

立法會
Legislative Council

LC Paper No. CB(1)248/13-14
(These minutes have been seen
by the Administration)

Ref : CB1/BC/12/12

Bills Committee on Securities and Futures (Amendment) Bill 2013

Second meeting on
Monday, 30 September 2013, at 2:30 pm
in Conference Room 1 of the Legislative Council Complex

Members present : Hon CHAN Kam-lam, SBS, JP (Chairman)
Hon Christopher CHEUNG Wah-fung, JP (Deputy Chairman)
Hon James TO Kun-sun
Hon WONG Ting-kwong, SBS, JP
Hon Starry LEE Wai-king, JP
Hon CHAN Kin-por, BBS, JP
Hon NG Leung-sing, SBS, JP
Hon Steven HO Chun-yin
Hon Kenneth LEUNG
Hon Dennis KWOK

Member absent : Hon SIN Chung-kai, SBS, JP

Public officers attending : Miss Salina YAN, JP
Deputy Secretary for Financial Services and
the Treasury (Financial Services) 1

Miss Ada CHAN
Principal Assistant Secretary for Financial Services and
the Treasury (Financial Services) 2

Mr Howard LEE
Executive Director (Monetary Management)
Hong Kong Monetary Authority

Mr Daryl HO
Head (Market Development)
Hong Kong Monetary Authority

Ms Polly LEE
Senior Manager (Market Development) 3
Hong Kong Monetary Authority

Attendance by invitation : Securities and Futures Commission

Mr Keith LUI
Executive Director (Supervision of Markets)

Mr Rico LEUNG
Senior Director (Supervision of Markets)

Ms Daphne DOO
Director (Supervision of Markets)

Deputations

Citigroup Global Markets Asia Ltd

Mr William CHING
Managing Director, Regional Product Control

Citibank N.A. Hong Kong Branch

Ms Pearl WAI
Director, Legal Department

The Hong Kong Society of Financial Analysts

Mr Jimmy JIM
Immediate Past President

Miss Ashley KHOO
Advocacy Chair

Clifford Chance

(On behalf of Barclays Bank PLC, BNP Paribas, Citibank, N.A., Credit Suisse AG, Deutsche Bank AG, Goldman Sachs (Asia) LLC, The Hongkong and Shanghai Banking Corporation Limited, J.P. Morgan, Morgan Stanley and Standard Chartered Bank)

Mr Francis EDWARDS

Partner

The Hongkong and Shanghai Banking Corporation Limited

Mr Ross MACHENZIE

Associate General Counsel

Civic Party

Mr Raymond LEE

District Developers

CME Group Hong Kong Limited

Mr Timothy LOH

Solicitor

Mr Hubert FENG

Associate General Counsel

Hong Kong Inter-Dealer Brokers Association

Mr Denis CHEUNG

Member of the Hong Kong Inter-Dealer Brokers Association

(Managing Director of Nittan Capital Asia Ltd.)

Mr Peter PAO

Member of the Hong Kong Inter-Dealer Brokers Association

(Greater China Director of BGC Partners)

Clerk in attendance : Ms Connie SZETO
Chief Council Secretary (1)4

Staff in attendance : Miss Winnie LO
Assistant Legal Adviser 7

Ms Angel SHEK
Senior Council Secretary (1)4

Ms Sharon CHAN
Legislative Assistant (1)4

Action

I Confirmation of minutes of meeting

(LC Paper No. CB(1)1794/12-13(01) — Minutes of the meeting on
24 July 2013)

The minutes of the meeting held on 24 July 2013 were confirmed.

II Meeting with deputations and the Administration

Meeting with deputations

(LC Paper No. CB(1)1817/12-13(01) — Submission from The Hong
Kong Society of Financial
Analysts

LC Paper No. CB(1)1817/12-13(02) — Submission from Clifford
Chance

LC Paper No. CB(1)1817/12-13(03) — Submission from CME Group
Hong Kong Limited

LC Paper No. CB(1)1817/12-13(07) — Submission from The Hong
Kong Inter-Dealer Broker
Association)

Submissions/letters from organizations not attending the meeting

(LC Paper No. CB(1)1817/12-13(04) — Submission from Hong Kong
Investment Funds Association

LC Paper No. CB(1)1817/12-13(05) — Submission from The Hong
Kong Association of Banks

LC Paper No. CB(1)1817/12-13(06) — Submission from SinoPac Securities (Asia) Limited

LC Paper No. CB(1)1817/12-13(08) — Submission from The Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies

LC Paper No. CB(1)1817/12-13(09) — Submission from TriOptima Group

LC Paper No. CB(1)1833/12-13(01) — Submission from Hong Kong Exchanges and Clearing Limited

LC Paper No. CB(1)1833/12-13(02) — Submission from Hong Kong Bar Association

LC Paper No. CB(1)1849/12-13(01) — Submission from the Law Society of Hong Kong
(tabled at the meeting and issued vide Lotus Notes email on 30 September 2013)

Other relevant papers

(LC Paper No. CB(3)742/12-13 — The Bill

LC Paper No. CB(1)1584/12-13(01) — Marked-up copy of the Bill prepared by the Legal Service Division (Restricted to Members)

File Ref: SUB 12/2/7 (2013) — Legislative Council Brief

LC Paper No. LS71/12-13 — Legal Service Division Report

LC Paper No. CB(1)1584/12-13(02) — Background brief on the Securities and Futures (Amendment) Bill 2013 prepared by the Legislative Council Secretariat)

2. The Chairman welcomed representatives of the Administration and deputations to the meeting. He reminded the deputations that their written submissions provided to the Bills Committee and views presented at the meeting would not be covered by the protection and immunity provided under the Legislative Council (Powers and Privileges) Ordinance (Cap. 382).

Declaration of interests

3. Mr Kenneth LEUNG declared that he was the head of the taxation division of Clifford Chance which was among the deputations attending the meeting. The Chairman declared that he was a non-executive director of the Securities and Futures Commission.

Discussion

4. The deputations presented their views on the Bill and the Bills Committee deliberated (Index of proceedings attached at **Appendix**).

Follow-up actions to be taken by the Administration

5. Regarding the proposed amendments to the Securities and Futures Ordinance (Cap. 571) and the Organized and Serious Crimes Ordinance (Cap. 455) relating to disgorgement orders for market misconduct offences under Part 5 of the Bill, the Administration was requested to (a) explain the rationale for the proposed amendments; (b) clarify the scope of disgorgement, including whether it would be limited to the gains as a result of market misconduct offences; and (c) provide the upper limit, if any, on the amount recoupable by the disgorgement orders.

(Post-meeting note: The Administration's written response was issued to members vide LC Paper No. CB(1)47/13-14(02) on 11 October 2013.)

III Any other business

Date of next meetings

6. Members agreed that the next meeting would be held on Tuesday, 15 October 2013, at 2:30 pm and the Bills Committee would commence clause-by-clause examination of the Bill at the meeting.

7. Members further agreed on the following schedule of meetings from late October to December 2013 –

Date of meeting	Time
28 October 2013 (Monday)	10:45 am – 12:45 pm
12 November 2013 (Tuesday)	10:45 am – 12:45 pm
22 November 2013 (Friday)	10:45 am – 12:45 pm
10 December 2013 (Tuesday)	2:30 pm – 4:30 pm
20 December 2013 (Friday)	8:30 am – 10:30 am

8. There being no other business, the meeting ended at 3:45 pm.

Council Business Division 1
Legislative Council Secretariat
7 November 2013

**Proceedings of the
Bills Committee on Securities and Futures (Amendment) Bill 2013
Second meeting on Monday, 30 September 2013, at 2:30 pm
in Conference Room 1 of the Legislative Council Complex**

Time Marker	Speaker	Subject(s)	Action Required
000414 – 000443	Chairman	Confirmation of minutes of meeting on 24 July 2013 (LC Paper No. CB(1)1794/12-13)	
000444 – 000923	Chairman	Introductory remarks	
000924 – 000959	Mr Kenneth LEUNG Chairman	Declaration of interests	
Presentation of views by deputations and the Administration's initial responses			
001000 – 001120	Citigroup Global Markets Asia Ltd ("CGMA")	CGMA expressed support for the initiative to provide a regulatory framework for the over-the-counter ("OTC") derivative market in Hong Kong in the light of the lesson drawn from the global financial crisis of 2008 and having regard to international regulatory developments. CGMA hoped that the reform would be conducive to enhancing the stability and liquidity of the OTC derivative market, and strengthening Hong Kong's competitiveness as an international financial centre.	
001121 – 001213	Citibank N.A. Hong Kong Branch ("Citibank")	Citibank was supportive of the legislative proposals to regulate the OTC derivative market in Hong Kong. Citibank's views were incorporated in the submission provided by Clifford Chance ("CC") (LC Paper No. CB(1)1817/12-13(02)).	
001214 – 001357	The Hong Kong Society of Financial Analysts ("HKSFSA")	(LC Paper No. CB(1)1817/12-13(01)) (a) HKSFSA supported in general the proposed mandatory reporting and clearing obligations in respect of OTC derivative transactions. (b) The reform should be taken forward under a reasonable timeframe and appropriate transitional arrangements with due regard to the readiness of the industry's system	

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		<p>infrastructure and practicability of the measures.</p> <p>(c) There should be a pilot scheme with large corporations and test runs to ensure industry readiness before full implementation of the reform.</p> <p>(d) Apart from the product class, the underlying securities of products should also be taken into account when considering the mandatory obligations.</p> <p>(e) Welcomed the proposal on mandatory clearing of standardized OTC derivative transactions through designated central counterparties ("CCPs") but the complex nature of derivatives and sufficiency of the CCP facilities to support clearing of trades from multiple venues should be amongst the factors to be considered.</p>	
001358 – 001757	CC	<p>(LC Paper CB(1)1817/12-13(02))</p> <p>(a) CC supported the two-stage process for implementing reforms to the OTC derivative market, i.e. providing the broad regulatory framework in the Bill and setting out the details in subsidiary legislation to be made by the Securities and Futures Commission ("SFC") with the consent of the Hong Kong Monetary Authority ("HKMA") after consultation with the Financial Secretary ("FS"). The regulators should conduct thorough market consultation on the detailed rules to be made under the regulatory regime.</p> <p>(b) It was important to align the requirements of OTC derivative regulatory regime with international standards to avoid potential conflicts with similar rules in other jurisdictions and adverse impact on the liquidity and efficiency of the OTC derivative market in Hong Kong, as well as to minimize the risk of regulatory arbitrage/cost. One way to address the risks was to provide for a mechanism whereby compliance with certain equivalent obligations imposed by overseas</p>	

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		<p>regulators would be deemed to be sufficient for compliance with mandatory obligations in Hong Kong.</p>	
001758 – 002034	Civic Party ("CP")	<p>(a) CP agreed on the need to introduce a regulatory framework for the OTC derivative market in Hong Kong in view of the structural deficiencies in the market revealed by the global financial crisis in 2008.</p> <p>(b) The proposed mandatory obligations should apply only to certain types of interest rate swaps and non-deliverable forwards ("NDFs") at the initial stage, and any subsequent extension to cover other types of OTC derivative transactions would be determined jointly by HKMA and SFC in the form of subsidiary legislation after public consultation and consultation with FS.</p> <p>(c) In view of the complexity of derivative products and the expected growth in retail investors in the OTC derivative market, it was necessary for the regulators to make reference to comparable legislation overseas, in particular the Dodd-Frank Wall Street Reform and Consumer Protection Act in the United States ("US"), in order to strengthen the protection of retail investors.</p>	
002035 – 002429	CME Group Hong Kong Limited ("CME")	<p>(LC Paper CB(1)1817/12-13(03))</p> <p>CME expressed support for the Bill in general and had the following concerns:</p> <p>(a) The absence of transitional provisions for the expanded definition of automated trading service ("ATS") and for the designation of CCPs and trading platforms might result in abrupt end to the business of existing service operators as the services in question were not authorized or designated before the approval of their applications for the new/expanded regulated activities ("RAs") by SFC. This might become a deterrent to offering such services locally, and the limited availability</p>	

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		<p>of operators of trading and clearing services for OTC derivative transactions might increase systemic risks.</p> <p>(b) There should be provisions for fast track authorization and designation of credible overseas operators of trading and clearing systems as ATS or CCP in Hong Kong. This would increase the number of trading and clearing systems available in Hong Kong, offer more options for risk reduction at a lower cost, particularly for local financial intermediaries, and reduce conflicts between requirements of different jurisdictions.</p> <p>(c) As all clearing systems posed systemic risks, statutory insolvency protection should be extended to all ATSs providing clearing services and not only limited to those designated by SFC as CCPs.</p>	
002430 – 002529	Hong Kong Inter-Dealer Brokers Association ("HKIDBA")	<p>(LC Paper CB(1)1817/12-13(07))</p> <p>HKIDBA generally supported the Bill to provide a regulatory framework for OTC derivative transactions but considered that the scope of OTC derivative transactions should be carefully determined as certain types of derivatives, such as NDFs involving foreign currency trading, were not suitable to be traded on an exchange or electronic platform.</p>	
002530 – 003312	Administration	<p>The Administration's initial responses to the deputations' views as follows:</p> <p>(a) It was observed that the industry generally supported the proposal to introduce a regulatory regime for the OTC derivative market and recognized the need for Hong Kong to implement related measures in line with G20 commitments of reforming the OTC derivative market.</p> <p>(b) HKMA and SFC were mindful of the need to strike a balance between strengthening regulation and reducing compliance burden on the industry. They would strive to facilitate a smooth implementation of the reform, including introducing appropriate</p>	

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		<p>transitional arrangements for the new licensing requirements.</p> <p>(c) In preparation for future implementation, licensed banks had been required to report certain OTC derivative transactions to the trade repository of HKMA since August 2013. HKMA and SFC would conduct thorough consultation with the relevant stakeholders in drafting the subsidiary legislation.</p> <p>(d) The legislative proposals would strengthen investor protection by introducing a regulatory framework for OTC derivative transactions, enhancing the transparency of these activities, enabling regulators to monitor build-up of exposures that might pose systemic risks to the market or the wider economy, thus reducing the contagion risk.</p> <p>(e) The existing investor protection regime under the Securities and Futures Ordinance ("SFO") (Cap. 571) would continue to offer protection for retail investors of OTC derivative products. Public offer of securities and futures products would continue to require SFC's authorization of the product documentation, and intermediaries involved in the sales process were subject to conduct regulation (e.g. the requirements on information disclosure, know-your-client, and audio-recording of the sales process).</p>	
003313 – 003629	Chairman SFC HKMA	<p>The responses of HKMA and SFC to the deputations' views as follows:</p> <p>(a) HKMA and SFC placed emphasis on alignment and harmonization of OTC derivative regulatory requirements with those in other major jurisdictions, and the need to provide adequate lead time for the industry to prepare for the reform. The two financial regulators had all along maintained communication with overseas regulatory bodies and the local financial services industry with a view to facilitating</p>	

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		<p>a smooth implementation of the new regulatory regime and minimizing conflicting requirements.</p> <p>(b) In view of the enhanced investor protection regime following the Lehman Brothers incident and that mainly institutional investors were involved in OTC transactions (and, if offered to retail investors, had to be governed by existing provisions of SFO), it was unnecessary to include provisions for retail investor protection in the Bill. It would be inappropriate to make a direct comparison on the legislative approach and provisions included in the Bill with those of the Dodd-Frank Wall Street Reform in US due to differences in the legal background and circumstances of the two regimes.</p>	
003630 – 004508	Chairman Mr Kenneth LEUNG CC Administration SFC	<p>Mr LEUNG sought the deputations' views on necessary improvement to the Bill for achieving alignment with international standards and requirements.</p> <p>CC pointed out that the regulatory framework was broadly in line with the international reform initiatives and it was essential that similar approach be adopted in the subsidiary legislation.</p> <p>Mr LEUNG observed that while the types of RA licences had increased since implementation of SFO in 2003, the scope of each RA had reduced. He expressed concern that industry players, in particular the small and medium securities firms, would be disadvantaged as a result because they had to apply for several licences for their business. He enquired about the criteria adopted by SFC for introducing new types of licences or expanding the scope of existing licences.</p> <p>SFC's responses as follows:</p> <p>(a) There were initially nine types of RA licences covering the general and common activities in the securities and futures market when SFO was implemented in</p>	

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		<p>2003. After the financial crisis of 2008, it was a global trend to strengthen financial regulation, including enhancing oversight of intermediaries, and hence licensing for certain types of financial activities/services not carried out by ordinary market participants were deemed necessary in the light of market developments. For instance, Type 10 RA was introduced in respect of credit rating services.</p> <p>(b) As the existing licences for Type 1 and 2 RA covered dealing in securities and futures contracts respectively and did not cover OTC derivatives, and in order to tie in with the requirements for the proposed mandatory clearing of OTC derivative transactions through designated CCPs, two new RAs in relation to OTC derivatives were introduced under the Bill, namely (i) a new Type 11 RA to cover the activities of dealers and advisers, and (ii) a new Type 12 RA to cover the activities of clearing agents. The services relating to the new Type 11 and 12 RA licences were mainly provided by large financial institutions.</p> <p>(c) The existing Type 9 RA (asset management) and Type 7 RA (provision of ATS) would be expanded to cover OTC derivative portfolios and transactions respectively.</p>	
004509 – 005449	Ms Starry LEE HKSF CME Administration	<p>Ms LEE welcomed the Bill and invited comments from deputations on difficulties envisaged in the implementation of the new regime.</p> <p>HKSF highlighted the following major concerns expressed by market participants:</p> <p>(a) increase in compliance cost on financial institutions and hence shift of business to overseas markets;</p> <p>(b) the potential difficulty for prescribed persons to report derivative transactions, and the regulators to ensure integrity in mandatory reporting given that the</p>	

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		<p>transactions might not be booked in Hong Kong and the prescribed persons might not deal with the transaction parties directly;</p> <p>(c) certain types of OTC derivatives, such as NDFs, might not be suitable for trading on exchanges; and</p> <p>(d) the need for the regulators to take into account the nature of derivatives in implementing the regulatory regime in a careful and phased manner in order to maintain Hong Kong's competitiveness.</p> <p>CME opined that the industry was uncertain about the details of implementation as the relevant subsidiary legislation had yet to be drawn up and released for public consultation.</p> <p>The Administration and HKMA responded as follows:</p> <p>(a) In implementing the new regulatory regime, the Administration and the regulators would be mindful that the increase in compliance cost should be reasonable and worthwhile vis-à-vis the benefits to be gained.</p> <p>(b) Given that regulation of OTC derivative transactions was a global initiative, market players around the world would equally face an increase in their compliance cost. This would enable all market players to operate on a level-playing field. On the other hand, Hong Kong might be put at a disadvantage position if it did not catch up with the international trends in regulating OTC derivative transactions.</p> <p>(c) HKMA and SFC planned to launch a public consultation on the relevant subsidiary legislation by the end of 2013. The two regulators would continue to engage the industry, consider deputations' views raised at the meeting and in the submissions, in drafting the subsidiary legislation.</p>	

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005450 – 005816	Mr CHAN Kin-por Deputy Chairman Administration	<p>Mr CHAN enquired if the Administration and regulators had received views or objections from stakeholders, in particular the small and medium financial institutions, on the Bill.</p> <p>The Administration advised that all views from the stakeholders regardless of their scale of operation would be taken into account. The major concerns raised by the said stakeholders were increase in compliance cost and licensing arrangements for the new/expanded RAs. The regulators would adopt a pragmatic approach to facilitate compliance of requirements by the market players.</p> <p>The Deputy Chairman pointed out that small to medium sized firms usually did not participate in the OTC derivative market.</p>	
005817 – 010123	Chairman Deputy Chairman Administration HKMA	<p>The Deputy Chairman was pleased to note the support from deputations for the reform and the need to enhance investor protection.</p> <p>The Deputy Chairman enquired about the sharing with market participants of information collected by HKMA under mandatory reporting of specified OTC derivative transactions in a transparent and fair manner as these data would be of valuable reference to the market.</p> <p>HKMA was aware that the data to be collected from mandatory reporting would be market sensitive and should be handled with care. HKMA advised that it would consult the industry and take into account international developments in this regard in working out the arrangements for disclosing the information, including the timing and means for releasing the relevant data to the market.</p>	
010124 – 010927	Chairman Mr Kenneth LEUNG SFC HKSA Administration	<p>In reply to Mr LEUNG, SFC advised that the financial resources requirements for obtaining the new Type 12 RA licence would be specified in subsidiary legislation.</p> <p>Mr LEUNG invited deputations' views on whether there should be a prescribed number of designated clearing systems for the purpose of mandatory clearing of OTC derivatives as a few</p>	

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		<p>or single designated clearing system could give rise to issues of monopoly. He also enquired about the Administration's policy in this regard, and the plan to designate the Central Clearing and Settlement System ("CCASS") of the Hong Kong Exchanges and Clearing Limited ("HKEx") as the sole clearing system.</p> <p>HKSFSA responded that the major concerns of the industry about the clearing systems to be designated related to the credit risks of the systems concerned and the costs on users. Currently, Hong Kong dollar debt securities were mainly cleared and settled through HKMA's Central Moneymarkets Unit ("CMU") which was a highly recognized clearing system in the market. The market might not prefer too many clearing systems for clearing OTC derivative transactions.</p> <p>SFC's responses as follows:</p> <p>(a) Prescribed persons would be required to clear specified OTC derivative transactions through a designated CCP either directly as a member of the designated CCP or indirectly through a third party that was a member of the designated CCP. The clearing agents had to obtain the Type 12 RA licence for providing the clearing services for OTC derivatives.</p> <p>(b) SFC would be empowered to designate CCPs for the purpose of mandatory clearing obligation, and both local and overseas CCPs might be designated subject to their meeting the relevant requirements. Subject to approval of SFC, HKEx would commence operation of a local CCP as one of the designated CCPs.</p> <p>(c) It would be a matter of commercial decision for the clearing agents and their clients to select the designated CCP for the purpose of mandatory clearing of OTC derivative transactions.</p> <p>Mr LEUNG enquired whether institutions undertaking very few and infrequent OTC derivative transactions in their business, say</p>	

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		<p>only for hedging purposes, would be required to clear the transactions through a designated CCP.</p> <p>The Administration and SFC advised that authorized institutions, approved money brokers, licensed corporations and other prescribed persons that were based in or operated from Hong Kong would be required to clear eligible OTC transactions through a designated CCP, irrespective of the number or frequency of the transactions conducted as long as their derivative positions were over certain thresholds. For those who were not licensed or registered with either HKMA/SFC, but whose positions and activities in the OTC derivative market were substantial which might pose systemic risks (i.e. the systematically important participants), they would be required to notify SFC if their OTC derivative positions exceeded certain notification thresholds.</p>	
010928 – 011322	Chairman Mr Kenneth LEUNG Administration	<p>Mr LEUNG enquired about the proposed amendments to SFO and the Organized and Serious Crimes Ordinance (Cap. 455) ("OSCO") relating to disgorgement orders and confiscation orders respectively for market misconduct offences under Part 5 of the Bill.</p> <p>The Administration explained that the proposed amendments to SFO aimed to allow recouping of the illegal gains from market misconduct offences through disgorgement orders made by criminal courts. The proposed amendments to OSCO would enable confiscation orders to be made under OSCO in relation to the proceeds derived from market misconduct offences so as to comply with the international standards in combating money laundering and terrorism financing activities.</p> <p>At the request of Mr LEUNG, the Administration agreed to provide written information to (a) explain the rationale for the proposed amendments; (b) clarify the scope of disgorgement, including whether it would be limited to the gains as a result of market misconduct offences; and (c) provide the upper limit, if any, on the amount recoupable by the disgorgement orders.</p>	The Administration to take follow-up action as required in paragraph 5 of the minutes

Time Marker	Speaker	Subject(s)	Action Required
011323 – 011509	Chairman	Dates of future meetings	

Council Business Division 1
Legislative Council Secretariat
7 November 2013