

Bills Committee on Securities and Futures (Amendment) Bill 2016

Responses to Questions Raised by the Legal Adviser of the Legislative Council in the letter of 16 March 2016

This paper sets out the responses from the Government and the Securities and Futures Commission (“the Commission”) to the questions raised by the Legal Adviser of the Legislative Council in the letter of 16 March 2016.

Part I - Legal issues

Incorporation and Registration

2. The effect of section 112D(4) is that the Commission must not register a proposed company unless it is satisfied that all the requirements for registration under section 112E will be met when the registration becomes effective. Therefore, the Commission will not be registering a proposed company before it is satisfied that it will fulfil all the registration requirements upon incorporation. The requirement in section 112D(4) addresses the distinction between a “proposed company” (i.e. a company intended to be incorporated as defined in section 112A) and the company upon incorporation, as the registration requirements may not be fully complied with until the proposed company becomes an open-ended fund company.

3. To illustrate the process, the operational procedures are summarized as follows -

- (a) The Commission will be the sole recipient of all application documents (including the documents required by the Commission for registration, the documents to be provided to the Registrar of Companies (“CR”) for incorporation and the Inland Revenue Department for business registration).
- (b) The Commission will then review those documents in relation to the application for registration to consider if the proposed company will meet the requirements for registration on the day on which the registration takes effect.

Once the Commission is satisfied that the proposed company is capable of meeting the registration requirements and decides to register the proposed company, it will notify the CR by way of a notice of registration. Registration of the OFC will take effect on the day on which a certificate of incorporation is issued by the CR under section 112D(3). The Commission will also forward the relevant documents and fees together with the notice of registration to the CR for the OFC's incorporation purpose.

- (c) Pursuant to section 112C, the CR will incorporate an OFC if it is satisfied that the requirements for incorporation have been met and it has been notified of the registration of the proposed company by the Commission.
- (d) The registration of the OFC will take effect on the day of issue of the certificate of incorporation by the CR under section 112D(3).

4. As stated in paragraph 3 above, the issuance of a notice of registration by the Commission must precede the issuance of certificate of incorporation, and such notice of registration will not be issued unless the Commission is satisfied that all registration requirements will be met upon incorporation and the registration will only take effect on the day on which a certificate of incorporation is issued by the CR.

Imposing conditions

5. The conditions in respect of registration and cancellation of registration will be imposed in writing.

6. Pursuant to section 232(2) of the Securities and Futures Ordinance ("SFO"), these conditions will take effect either on the expiry of the period (i.e. 21 days) for appeal against such decisions, or when the party on whom such conditions are imposed notifies the Commission that the conditions are accepted.

7. In practice, during the application process for registration of a proposed OFC, the Commission will inform the applicant that the Commission is minded to impose the proposed registration conditions and the applicant will have an opportunity to be heard. If the applicant accepts the Commission's proposed conditions, such conditions would take effect at the same time when the OFC is registered. Under section

112D(5), the Commission may refuse to register a proposed company if it is not satisfied that the registration is in the interest of the investing public. The acceptance of registration conditions by the applicant would be a factor to be taken into account by the Commission in this connection.

8. For any new conditions which may be imposed after registration and conditions in respect of cancellation of registration, the Commission will similarly inform the OFC that the Commission is minded to impose the proposed conditions in advance. If the OFC accepts the Commission's proposed new conditions, such new conditions would take effect at the same time when they are imposed on the OFC. The OFC will be provided with a reasonable period to give its views prior to imposition.

9. The imposition of conditions by the Commission in respect of registration and cancellation of registration and new conditions would be subject to appeal pursuant to section 217 of the SFO at the Securities and Futures Appeal Tribunal, as such imposition of conditions will be "specified decisions" as defined under section 215 of the SFO. Please refer to Clause 22 of the Bill, pursuant to which the imposition of such conditions will fall under "specified decisions" by way of the addition of 15B, 15C, 15G, 15H, 15J and 15K to Division 1 of Part 2 of Schedule 8.

Publication of particulars of open-ended fund company

10. With regard to the publication of particulars under section 112G, similar to existing practice regarding authorization of investment products, the Commission in general will publish on its website the names of registered OFCs and the date of registration as soon as practicable after the registration takes effect. Notwithstanding the use of the word "may" in similar existing provisions in relation to the authorization of investment products (for example section 104(8), section 104A(8)), for transparency purpose, it is the Commission's established policy to publish the relevant particulars of the investment products as soon as practicable following the Commission's authorization. We consider the use of the word "may" in section 112G appropriate and do not propose to specify in the legislation a time frame for publication of such information as the uploading of information to the website would be more of a logistical matter following the checking of accuracy of all information received.

Custodian

11. In line with the existing market practice locally and in comparable overseas major jurisdictions, section 112ZA(5) provides that a custodian

or a sub-custodian is not prohibited from entrusting to another person for safekeeping any or all of the scheme property of an OFC. Sub-delegation is allowed provided that the applicable requirements in the OFC Code are met, including that the custodian should carry out due oversight in the selection, appointment and ongoing monitoring of the sub-delegates. Notwithstanding such sub-delegation, the custodian will remain responsible for all of its regulatory responsibilities. We also expect that the requirement to take reasonable care, skill and diligence as provided in section 112ZA(4) should also apply to a sub-custodian to whom any scheme property is entrusted for safe keeping. Such requirements on sub-custodians will be set out in the OFC Rules, which will be subject to public consultation. The consultation feedback can thus be taken into account when devising the relevant provision.

12. The care, skill and diligence required are expected to be that under the common law. We do not propose for elaborative provisions to be added to avoid limiting the scope of application of such care, skill and diligence, which would be determined by the court based on the facts of the case in accordance with common law principles.

Publication of the notice of the cancellation

13. Section 112ZH and section 112ZI refer to two different scenarios in which cancellation of registration may take place. Section 112ZH provides for the cancellation of registration upon the OFC's own application. This is to enable investment funds to be terminated for commercial reasons in accordance with its constitutive documents, in line with the existing market practice. Pursuant to the OFC Rules and/or OFC Code to be made, the Commission will require the OFC to provide written notification to investors prior to and upon the cancellation of registration. As the OFC will be the party initiating the termination, the OFC should generally be the primary party to issue such notification to the investors with explanation of the grounds for termination. If there are exceptional circumstances which call for a notice of the cancellation to be published with regard to such termination, section 112ZH(8)(b) would enable the Commission to make such publication.

14. Section 112ZI provides for the cancellation of registration by the Commission of its own volition in the circumstances specified in section 112ZI(1). These circumstances essentially being where a contravention has occurred as set out in section 112ZI(1)(a), (b) or (c), or where the Commission is not satisfied that the continued registration of the OFC is in the interests of the investing public as per section 112ZI(1)(d), or if a

winding up order has been made by the court as specified in section 112ZI(1)(e). Whilst in general the Commission intends to publish a notice of cancellation of registration where this takes place under section 112ZI, there may be circumstances where alternative means of communication would more effectively serve the purpose of notification. The Commission would like to retain the discretion to use other effective means of notification where there is no apparent public interest consideration which calls for a publication of notice. For example, where the subject OFC involved is a privately offered OFC which has no or very few remaining investors, or has only a few overseas investors and no outstanding creditors, it may be more administratively efficient to give direct notification to them. The Commission will act reasonably in deciding if a notice is required to be published.

15. For the reasons stated above on the operating mechanism with regard to the notification of the cancellation of registration, we consider the use of the word “may” in sections 112ZH and 112ZI appropriate. We also propose to retain the use of the word “may” having regard to consistency with existing provision in the SFO (section 106(7)) in respect of the withdrawal of authorization for collective investment schemes. Nonetheless, the Commission will establish a policy to make known the cancellation of the registration of an OFC under both sections 112ZH and 112ZI to the public by way of disclosure on the Commission’s website. Specifically, the Commission will remove the name of an OFC from the list of registered OFCs immediately following a cancellation of registration. In addition, similar to the current practice to publish a monthly list on the collective investment schemes from which authorization have been withdrawn, the Commission will publish on its website on a regular basis a list of all the cancellation of registrations of OFC.

Part II - Drafting issues

New section 112ZG(3)

16. From a policy angle, we do not think it is necessary to add the words “the Commission considers that” to section 112ZG(3). The Commission is obliged under the law to act reasonably in making such an application in any event and we do not think that the addition of the words “the Commission considers that” would make a material difference. In making an application to the court under any such provision (including section 112ZG(3), and similar provisions such as sections 211(2) and

101Y(4)), the Commission would need to provide evidence in support of such an application and to satisfy the court that there is such a reasonable likelihood. This serves as a check and balance on the Commission in seeking such orders and means that the Commission may not bring such an application on mere suspicion.

17. Moreover, the proposed section 112ZG(3) is modelled on section 211(2) of the SFO and, as mentioned above, similar provision can also be found in section 101Y(4) of the SFO. We consider it important to enable the court to conduct judicial assessment of cases brought under similar provisions within the SFO based on the same wording.

New section 112C(3)

18. We note that a subject (主語) is missing in the suggested formulation “就某擬成立公司而言，已符合《開放式基金型公司規則》所訂明的關於成立法團的規定”. We consider it more desirable from the Chinese language perspective to retain the formulation in the Bill, i.e. “就某擬成立公司而言，《開放式基金型公司規則》所訂明的關於成立法團的規定已獲符合”, in which “規定” acts as the subject of the sentence.

New section 112D(4)

19. We note that a subject is missing in the suggested formulation “就某擬成立公司而言，將會在註冊當日符合第112E條指明的註冊規定”. We consider it more desirable from the Chinese language perspective to retain the formulation in the Bill, i.e. “就某擬成立公司而言，第112E條指明的註冊規定，將會在註冊當日獲符合”, in which “規定” acts as the subject of the sentence.

New sections 112ZF(1)(a) and 112ZI(1)(a)

20. We note that a subject is missing in the suggested formulation “就某開放式基金型公司而言，不再符合第112E條指明的任何一項註冊規定”. We consider it more desirable from the Chinese language perspective to retain the formulation in the Bill, i.e. “就某開放式基金型公司而言，第112E條指明的任何註冊規定，不再獲符合”, in which “規定” acts as the subject of the sentence.

New section 112ZF(1)(c) and 112ZF(1)(e)

21. The brackets in the Chinese text serves as a visual aid to separate the alternative conditions “明知而向證監會提供” and “罔顧實情地向證監會提供” in the otherwise long sentence “明知而向證監會提供或罔顧實情地向證監會提供在要項上屬虛假或具誤導性的資料”. The use of brackets helps the reader figure out the structure of the sentence more readily. We therefore consider it more desirable to retain the brackets in the Chinese text from the drafting perspective.

**Financial Services and the Treasury Bureau
Securities and Futures Commission
April 2016**