reviews, while no further follow-up actions were required for the remaining two cases. The Chairman, FRC stated that in cases (arising from either complaints received or review of financial statements) involving potential non-compliance with accounting requirements which did not affect the fair presentation of the financial statements, FRC would issue letters of advice to the listed companies and/or their auditors outlining its findings and suggesting improvement measures,

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instead of instituting an investigation and/or an enquiry. In 2011, FRC had issued 11 letters of advice to listed companies.

43. In reply to Mr Paul CHAN's enquiry about the actions taken by FRC regarding the termination of the service of two auditors shortly after two relevant companies had been listed in Hong Kong, the Chairman, FRC said that SFC was investigating into the two cases, and FRC would review the financial statements of the two listed companies when the relevant financial statements were published.

## **VI Progress in the regulation of over-the-counter derivatives market**

(LC Paper No. CB(1)1411/11-12(05) — Administration's paper on "Progress in the Regulation of Over-the-counter Derivatives Market"

LC Paper No. CB(1)1410/11-12 — Background brief on the regulation of over-the-counter derivatives market prepared by the Legislative Council Secretariat)

44. At the invitation of the Chairman, the Head, Market Development, Hong Kong Monetary Authority (H(MD)/HKMA) and Senior Director, Supervision of Markets Division, Securities and Futures Commission (SD(SM)/SFC) briefed members, through a Powerpoint presentation, the progress in developing a full-fledged regulatory regime for the over-the-counter (OTC) derivatives market and the proposed introduction of interim measures to facilitate voluntary clearing on OTC derivatives transactions.

*(Post-meeting note: The notes of the Powerpoint presentation (LC Paper No. CB(1)1502/11-12(02)) were issued to members vide Lotus Notes e-mail on 2 April 2012.)*

### Discussion

45. Mrs Regina IP enquired about the financial arrangement for the establishment and operation of the Central Counterparty (CCP) by Hong Kong Exchanges and Clearing Limited (HKEx). Mrs IP opined that a levy could be imposed on the transactions of OTC derivatives cleared at the CCP in order to finance the operation of the CCP.

46. The Executive Director, Supervision of Markets Division, Securities and Futures Commission (ED(SM)/SFC) remarked that the CCP would charge a fee on the OTC derivative transactions based on "the user pays" principle and no levy would be imposed by the SFC on transactions cleared by the CCP under the current regulatory regime. ED(SM)/SFC pointed out that currently many OTC derivatives transactions were made directly between institutional investors. When a public platform was required to be set up for trading OTC derivatives transactions, e.g. in the Stock Exchange of Hong Kong, the SFC would consider imposing a levy on transactions conducted by users of the platform.

47. Mrs Regina IP enquired about the international trend in the volume of OTC derivatives transactions after the global financial crisis and the Lehman Brothers incident. Mr Paul CHAN enquired whether the proposed regulatory framework would cover foreign exchange derivatives.

48. The Executive Director, Monetary Management, HKMA (ED(MM)/HKMA) remarked that the total notional amount outstanding of OTC derivatives transactions in the world amounted to about US\$614,674 billion by the end of December 2009, the majority of which were interest-rate related derivatives. The OTC derivatives transactions in Hong Kong followed the international pattern although the size of the market in Hong Kong was relatively small, constituting less than 1% (about 0.6% in 2009) of the overall transactions in the world. The OTC derivatives market continued to grow after the Lehman Brothers incident, as derivatives were required for hedging purpose in the securities markets. Since the majority of the foreign exchange derivatives involved short-term foreign exchange swaps whose risk was relatively low, these derivatives would not be covered in the initial stage of the proposed OTC derivatives regulatory regime. ED(MM)/HKMA remarked that the requirement for foreign exchange derivatives transactions to be cleared at the CCP would probably be introduced at the next stage of the regulatory proposal in 2013, having regard to the international development of the regulation of OTC derivatives. ED(MM)/HKMA stressed that the scope of coverage for regulation of foreign exchange derivatives had to be carefully mapped out as the majority of the derivatives involved short-term foreign exchange swaps whose risk was relatively low.

49. Mrs Regina IP enquired about the estimated volume of the OTC derivatives transactions to be cleared through the proposed CCP. Mrs IP further enquired whether a compensation fund would be established to protect the investors under the proposed regulatory regime.

50. ED(MM)/HKMA responded that at the initial stage, the reporting and clearing requirement would be applied to interest rate swaps and non-deliverable forwards, the transactions of which amounted to a gross notional value of about US\$2,428 billion and about US\$2,770 billion respectively in 2009. ED(MM)/HKMA pointed out that institutional investors might choose to clear the transactions of interest rate swaps and non-deliverable forwards through a recognized overseas CCP. ED(SM)/SFC added that as generally speaking only institutional investors were involved in OTC derivatives transactions, SFC did not consider that the establishment of an investor compensation protection fund for such transactions was necessary.

51. Mr Paul CHAN was concerned that apart from institutional investors and Authorized Institutions (AIs), some insurance companies and large enterprises, e.g. Citic Pacific, were also involved in transactions of foreign exchange derivatives. Mr CHAN pointed out that the OTC derivatives transactions of insurance companies and large enterprises might be of such volume that posed systemic risks. He considered that there should be mechanisms to enable interference of the regulatory bodies with such activities of insurance companies and large enterprises.

52. ED(SM)/SFC responded that many insurance companies and large enterprises were end-users rather than dealers in foreign exchange derivatives. As a mechanism to handle systemic risks, the legislative proposals would include provisions whereby if an end-user was found to have acquired a large volume of OTC derivatives, SFC could exercise its power to request the end-user to provide details of the transactions, and if necessary, demand the end-user to reduce the size of OTC derivatives held by it. Companies, including insurance companies, if dealing in OTC derivatives transactions, would be required to be licensed by SFC.

53. The Chairman remarked that given that the current term of the Legislative Council would end in July 2012, the Government should submit the relevant legislative proposals to the Council for consideration as soon as possible.

## **VII Any other business**

### Complaints relating to the Lehman Brothers incident

54. Referring to her question raised at the Council meeting of 28 March 2012 regarding claims for compensation from investors of Lehman Brothers-related investment products, Mrs Regina IP requested that the



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Administration should provide more information on the latest development of the issue, including:

- (a) the number of eligible investors in Hong Kong who might claim for compensation from Lehman Brothers Holdings Inc., the respective types of Lehman Brothers-related investment products concerned, the respective amounts of claims involved, and the estimated time when the investors would receive their compensation;
- (b) the channels through which the eligible investors in Hong Kong might file their claims;
- (c) what assistance the Government, the HKMA, SFC and/or the distributing banks concerned would render to the eligible investors in making their claims; and
- (d) whether the Government had any mechanism to monitor the liquidation process of the Lehman Brothers Holdings Inc. and report the progress to the public/investors concerned.

*(Post-meeting Note: The information provided by the Government was issued members vide LC Paper No. CB(1)1719/11-12 on 27 April 2012.)*

55. There being no other business, the meeting ended at 12:55 pm.

Council Business Division 1  
Legislative Council Secretariat  
29 May 2012