

立法會
Legislative Council

LC Paper No. CB(1)1838/12-13

(These minutes have been seen
by the Administration)

Ref : CB1/PL/FA/1

Panel on Financial Affairs

Minutes of meeting

held on Friday, 5 July 2013 at 10:00 am

in Conference Room 1 of the Legislative Council Complex

Members present : Hon Starry LEE Wai-king, JP (Chairman)
Hon CHAN Kin-por, BBS, JP (Deputy Chairman)
Hon Albert HO Chun-yan
Hon James TO Kun-sun
Hon CHAN Kam-lam, SBS, JP
Hon Abraham SHEK Lai-him, GBS, JP
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon Andrew LEUNG Kwan-yuen, GBS, JP
Hon WONG Ting-kwong, SBS, JP
Hon Ronny TONG Ka-wah, SC
Hon Mrs Regina IP LAU Suk-yea, GBS, JP
Hon James TIEN Pei-chun, GBS, JP
Hon NG Leung-sing, SBS, JP
Hon Kenneth LEUNG
Hon Dennis KWOK
Hon Christopher CHEUNG Wah-fung, JP
Hon SIN Chung-kai, SBS, JP

Member attending : Hon KWOK Wai-keung

Public officers : Agenda Item IV
attending

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

Mr Eddie CHEUNG
Deputy Secretary for Financial Services and the
Treasury (Financial Services) 2

Mr Paul WONG
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services)
Special Duties

Mr Danny YUEN
Assistant Law Officer (Commercial) (Acting)
Department of Justice

Agenda Item V

Miss Sara TSE
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services) 1

Attendance by invitation : Agenda item V

Mrs Alexa LAM
Acting Chief Executive Officer,
Deputy Chief Executive Officer,
Executive Director, Investment Products
International and China
Securities and Futures Commission

Ms Christina CHOI
Senior Director, Investment Products
Securities and Futures Commission

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 meetings and matters arising

(LC Paper No. CB(1)1403/12-13 — Minutes of the special meeting on 28 January 2013)

The minutes of the special meeting held on 28 January 2013 were confirmed.

II Information papers issued since the last meeting

(LC Paper No. CB(1)1242/12-13(01) — Letter dated 4 June 2013 from Hon TANG Ka-piu proposing discussion on issues arising from over-deduction of cash value from Octopus cards (Chinese version only)

LC Paper Nos. CB(1)1265/12-13(01) — Letter dated 11 June 2013 and (02) from the Hong Kong Mortgage Corporation Limited ("HKMC") (English version only) attaching the 2012 Annual Report of HKMC)

2. Members noted the information papers issued since the last regular meeting held on 3 June 2013.

III Date of next meeting and items for discussion

(LC Paper No. CB(1)1401/12-13(01) — List of outstanding items for discussion

LC Paper No. CB(1)1401/12-13(02) — List of follow-up actions)

3. The Chairman said that Mr Christopher CHEUNG proposed in his letter dated 29 May 2013 that the Panel should discuss the consultation paper issued by the Securities and Futures Commission ("SFC") on the proposed amendments to the professional investor regime and client agreement requirements. Mr CHEUNG said that, as SFC's proposed amendments would have a potential impact on the operation of securities firms, and the public consultation would end on 14 August 2013, he hoped that the Panel could convene a special meeting as soon as possible to receive views from representatives of the securities industry on the consultation paper. Supporting Mr CHEUNG's suggestion, Mr Abraham SHEK considered that the special meeting should be held before the end of the current legislative session.

4. Referring to the letter dated 24 May 2013 from Mr KWOK Wai-keung, the Chairman said that Mr KWOK had proposed the Panel to discuss regulatory issues relating to the sale of travel insurance arising from the hot air balloon accident in Egypt. The Administration had been requested to provide a written response to the issues raised by Mr KWOK, which was circulated to members earlier on. Mr KWOK said that, as the issues essentially concerned the interests of the general public in taking out travel insurance, the Panel should discuss the matter as soon as possible. Members did not raise objection to Mr KWOK's request.

5. At the suggestion of the Chairman, members agreed that a special meeting be held on Tuesday, 16 July 2013 from 3:00 pm to 6:00 pm to –

- (a) discuss regulatory issues relating to the sale of travel insurance; and
- (b) meet with deputations for views on SFC's consultation paper on the proposed amendments to the professional investor regime and client agreement requirements.

6. For item (a) above, members agreed to Mr KWOK Wai-keung's suggestion that representatives from the travel and insurance industries and members of the Panel on Economic Development be invited to join discussion of the item. For item (b), members agreed on posting a notice on the website of the Legislative Council ("LegCo") and writing to the 18 District Councils ("DCs") to invite the views of the public and DCs on SFC's consultation paper. The Chairman said that members might contact the Secretariat after the meeting if they wish to invite relevant organizations for providing submissions and/or making oral presentation of views on item (b).

(Post-meeting note: A notice was posted on LegCo's website and invitation letters were issued to the 18 DCs on 5 July 2013 to invite

submissions on SFC's consultation paper. Members were informed of the arrangements and the list of organizations invited to give views vide LC Paper No. CB(1)1467/12-13 issued on 8 July 2013.)

7. Members noted that Mr TANG Ka-piu had written to the Chairman on 4 June 2013 proposing discussion on issues relating to over-deduction of amounts by Octopus cards. The Chairman suggested and members agreed that the Hong Kong Monetary Authority ("HKMA") be invited to provide a written response on the matter before the Panel considered how to follow up Mr TANG's request. The matter would be included in the Panel's "List of outstanding items for discussion" in the meantime.

(Post-meeting note: HKMA's written response was issued to members vide LC Paper No. CB(1)1684/12-13 issued on 12 August 2013.)

IV Proposed establishment of an independent Insurance Authority – consultation conclusions on key legislative proposals

(LC Paper No. CB(1)1387/12-13(01) — Administration's paper on "Key Legislative Proposals on Establishment of an Independent Insurance Authority – Consultation Conclusions"

LC Paper No. CB(1)1401/12-13(03) — Background brief on proposed establishment of an independent Insurance Authority prepared by the Legislative Council Secretariat)

Briefing by the Administration

8. At the invitation of the Chairman, the Deputy Secretary for Financial Services and the Treasury (Financial Services) 2 gave a powerpoint presentation on the outcomes of the public consultation on the key legislative proposals for the establishment of an independent Insurance Authority ("IIA"), and the Administration's responses to major views expressed by the respondents. The proposals included the governance, funding mechanism and power of IIA, and the licensing regime for insurance intermediaries and conduct requirements on insurance intermediaries. Members noted that the Administration planned to introduce a bill to amend the Insurance Companies

Ordinance (Cap. 41) for establishing IIA ("the amendment bill") into LegCo in the 2013-2014 legislative session with a view to setting up IIA in 2015.

(Post-meeting note: The powerpoint presentation (LC Paper No. CB(1)1463/12-13(01)) was issued to members vide Lotus Notes e-mail on 5 July 2013.)

Discussion

9. The Chairman declared that she was a member of the Insurance Advisory Committee and Mr CHAN Kin-por declared that he was returned by the Functional Constituency of Insurance.

Power and functions of the independent Insurance Authority

10. In response to Mr Albert HO's enquiry about the major difference between the regulatory regime of IIA and that under the Securities and Futures Ordinance (Cap. 571) ("SFO"), the Permanent Secretary for Financial Services and the Treasury (Financial Services) ("PS(FS)) pointed out that in formulating the regulatory regime of the insurance intermediaries, the Administration had made reference to similar regulatory regimes, including that for the Mandatory Provident Fund ("MPF") intermediaries which was endorsed by the Legislative Council in 2012. The regulatory regime for the MPF intermediaries itself had also drawn reference from the regime under SFO. Therefore, there were common features among the three regimes.

11. With the increase in the number of complex insurance products in the market, Mr Kenneth LEUNG enquired whether IIA would be empowered to authorize new insurance products. PS(FS) responded that insurance was a private contract between a policyholder and an insurer. The insurer would need to design different insurance products to meet the needs of their clients. Having regard to overseas experience, the Administration considered that the IIA would not possess the necessary commercial knowledge to approve new insurance products to meet evolving market needs. However, with a view to enhancing consumer protection, she believed that the IIA should closely monitor the changing market landscape and issue guidelines for strengthening product disclosure, in order to enable potential policyholders to make an informed decision.

12. The Chairman considered that the function of IIA should include promoting the development of the insurance industry apart from regulation of the insurance market. PS(FS) said that the revised proposal had included a new function for IIA to promote the competitiveness of the insurance industry in the global insurance market. In formulating new regulatory requirements for

insurance intermediaries, IIA would also seek to adopt a pro-compliance attitude in order to facilitate the intermediaries to comply with the requirements, e.g. by issuing guidelines.

13. Mr Jeffrey LAM remarked that the industry welcomed the Administration's decision not to pursue the original proposal to introduce the specified suspension power ("SSP"). Given the Administration's decision on SSP, Mr WONG Ting-kwong enquired about measures IIA would take to enhance protection for policyholders against repeated misconduct committed by insurers or insurance intermediaries and breaches of requirements by them. Mr Albert HO enquired whether SFC was currently vested with power similar to SSP.

14. PS(FS) pointed out that there were concerns from the insurance industry to the introduction of SSP on grounds of procedural justice, as the effect of SSP would be akin to imposing a disciplinary sanction before a disciplinary proceeding was concluded. She further noted that SFC was not vested with any power similar to SSP under SFO. The Administration had considered these concerns, and on balance, decided not to pursue the introduction of SSP but to ensure effective implementation of the other regulatory arrangements in order to protect the policyholders. For instance, to enhance conduct regulation, an insurer and a corporate insurance intermediary would be required to appoint a responsible officer ("RO") to ensure that there would be a specified person responsible for the internal control system in respect of conduct compliance by insurance intermediaries, and for the provision of appropriate training to the intermediaries. Moreover, under the proposed licensing regime, IIA could impose proportionate disciplinary sanctions against misconduct committed by regulated persons. IIA would also step up investor education for assisting potential policyholders to make an informed decision.

Pecuniary penalty on insurers and insurance intermediaries

15. Mr Jeffrey LAM pointed out that the industry remained concerned about the heavy pecuniary penalty limit of \$10 million for misconduct of regulated persons. He enquired whether the Administration would consider the industry's suggestion of imposing different pecuniary penalties for corporate intermediaries and individual intermediaries. Mr CHAN Kin-por suggested that the Administration should specify in the amendment bill that the pecuniary penalty imposed by IIA should not put a regulated person into financial jeopardy. The Chairman said that she did not subscribe to the Administration's response to the industry's concern about the proposed pecuniary penalty. She pointed out that the maximum penalty of \$10 million would have serious impacts on small and medium sized insurance intermediaries or individual

agents/brokers, but might have little deterrence effect on large insurance intermediaries. The Chairman enquired whether the Administration would consider the industry's suggestion of imposing the pecuniary penalty on regulated persons with reference to the profit gained by them as result of the misconduct. On the other hand, Mr James TO expressed support for the maximum pecuniary penalty of \$10 million given that the senior staff of some insurance companies had received huge bonuses and the imposition of disciplinary sanctions with sufficient deterrence would be necessary to prevent regulated persons from using improper means (like misleading clients in the sale of insurance products) to gain profits.

16. PS(FS) responded that there was a wide spectrum of regulated persons in the insurance industry ranging from small individual insurance intermediaries to large corporations such as multinational banks and international insurance brokers. Hence, it was important that the pecuniary penalties should have adequate deterrence against non-compliance or misconduct of different regulated persons. On the suggestion of imposing different pecuniary penalty levels for corporate and individual regulated persons, PS(FS) responded that implementation of the suggestion would be difficult as there was a broad range of financial positions among corporate insurance intermediaries and individual intermediaries, e.g. even individual insurance intermediaries could enjoy a high income. She advised that the Administration had made reference to the practices of other financial regulators. In addition to a statutory pecuniary penalty maximum, these regulators would also publish guidelines on how they might calibrate the level of a pecuniary penalty. Relevant factors for consideration in determining an appropriate level of penalty would usually include proportionality of the penalty to the nature and severity of the misconduct, whether it was a repeated act, the deterrence of the penalty, and the financial position of the regulated persons (which could include the profits made). PS(FS) said that the future IIA would also be mindful that the penalty imposed should not put the regulated persons into financial jeopardy. PS(FS) pointed out that apart from the absolute amount, insurance intermediaries, especially the large ones, would also be concerned as to how the pecuniary penalty would affect their reputation. On the other hand, PS(FS) advised that besides the pecuniary penalty, a range of other disciplinary sanctions, including reprimand, suspension or revocation of licence, and prohibition of licence application within a specified period, would be available to IIA.

Sale of investment-linked insurance products

17. Pointing out that some investment-linked insurance products consisted mainly of investment elements and were financial products in essence, Mr Albert HO enquired whether such insurance products were subject to the regulation of SFC. He also expressed concern about insufficient training for intermediaries selling such products in ensuring protection of interest of investors/policyholders concerned.

18. On investment-linked insurance products, PS(FS) responded that under the existing law, the offering documents were subject to the approval of SFC. The Administration welcomed the various regulatory requirements introduced by the industry and the regulators for investment-linked insurance products since 2009. These included requirements on disclosure, professional training and post-sale services. On professional training, the insurance intermediaries were required to pass additional examinations before being allowed to sell such products. Another development was the introduction of a "cooling-off period" to enhance consumer protection. Also, insurers would have to make post-sale calls to policyholders during the "cooling-off period" to ensure that they understood the salient features of these products.

19. Mr CHAN Kin-por pointed out that after the Lehman Brothers incident, there had been substantial changes in the approval and sale process for financial products. For instance, invitation or document on the offer of funds and investment-linked insurance products were subject to approval by SFC. As for the sale of financial products, banks were required to make audio record of the selling process between bank staff and their clients. Similar measure would be implemented in the insurance industry for investment-linked insurance products from July 2013 onwards. A "cooling-off period" arrangement had also been implemented.

20. Mr James TO considered that investment-linked insurance products should be subject to stringent approval as the potential problems associated with such products might not surface in the short run but he had reservation about providing IIA with the power to regulate investment-linked insurance products.

21. While supporting the establishment of IIA, Mr Abraham SHEK pointed out that the Lehman Brothers incident had exposed problems of subjecting one industry to the regulation by multiple regulatory authorities, including inconsistent regulatory standards adopted by different regulators and practitioners unfamiliar with certain financial products could be allowed to sell such products. Mr SHEK suggested that the amendment bill should plug these loopholes. Noting that insurance intermediaries selling investment-linked

insurance products were not required to apply for relevant licences from SFC at present, Mr Albert HO shared Mr SHEK's concern. Mr CHAN Kin-por remarked that before insurance intermediaries were allowed to sell investment-linked insurance products, they were required to take the relevant examination. The industry was also advocating the issuance of licences by SFC for such insurance intermediaries.

22. PS(FS) said that a stringent regulatory approach was adopted in approving the offering documents of investment-linked insurance products. She confirmed that such products would fall under the definition of "collective investment scheme" ("CIS") of SFO and were subject to approval by SFC. This arrangement would remain unchanged upon the establishment of IIA. PS(FS) added that the conduct requirements of insurance intermediaries would be strengthened upon the establishment of IIA. The IIA would enforce a statutory licensing regime for insurance intermediaries which would replace the current self-regulatory regime operated by several trade bodies. Moreover, SFC had established the Investor Education Centre to enhance consumers' understanding and knowledge of financial products, and investment-linked insurance products were on top of its agenda. PS(FS) further pointed out that under the proposed licensing regime, IIA could impose licensing conditions on insurance intermediaries in view of new market developments.

The Governing Board of the independent Insurance Authority

23. Mr KWOK Wai-keung welcomed the revised proposal to incorporate more representatives of the insurance industry in the Governing Board of IIA ("the GB"), and the proposals that the two Industry Advisory Committees ("IACs") of IIA and the Expert Panel would both comprise members from the insurance industry. Noting that the revised proposal only specified that the GB would comprise "at least two directors with knowledge of and experience in the insurance industry", Mr KWOK relayed the industry's concern that the revised proposal could not ensure sufficient representation of the insurance industry on the GB as there was no ceiling on the number of directors in the GB. Moreover, given that retired insurance practitioners and professionals like accountants, actuaries and lawyers etc, could meet the requirement of persons "with knowledge of and experience in the insurance industry", he opined that there was no assurance that the two directors would include representatives of the insurance intermediaries such as agents and brokers who were front-line practitioners in the industry. Mr KWOK suggested that the amendment bill should specify that one-third of the directors in the GB must be representatives from the insurance industry and include representatives from the insurance intermediaries such as the relevant trade unions of the industry in order to ensure sufficient representation of the practitioners in the GB. Mr KWOK

further stressed the need for IIA to fully consult the views of the industry on its work.

24. Mr CHAN Kin-por supported specifying in the legislation the proportion of directors with knowledge of and experience in the insurance industry in the GB. The Chairman noted the insurance industry's concern about the representation of the industry in the GB, and opined that consideration should be given to revise the reference of "with knowledge of and experience in the insurance industry" to "representatives from the insurance industry" to ensure that the views of the insurance industry would be effectively reflected.

25. PS(FS) responded that IIA was an independent financial regulator with law enforcement power. It was not an industry organization. It was important that the GB should be broadly based and representative of stakeholders and have the necessary expertise in carrying out its regulatory functions. On the other hand, issues relating to the composition of the GB of a financial regulator had to be considered carefully given the need to ensure independence in exercising the regulatory powers by IIA. She pointed out that there had been diverse views among respondents to the public consultation on the participation of the insurance industry in the GB of IIA. There were views opposing the participation of the insurance industry in the GB on concerns of conflict of interest hence undermining the independence of IIA. For example, there were concerns that GB members from the insurance industry could have access to sensitive financial information of their competitors in conducting prudential regulation of insurers. Taking into account various views, the Administration had revised the original proposal of "at least one but not more than two directors with knowledge of and experience in the insurance industry" to "at least two directors with knowledge of and experience in the insurance industry" in the current proposal. PS(FS) further remarked that the Administration was mindful of the need for IIA to maintain close dialogue and liaison with the insurance industry on matters relating to its regulation and development. There were more effective channels than joining the GB in achieving this. For instance, the two proposed IACs (which were to advise IIA on policy matters governing regulation and market development) and the proposed Expert Panel (which was to advise IIA on market practices in relation to the disciplinary process).

Issue of "dual regulators for one industry"

26. Mr WONG Ting-kwong expressed concern about inconsistent regulatory standards resulted from the proposed regulatory regime involving IIA and HKMA. Pointing out that HKMA had recently imposed its first sanction on misconduct committed by an insurance intermediary engaged by a bank for selling investment-linked insurance products and the guidelines issued

by HKMA to banks on the sale of such insurance products (which included the requirement of the disclosure of commission) had taken effect, Mr WONG enquired how the Administration would address the insurance industry's concern about "dual regulators for one industry".

27. PS(FS) responded that under the current proposal, IIA would be the lead regulator for all insurance intermediary activities by, say setting the relevant conduct standards and requirements, and acting as the sole licensing authority for intermediaries working for insurance agencies and banks alike. HKMA, which possessed more experience and expertise in the overall regulation of banks, would be delegated with specified functions (viz. day-to-day inspection and investigation) for effective regulation of banks' insurance intermediary activities in the context of the whole operation of banks. However, IIA would be the focal point for administering the disciplinary process; and the independent Insurance Appeals Tribunal ("IAT") would hear all appeal cases concerning licensed insurance intermediaries working for insurance agencies and banks.

28. Mr James TO remarked that, if there were regulatory gaps among IIA, SFC and HKMA, he would support providing power to SFC and HKMA to bridge such gaps as he had relatively more confidence in the work of these two regulators. Mr TO also expressed concern about the different disclosure requirements for insurance intermediaries and bank employees selling insurance products as only the former were required to disclose their commissions.

29. PS(FS) pointed out that as many banks in Hong Kong were offering a mix of financial products to their clients, it was important that IIA would maintain close liaison and coordination with HKMA to ensure effective regulation, minimize regulatory duplication or gaps, and avoid inconsistency in regulatory standards in order to create a business-friendly environment and level playing field for both bank and non-bank insurance intermediary activities. In discharging their responsibilities in specific cases, they had to act in accordance with the law.

30. Referring to a recent case in which an insurance intermediary was subject to both the sanction of the Insurance Agents Registration Board and HKMA, Mr Chan Kin-por expressed concern about subjecting the insurance industry to the regulation by both IIA and HKMA. He enquired how IIA and HKMA would prevent double jeopardy on the same misconduct committed by an intermediary. PS(FS) re-iterated that IIA would have to maintain close liaison with HKMA and stressed that IIA would be the sole regulator responsible for imposing sanctions on misconduct of all insurance intermediaries including those engaged by banks.

Disciplinary and appellate mechanism

31. Mr Kenneth LEUNG enquired whether IIA's disciplinary sanctions imposed on insurers and insurance intermediaries would be determined by an independent disciplinary committee, and the details of the proposed IAT for review of IIA's disciplinary sanctions. Mr Christopher CHEUNG suggested that IIA should make reference to the existing appellate mechanism of SFC. The Chairman enquired whether IIA's disciplinary committee would include representatives from the insurance industry or persons with knowledge of and experience in the insurance industry.

32. PS(FS) responded that in formulating the disciplinary and appellate mechanism under IIA regime, the Administration had made reference to other relevant regulatory regimes, including that for MPF intermediaries and that under SFO. PS(FS) advised that IAT would be set up as an independent quasi-judiciary body to hear appeals against the decisions of IIA. Under the current proposal, an IAT hearing would be chaired by a person eligible for appointment as a High Court judge with two market practitioners as members. IAT might confirm, vary or set aside IIA's decisions or remit the matter to IIA with directions as appropriate. IIA would also set up an Expert Panel with a broad range of insurance expertise to provide it with advice on market practices or specific products for making disciplinary decisions.

Appointment of a responsible officer

33. Noting that an insurer and a corporate insurance intermediary was required to appoint an RO to monitor the internal control system to ensure compliance of conduct requirements by insurance practitioners, Mr CHAN Kin-por suggested that the Administration should consider the Hong Kong Federation of Insurers' ("HKFI") suggestion to allow the delegation of the responsibility of RO to a designated officer of the insurance company so that the Chief Executive Officer ("CEO") of the company would concentrate on other important tasks.

34. PS(FS) said that the CEO of an insurance company should be appointed as the RO because the CEO would have the power to deploy adequate resources for putting in place an appropriate internal control system and staff training programmes to ensure conduct compliance by insurance agents appointed by the company. PS(FS) added that the CEOs of insurance companies were already held responsible for the whole of the company's business under the existing law and the Administration considered that the new regulatory regime should not dilute the pre-existing requirement.

Other issues

35. Mr James TO supported the proposed conduct requirement of "acting in the best interest of policyholders" on insurance intermediaries. The Chairman enquired whether IIA would develop guidelines to elaborate the standards expected by the regulator to facilitate compliance by the insurers and insurance intermediaries.

36. PS(FS) agreed that it would be useful if IIA issued guidelines or code of practice on the conduct requirement of "acting in the best interest of policyholders". The IIA would issue relevant guidelines to facilitate compliance with conduct requirements by insurers and insurance intermediaries, and the guidelines might cover areas such as providing suitable training for employees to promote conduct compliance, conducting regular assessment of conduct compliance by insurance intermediaries, etc.

37. Mr CHAN Kin-por referred to the letter dated 4 July 2013 from HKFI tabled at the meeting and requested the Administration to provide a written response to concerns raised, and continue to communicate with HKFI and consider its views and suggestions where appropriate before introducing the amendment bill into LegCo.

38. PS(FS) responded that the Administration had all along been maintaining close dialogue with HKFI and the industry. She agreed that there was a need to form a preparatory committee with the industry to discuss issues relating to the transitional arrangements. In response to the Chairman's enquiry, PS(FS) advised that the preparatory committee would be set up soon and it would first focus its work on ensuring a smooth transition for insurance intermediaries from the existing self-regulatory regime to the statutory licensing regime.

39. Pointing out that there would be no direct transfer of the existing staff working in the Office of the Commissioner of Insurance ("OCI") to the proposed IIA, Mr KWOK Wai-keung requested the Administration to provide information on the arrangements for OCI staff upon abolition of OCI, including the number of existing civil service staff of OCI and the transitional arrangements for them (e.g. re-appointment by the proposed IIA, re-deployment to other Government bureaux/departments, voluntary departure scheme, termination of service and severance payments). The Administration undertook to provide the requested information.

(Post-meeting note: The Administration's written response was circulated to members vide LC Paper No. CB(1)1633/12-13 issued on 30 July 2013.)

40. In concluding the discussion, the Chairman requested the Administration to provide a copy of its written response to HKFI's letter for reference of Panel members and provide information on the preparatory committee to be established for the proposed IIA, including its tasks and timetable.

(Post-meeting note: The Administration's written response to HKFI was circulated to members vide LC Paper No. CB(1)1685/12-13 issued on 13 August 2013.)

V Regulation of collective investment schemes

(LC Paper No. CB(1)1401/12-13(04) — Administration's paper on regulation of collective investment schemes

LC Paper No. FS31/12-13 — Fact sheet on "Regulation of collective investment schemes" prepared by the Legislative Council Secretariat)

Other relevant papers

(LC Paper No. CB(1)1168/12-13(01) — Letter dated 13 May 2013 from Hon Dennis KWOK on issues arising from the cancellation of sale contracts of hotel room units at The Apex Horizon (Chinese version only)

LC Paper No. CB(1)1168/12-13(02) — Letter dated 20 May 2013 from Hon Albert HO on issues arising from the cancellation of sale contracts of hotel room units at The Apex Horizon (Chinese version only)

LC Paper No. CB(1)1168/12-13(03) — Securities and Futures Commission's written

response dated 24 May 2013 to issues raised in the letters of Hon Dennis KWOK and Hon Albert HO arising from the cancellation of sale contracts of hotel room units at The Apex Horizon)

Briefing by the Securities and Futures Commission

41. At the invitation of the Chairman, the Acting Chief Executive Officer, SFC ("Atg CEO/SFC") briefed members on the role and power of SFC in relation to the regulation of CIS under SFO, including the definition of CIS under SFO, the main elements of CIS, the authorization regime for CIS. She also referred members to the Administration's paper (LC Paper No. CB(1)1401/12-13(04)) which discussed in detail the authorization process of CIS and provided a regulatory overview of CIS. Atg CEO/SFC pointed out that CIS was defined under the SFO to mean investment products of a collective nature and embraced familiar market concepts such as unit trusts and mutual funds. Atg CEO/SFC emphasized that a CIS generally included four elements. Firstly, it must involve an arrangement in respect of property. Secondly, participants did not have day-to-day control over the management of the property. Thirdly, the property was managed as a whole by or on behalf of the person operating the arrangements, and/or the contributions of the participants and the profits or income from which payments were made to them were pooled. Lastly, the purpose of the arrangement was for participants to participate in or receive profits, income or other returns from the acquisition or management of the property. Atg CEO/SFC said that during the legislative discussions of the SFO, a broad definition of CIS was considered appropriate to provide reasonable protection for investors; one of the major considerations was that if the definition was too narrowly construed, it might be unable to keep in pace with new products arising from market developments. Atg CEO/SFC further said that, as SFC was investigating into the case of the sale of hotel room units at The Apex Horizon, she could not comment on the case or other individual cases, including when SFC became aware that the investment scheme in respect of The Apex Horizon case constituted a CIS subject to the regulation and monitoring by SFC; and SFC's regulation for past or current investment schemes of a similar nature.

Discussion

Compensation to purchasers of hotel room units at The Apex Horizon

42. Mr James TO relayed the concerns from some 20 purchasers of hotel room units at The Apex Horizon development about the arrangements for unwinding the sale following the agreement entered into between SFC and Cheung Kong (Holdings) Limited, Cheung Kong Property Development Limited, Pearl Wisdom Limited ("PWL") and Horizon Hotels & Suites Limited (collectively referred to "the Cheung Kong parties") as announced in SFC's press release on 13 May 2013. Accordingly, PWL would cancel each contract and, in return, reimburse every purchaser the deposit and any part payments together with interest, and offer an amount of \$10,000 as reimbursement of any reasonable legal and other expenses. Mr TO pointed out that, as the market value of the hotel room units at The Apex Horizon had increased by some 8-15% and the case did not involve an offence on the part of the purchasers, it would be unfair to the purchasers if PWL offered compensation based on the property's sale price instead of its market price at the time of cancellation of the sale contracts.

43. Mr James TIEN noted that some purchasers of the hotel room units at The Apex Horizon contended that the compensation should cover loss arising from a rise in the property value of the hotel room units they had purchased. He enquired about SFC's guidelines for CIS, if any, in making compensation to investors for cancellation of the contracts, in particular whether the market price of the property or investment product in question should be taken into account. The Chairman enquired whether SFC had considered making reference to the market value of the hotel room units at The Apex Horizon for unwinding before entering into the current agreement with the Cheung Kong parties.

44. Mr Abraham SHEK remarked that, as the purchasers of the hotel room units at The Apex Horizon had paid only the deposit and part payments, the compensation should only cover these payments and other expenses, if any, incurred by the purchasers. If purchasers were not satisfied with the compensation, they might consider taking further action under the relevant provisions of SFO where appropriate, e.g. section 108 "Civil liability for inducing others to invest money in certain cases" or section 277 "Disclosure of false or misleading information inducing transactions".

45. Atg CEO/SFC advised that SFC had formed the view that the offer to purchase hotel room units at The Apex Horizon appeared to be an invitation to acquire interest in or to participate in a CIS as defined in SFO. Pursuant to section 103 of SFO, any advertisement, invitation or document which was or contained an invitation to the Hong Kong public to acquire an interest or participate in a CIS could not be issued unless it was authorized by SFC or an exemption applied. In the case of The Apex Horizon, its offering documents had not been authorized by SFC. The purpose of the agreement between SFC

and the Cheung Kong parties was to make arrangements for unwinding the sale of the hotel room units at The Apex Horizon and to restore the investors of The Apex Horizon into the same position they were in immediately prior to entering into the purchase of the concerned hotel rooms, which broadly achieved the same result as pursuing the case in the courts to obtain a court order under section 213 of SFO to bring about equivalent remediation effect. Under this premise, the reimbursement to purchasers of the hotel room units at The Apex Horizon mainly concerned the deposit and any part payments together with the interest, and hence the price of the properties (i.e. its sale price or market value after sale) was not the issue. The arrangement was in line with the common law practice for cancellation of contracts in those circumstances in general.

46. Mr Dennis KWOK pointed out that, among the 300 transactions or so involved in the sale of hotel room units at The Apex Horizon, about 260 had been cancelled and the purchasers in the remaining cases did not accept the unwinding arrangements as they were dissatisfied with the compensation offered by PWL. In some cases, the purchasers considered that the amount of \$10,000 offered by PWL for reimbursement of expenses other than the deposit and part payments with interest could not cover the legal expenses they had paid for the transactions. Mr KWOK pointed out that the Cheung Kong parties had stated, in a letter dated 21 June 2013 issued by Woo Kwan Lee & Lo on behalf of the Cheung Kong parties to the purchasers on the unwinding arrangements, that the contractual parties in the sale of the hotel room units at The Apex Horizon "have not completed the sale and purchase pursuant to the terms of the agreement and the agreement has been thereby rescinded and completely discharged". In his view, such description was not legally appropriate as it was essentially the Cheung Kong parties alone, and not the purchasers, who could not complete the contract and hence they should shoulder the obligation to compensate the full loss of the purchasers. The purchasers had the right of action to seek compensation for any pecuniary loss sustained as a result of non-compliance of SFO by the Cheung Kong parties. Mr KWOK considered that SFC should exert pressure on the Cheung Kong parties to make compensation based on the expenses actually incurred by the purchasers involved in the purchases so as to minimize the need for purchasers to seek legal redress. He considered that there was no conflict between section 213 of SFO and requiring the Cheung Kong parties to make full compensation on the purchasers' expenses. He also suggested SFC making reference to the loss of bargain for considering the reasonableness of the compensation offered or made by the Cheung Kong parties.

47. Mr James TO considered that any restitution arrangement to bring the parties concerned back to the same positions they were in before the sale of the hotel rooms units at The Apex Horizon should not give rise to any loss on the part of the purchasers. As such, he queried the criteria for setting a fixed

amount of \$10,000, instead of full reimbursement of all relevant costs (e.g. legal fees, commission for estate agents and mortgage fees, etc.) from the sale given that the actual expenses paid by purchasers might exceed this amount. The Chairman enquired whether the amount for reimbursement was negotiable depending on the circumstances of individual cases.

48. Atg CEO/SFC re-iterated that the purpose of the agreement between SFC and the Cheung Kong parties was to restore the investors to their original position before entering into the sales contract. As investigations remained afoot, she apologized that she could not disclose further details in this regard. Nevertheless, she assured members that SFC had been monitoring the progress of unwinding the sale and the Cheung Kong parties' compliance with the terms and conditions in the agreement between SFC and the Cheung Kong parties. Among others, SFC would monitor whether the restitution would appropriately and adequately help purchasers to recover their paid expenses for the transactions. SFC was also collecting information from relevant third parties in assessing the situation. Mr Dennis KWOK urged SFC to follow up on the issue of reimbursement of legal and other expenses to purchasers, and to assist aggrieved purchasers who were not offered reasonable compensation.

49. Mr James TO noted that SFC originally intended to commence proceedings under section 213 of SFO in the Court of First Instance to seek orders unwinding the sale and returning all deposit moneys and part payments to purchasers, and the agreement SFC subsequently entered into with the Cheung Kong parties had served to avoid commencement of such proceedings. On the other hand, he observed that a number of purchasers intended to apply for a court order compelling the sale of hotel room units at The Apex Horizon by PWL instead of cancelling the contract. Mr TO cautioned that, in the event that the court made an order compelling execution of the sale contracts, SFC should not intervene by seeking order under section 213 of SFO to unwind the sale as it would be against the wish of the purchasers in question. Atg CEO/SFC said that she could not comment on the actions SFC might take in the circumstances referred to by Mr TO as it was a hypothetical situation.

(The Chairman directed that the meeting be extended by 15 minutes to 12:15 pm.)

50. The Chairman reminded members that, while she had been flexible in allowing members to ask questions relating to the case of The Apex Horizon in view of the wide public concern the case had aroused, the discussion of the Panel should focus on policy matters relating to the regulation of CIS. Mr James TO said that, as the case could shed light on the regulation of CIS by SFC, it was essentially relevant to policy matters.

Definition of collective investment scheme

51. Mr Kenneth LEUNG pointed out that the definition of CIS appeared to be wide and unclear to investors and the scope seemed to cover family trusts or an arrangement among family members buying a real estate property and owning it jointly for earning rental income. He suggested that SFC should issue guidelines in this respect for the reference of intermediaries and the investing public. Mr Dennis KWOK remarked that the definition of CIS under SFO was clear, and it was necessary that a definition with a wide scope was adopted for CIS in view of numerous types of CIS available in the market, e.g. unit trusts, mutual funds, paper gold schemes and real estate investment trusts, etc. Mr James TIEN said that it was a common arrangement for a company founder to seek investment partners and enter into an agreement with them for the purpose of management of the company and its investment. He enquired whether this kind of shareholders' agreement would constitute a CIS.

52. Atg CEO/SFC said that the current definition of CIS broadly followed previous legislation. During the enactment of SFO, careful consideration had been given to the merit of a relatively wide definition of CIS in order to provide flexibility to cater for changing market conditions and the development of new products. Referring to section 103 of SFO, Atg CEO/SFC said that an investment scheme would not be required to apply for authorization from SFC if it did not involve an invitation to the Hong Kong public to acquire an interest or participate in the scheme. If the party in question issued, or possessed for the purposes of issue, an advertisement, invitation or document which was or contained such an invitation to the Hong Kong public, the issue required prior authorization by SFC in accordance with the requirements under section 104 of SFO. As regards whether a particular arrangement made by a family, a company owner or other parties would constitute a CIS, determination could only be made having regard to all the facts and circumstances of an individual case. She added that SFC had issued product codes, guidelines and answers to frequently-asked questions applicable to specific types of CIS, which were available on SFC's website and the relevant information was and would continue to be updated from time to time.

53. Mr James TIEN sought clarification as to how an investment scheme would be regarded as "offered to the Hong Kong public", for instance, whether invitation through brokers to participate in an investment scheme would constitute "public offer". Atg CEO/SFC said that, should any dispute arise on whether an investment scheme was offered to the Hong Kong public, it would be a matter for the court to determine with regard to the applicable legal provisions and facts and circumstances of the case. For example, an advertisement of an investment scheme to invite participation in it through a

local newspaper, on a tram or an outdoor advertisement board, would be more likely to be regarded as an offer being made to the Hong Kong public.

54. Mr Abraham SHEK considered that SFC should clarify the difference between CIS and deed of mutual covenant ("DMC") which set out the rules on the regulation of the rights and liabilities of co-owners of a multi-unit or multi-storey building and establishing the management machinery for the co-owned property. He opined that a distinction should be made between the property controller and the management agent. Mr SHEK stressed the importance of a clear definition of CIS to avoid inadvertent breach of the law by developers because of the existence of "grey areas" in relevant legislation, and to maintain the operation of an orderly market.

55. Mr James TO pointed out that, while a developer should observe the relevant requirements of DMC, this could not obviate its obligation to comply with all other applicable rules and legislation in Hong Kong, including SFO and the relevant requirements governing CIS. Mr Dennis KWOK said that sale of property in general would not trigger the definition of CIS as each unit or flat in a development would be owned and managed by the purchaser individually and separately from other units that did not involve collective investment.

56. Atg CEO/SFC said that whether any arrangement was a CIS depended on whether that arrangement met the key elements constituting a CIS as described earlier. Major considerations included whether the participants had day-to-day control over the management of the property and whether the property was managed as a whole by or on behalf of the person operating the arrangements for instance, could the relevant management agent decide whether and how to lease the rooms, and set the room charges, etc.

VI Any other business

57. There being no other business, the meeting ended at 12:05 pm.

Council Business Division 1
Legislative Council Secretariat
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