

Bills Committee on Securities and Futures (Amendment) Bill 2016

**Clause-by-clause Examination
Draft Committee Stage Amendments**

Members are invited to examine the Government's proposed draft Committee Stage Amendments ("CSAs") marked in the relevant parts of the Securities and Futures (Amendment) Bill 2016 ("Bill") (**Annex**). The reasons for proposing these amendments are set out in the footnotes. The proposed CSAs may be subject to revision.

**Financial Services and the Treasury Bureau
April 2016**

Securities and Futures (Amendment) Bill 2016

Amendments to the Securities and Futures Ordinance (Cap. 571) (“SFO”)

Clause 6

In the proposed section 112A¹:

“*sub-custodian* (次保管人), in relation to an open-ended fund company, means a person to whom any scheme property of the company is entrusted for safe keeping ~~by virtue of section 112ZA(5)(a) or (b),~~ other than the custodian of the company;”

In the proposed section 112U(3)²:

“112U. Directors

~~(3) A director of an open ended fund company owes the open ended fund company the same fiduciary and other duties that are owed by a director of an ordinary company to the ordinary company.~~

¹ This proposed amendment is consequential to the proposed amendment to section 112ZA(5) and is aimed at ensuring that the enforcement powers of the Securities and Futures Commission (“SFC”) will reach sub-custodians.

² Since not all duties of the directors of an ordinary company, particularly those prescribed under the Companies Ordinance (Cap. 622) (“CO”), are applicable to open-ended fund company (“OFC”) directors (for example, duties of directors in relation to distributions, capital maintenance, shares buy-back and redemptions, and financial assistance to acquire own shares), this amendment is proposed to specify that the “other duties” that are owed by a director of an OFC should only comprise the duty to exercise reasonable care, skill and diligence that is owed by the directors of an ordinary company to the ordinary company under section 465 of the CO. It is noted that similarly, in the UK under the Open-Ended Investment Company Regulations and in Ireland under the Irish Collective Asset-management Vehicles Act, the directors’ duties are prescribed specifically for their comparable corporate fund vehicles rather than incorporating the directors’ duties on a wholesale basis from their respective conventional company law regimes.

- (3) A director of an open-ended fund company owes the open-ended fund company—
- (a) the same fiduciary duties that are owed by a director of an ordinary company to the ordinary company; and
 - (b) the duty to exercise reasonable care, skill and diligence that is owed by a director of an ordinary company to the ordinary company under section 465 of the Companies Ordinance (Cap. 622).

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In the proposed section 112ZA(5)³:

“112ZA. Custodian

- (1) An open-ended fund company must have a custodian.
- (2) All the scheme property of an open-ended fund company must be entrusted to a custodian of the company for safe keeping.
- (3) Despite subsection (2), any scheme property of a class or description specified by the Commission for the purposes of this subsection is not required to be entrusted to a custodian.
- (4) A custodian of an open-ended fund company must take reasonable care, skill and diligence to ensure the safe keeping of the scheme property of the company that is entrusted to the custodian under subsection (2).

- ~~—(5) This section does not prohibit a custodian to whom any scheme property is entrusted for safe keeping from—~~
 - ~~—(a) entrusting to a third party for safe keeping any or all of the scheme property; or~~
 - ~~—(b) authorizing a third party, to whom the custodian has entrusted any scheme property for safe keeping, to entrust any or all of the scheme property to other persons.~~

³ The amendment is proposed to reflect our policy intent to allow sub-custodial arrangements to be conducted by a custodian or a sub-custodian in respect of the scheme property of an OFC, which is in line with the existing market practice. The OFC Rules will provide for the duty of sub-custodians to take reasonable care, skill and diligence to ensure the safe keeping of the scheme property of the OFC that is entrusted to the sub-custodian. Such requirements on sub-custodians will be set out in the OFC Rules, which will be subject to public consultation.

- (5) This section does not prohibit any of the following persons from entrusting, by an agreement in writing, to another person for safe keeping any or all of the scheme property of an open-ended fund company that is entrusted to the first-mentioned person—
- (a) a custodian of the company;
 - (b) a person to whom any scheme property of the company is entrusted for safe keeping under an agreement in writing, other than the custodian of the company.”

In the proposed section 112ZF⁴:

“112ZF. Commission’s power to give directions

- (1) The Commission may, by notice in writing, give any of the directions specified in subsection (2) if it appears to the Commission that—
 - (a) with respect to an open-ended fund company, any of the requirements for registration specified in section 112E is no longer met;
 - (b) an open-ended fund company or a director, an investment manager, a custodian or a sub-custodian of an open-ended fund company has contravened—
 - (i) any of the relevant provisions;
 - (ii) any notice or requirement given or made by the Commission under or pursuant to this Ordinance; or
 - (iii) any of the conditions imposed in respect of the registration of the company;

⁴ This amendment is proposed to enable the directions and any amendment or revocation of such directions made by the SFC under this section to take effect at the time of notice or a later time as specified in the notice. Pursuant to section 232(2) of the Securities and Futures Ordinance (Cap. 571) (“SFO”), decisions of the SFC which are subject to appeal to the Securities and Futures Appeal Tribunal (other than those in Division 5 of Part 3 of Schedule 8) do not become effective until the expiry of the 21-day period in which the person affected may appeal. As the power to issue directions under section 112ZF is an intervention power which is intended to enable the SFC to take action swiftly to safeguard investor interests, the amendment is proposed to ensure that directions issued under this section and any amendment or revocation of a direction can be immediately effective.

- (c) an open-ended fund company or a director, an investment manager, a custodian or a sub-custodian of an open-ended fund company has, in purported compliance with—
 - (i) any of the relevant provisions;
 - (ii) any notice or requirement given or made by the Commission under or pursuant to this Ordinance; or
 - (iii) any of the conditions imposed in respect of the registration of the company, knowingly or recklessly provided to the Commission any information that is false or misleading in a material particular;
 - (d) an investment manager of an open-ended fund company has contravened any of the terms and conditions of its licence or registration under this Ordinance;
 - (e) an investment manager of an open-ended fund company has, in purported compliance with any of the terms and conditions of its licence or registration under this Ordinance, knowingly or recklessly provided to the Commission any information that is false or misleading in a material particular; or
 - (f) it is desirable to do so in order to protect the interest of the investing public.
- (2) The directions are—
- (a) a direction to the company or its investment manager that the company is to cease to issue or redeem, or cease to issue and redeem, shares or any class of shares in the company; and
 - (b) a direction to a director of the company that the director is to cease to transfer shares or any class of shares in the company to or from, or to and from, the director's own holding of shares.
- (3) The Commission may, by notice in writing served on the person to whom a direction is given under this section, amend or revoke the direction.
- (3A) A direction given under subsection (1), or an amendment or revocation of such a direction under subsection (3), takes effect—

- (a) at the time of the service of the notice in respect of the direction, amendment or revocation; or
- (b) if a later time is specified in the notice, at that time.

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In the proposed section 112ZG⁵:

“112ZG. Application to Court of First Instance ~~for inquiry into~~ in respect of failure to comply with direction

- ~~(1) If a person fails to comply with a direction given under section 112ZF, the Commission may apply to the Court of First Instance for an inquiry into the failure.~~
- (12) In the inquiry, the Court of First Instance If a person fails to comply with a direction given under section 112ZF, the Commission may apply to the Court of First Instance in respect of the failure and the Court may—
 - (a) if satisfied that there is no reasonable excuse for the person not to comply with the direction, order the person to comply with the direction within the period specified by the Court; and
 - (b) if satisfied that the failure was without reasonable excuse, punish the person, and any other person knowingly involved in the failure, in the same manner as if the person and, if applicable, that other person had been guilty of contempt of court.

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⁵ Section 112ZG, as currently drafted, refers to enquiries by the Court of First Instance (“CFI”) into failures to comply with directions. Although it is not envisaged that the Court would make a true inquiry, the Court may direct questions to the SFC about the case if it so desires. Having regard to the views of the Judiciary, we propose to remove all references to “inquiry” in the section to avoid giving the impression that the CFI conducts inquiries.

In the proposed section 112ZJ⁶:

“112ZJ. Permission to carry on essential business operations on cancellation of registration

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- (5) A permission given or a condition imposed in respect of it under subsection (3) takes effect—
 - (a) at the time of the service of the notice in respect of the permission; or
 - (b) if a later time is specified in the notice, at that time.
- (6) The Commission may, by notice in writing served on an open-ended fund company to which permission is given, amend or revoke any of the conditions imposed, or impose new conditions, in respect of the permission.
- (6A) An amendment or revocation of a condition, or a new condition imposed, under subsection (6) takes effect—
 - (a) at the time of the service of the notice in respect of the amendment or revocation of the condition or the imposition of the new condition; or
 - (b) if a later time is specified in the notice, at that time.”.
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⁶ This section provides for the Commission’s power to permit an OFC whose registration has been cancelled to carry on essential business operations. While section 112ZJ(5) provides that a permission given or a condition imposed takes effect at the time of the service of the notice or such later time as specified in the notice to permit the continuation of the OFC’s essential business operations, there is no similar provision for amendment or revocation of conditions or imposition of new conditions under section 112ZJ(6). To be consistent with section 112ZJ(5), we propose to add a new subsection (6A) so that an amendment or revocation of conditions or imposition of new conditions under section 112ZJ(6) also takes effect at the time of notice or such later time as specified in the notice.

In the proposed section 112ZK(4)⁷:

“112ZK. Commission’s power to make rules

- (1) The Commission may make rules to provide for—
 - (a) the carrying on of collective investments by means of open-ended fund companies; and
 - (b) the regulation of open-ended fund companies.

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- (4) Rules made under subsection (1) may also provide for—

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- (g) the power of the Court of First Instance to make an order to disqualify a person from acting in any capacity in relation to open-ended fund companies or the scheme property of open-ended fund companies, or from acting in any capacity in the promotion or incorporation of proposed companies;

(ga) the liability of a person acting in contravention of section 112X or of an order made by the Court of First Instance under rules made under paragraph (g);

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⁷ This amendment is proposed to provide for the SFC’s rule-making power in respect of the creation of personal liability of a person acting as a director or being involved in the management of an OFC while being an undischarged bankrupt or acting in contravention of a disqualification order. The provisions to be made under this power will be similar to those in section 168O of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap.32).

Clause 12(1)

In the proposed section 213(3A)⁸:

- ~~“(3A) The Court of First Instance may also, on the application of the Commission, make any of the orders specified in subsection (3B) if—~~
- ~~— (a) an open ended fund company or a director, an investment manager, a custodian or a sub-custodian of an open ended fund company has contravened—~~
 - ~~— (i) any of the relevant provisions;~~
 - ~~— (ii) any notice or requirement given or made by the Commission under or pursuant to this Ordinance;~~
 - ~~— (iii) any of the conditions imposed in respect of the registration of the company; or~~
 - ~~— (iv) any direction given by the Commission under or pursuant to this Ordinance; or~~
 - ~~— (b) an investment manager of an open ended fund company has contravened any of the terms and conditions of its licence or registration under this Ordinance.~~
- (3A) If the contravention involved in a case is a contravention by an open-ended fund company or a director, an investment manager, a custodian or a sub-custodian of an open-ended fund company, the Court of First Instance may also, on the application of the Commission, make any of the orders specified in subsection (3B).
- (3AB) The power under subsection (3A) may be exercised whether or not the Commission also applies for an order specified under subsection (2).”

⁸ The proposed amendments relate to the grounds on which the SFC may apply to the CFI for the additional orders in section 213(3B) in the case where an OFC or a director, an investment manager, a custodian or a sub-custodian of an OFC has contravened any of the relevant provisions or conditions of any licence or registration under the SFO. The proposed amendments aim to ensure that these orders can also be sought in the circumstances where a person aids, abets, assists or induces such contraventions by an OFC or its key operators. This will ensure that the grounds for seeking the additional orders in respect of OFCs are consistent with those in respect of contraventions by other persons as set out in section 213(1) of the SFO.

In the proposed section 213(3B)⁹:

- “(3B) The orders specified for the purposes of subsection (3A) are—
- (a) for an open-ended fund company without sub-funds—
 - (i) an order removing a director of the company;
 - (ii) an order removing an investment manager of the company;
 - (iii) an order removing a custodian of the company;
 - (iv) an order removing a sub-custodian of the company;
 - (v) an order requiring a part of the investments of the company to be realized and the funds remaining after the discharge of the liabilities (if any) of the company attributable to the part to be distributed to shareholders of the company in accordance with the OFC rules;
 - (vi) an order requiring all of the investments of the company to be realized and the funds remaining after the discharge of the liabilities (if any) of the company to be distributed to shareholders of the company in accordance with the OFC rules;~~and;~~
 - (vii) an order requiring the company to be wound up under the OFC rules; and
 - (viii) any ancillary order that the Court of First Instance considers necessary as a result of the making of any of the orders referred to in subparagraphs (i), (ii), (iii), (iv), (v), (vi) and (vii); and
 - (b) for an open-ended fund company with sub-funds—
 - (i) any of the orders specified in ~~paragraph (a)~~ paragraph (a)(i), (ii), (iii), (iv), (v), (vi) and (vii);
 - (ii) an order requiring the investments made in respect of a part of a sub-fund of the company to be realized and the funds remaining after the discharge of the liabilities (if any) of the company attributable to the part to be distributed to shareholders of the company in accordance with the OFC rules;

⁹ The proposed amendments to section 213(3B)(a) and (b) aim to include any ancillary order that the CFI considers necessary for the purposes of subsection (3A). Similar orders can be made by the CFI under the existing section 213(2)(g) of the SFO.

- (iii) an order requiring all of the investments made in respect of a sub-fund of the company to be realized and the funds remaining after the discharge of the liabilities (if any) of the company attributable to the sub-fund to be distributed to shareholders of the company in accordance with the OFC rules;~~and;~~
- (iv) an order requiring a sub-fund of the company to be wound up under the OFC ~~rules.~~rules; and
- (v) any ancillary order that the Court of First Instance considers necessary as a result of the making of any of the orders referred to in subparagraphs (i), (ii), (iii) and (iv)."

Clause 12(6)¹⁰:

~~(6) Section 213(7)(a), after "to (v)"~~

Add

~~"or (3A)(a) or (b)".~~

Clause 13

In the proposed section 214A¹¹:

"214A. Remedies in cases of unfair prejudice etc. to interests of shareholders of open-ended fund companies

- (1) The Commission may by petition apply to the Court of First Instance for an order under this section if it appears to the Commission that at any time since the incorporation

¹⁰ This technical amendment is consequential to the proposed amendments to section 213(3A).

¹¹ The amendment is proposed to provide that the SFC must first consult the Monetary Authority ("MA") when making applications under section 214A(1) for orders against an authorized financial institution, or a corporation which is a controller of an authorized financial institution, has as its controller an authorized financial institution or has a controller that is also a controller of an authorized financial institution. The proposed amendment is in line with the existing section 214(3) of the SFO.

of an open-ended fund company, the business or affairs of the company have been conducted in a manner—

- (a) oppressive to its shareholders or any part of its shareholders;
- (b) involving defalcation, fraud, misfeasance or other misconduct towards it or its shareholders or any part of its shareholders;
- (c) resulting in its shareholders or any part of its shareholders not having been given all the information with respect to its business or affairs that they might reasonably expect; or
- (d) unfairly prejudicial to its shareholders or any part of its shareholders.

(2A) If the order to be applied for under subsection (1) is an order against—

- (a) an authorized financial institution; or
- (b) a corporation that, to the knowledge of the Commission—
 - (i) is a controller of an authorized financial institution;
 - (ii) has as its controller an authorized financial institution; or
 - (iii) has a controller that is also a controller of an authorized financial institution,

the Commission must not make the application unless it has first consulted the Monetary Authority.

(5) In this section—

controller (控制人) means a person who is an indirect controller or a majority shareholder controller as defined by section 2(1) of the Banking Ordinance (Cap. 155).”

Clause 22

Schedule 8 amended (Securities and Futures Appeals Tribunal)

(1) Schedule 8, Part 2, Division 1, after item 15—

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(2) Schedule 8, Part 3, Division 5, after item 2—¹²

Add

- 2A. A specified decision set Section 112ZF(3A) of this
out in item 15D of Ordinance.
Division 1 of Part 2.
- 2B. A specified decision set Section 112ZF(3A) of this
out in item 15E of Ordinance.
Division 1 of Part 2.
- 2C. A specified decision set Section 112ZJ(5) of this
out in item 15L of Ordinance.
Division 1 of Part 2.
- 2D. A specified decision set Section 112ZJ(6A) of this
out in item 15M of Ordinance.”
Division 1 of Part 2.

¹² See footnotes 4 and 6. As the relevant specified decisions may take effect immediately, they are included in Division 5 of Part 3 of Schedule 8. Please refer to section 232(2) (which provides that any specified decision takes effect upon expiry of 21 days unless included in Division 5 of Part 3 of Schedule 8).

Related amendments to the Stamp Duty Ordinance (Cap. 117)¹³

Clause 27

~~Section 19 amended (contract notes, etc. in respect of sale and purchase of Hong Kong stock)~~

~~Section 19(1DA), after “Schedule 8”~~

Add

“or Part 2 of Schedule 9”.

Section 19 amended (contract notes, etc. in respect of sale and purchase of Hong Kong stock)

Section 19(1DA)

Repeal

“or Part 2 of Schedule 9”

Substitute

“, Part 2 of Schedule 9 or Part 2 of Schedule 10”.

Clause 30

~~Section 63 amended (regulations)~~

~~Section 63(e)~~

Repeal

“Schedule 8”

Substitute

“Schedules 8 and 9”.

Section 63 amended (regulations)

Section 63(c)

Repeal

“and 9”

Substitute

“, 9 and 10” .

¹³ The proposed amendments to clauses 27 and 30 to 33 are technical amendments involving re-numbering only, in relation to the Inland Revenue (Amendment) (No. 4) Bill 2015.

Clause 31

First Schedule amended

~~(1) First Schedule—~~

Repeal

~~“& 8]”~~

Substitute

~~“, 8 & 9]”.~~

~~(2) First Schedule, head 2(4), Note 2, after “Schedule 8”—~~

Add

~~“or Part 3 of Schedule 9”.~~

First Schedule amended

(1) First Schedule—

Repeal

“8 & 9]”

Substitute

“8, 9 & 10]”.

(2) First Schedule, head 2(4), Note 2—

Repeal

“or Part 4 of Schedule 9”

Substitute

“, Part 4 of Schedule 9 or Part 3 of Schedule 10”.

Clause 32

Schedule 8 amended (transactions and transfers relating to exchange traded funds)

Schedule 8—

Repeal

“Sch.]”

Substitute

“Sch. & ~~Sch. 9]~~ Sch. 10]”.

Clause 33

Schedule 9~~Schedule 10~~ added

~~After Schedule 8~~After Schedule 9—

Add

“~~Schedule 9~~Schedule 10”

[ss. 19 & 63 &
1st Sch.]

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Related amendments to the Banking Ordinance (Cap. 155)

New Clause

By adding —

“Division 4A—Amendments to Banking Ordinance (Cap. 155)

33A. Section 58A amended (disciplinary action in respect of relevant individuals)

(1) Section 58A(6), definition of *misconduct*, paragraph (a)—

Repeal

“; or”

Substitute a semicolon.

(2) Section 58A(6), definition of *misconduct*, paragraph (b)(ii)—

Repeal

“public interest,”

Substitute

“public interest; or”.

(3) Section 58A(6), definition of *misconduct*, after paragraph (b)—

Add

“(c) an act or omission of the individual that—

(i) relates to the carrying on of any activity—

(A) that is not a regulated activity; and

(B) that the registered institution, in relation to which the individual is a relevant individual, may carry on for an open-ended fund company under the Securities and Futures Ordinance (Cap. 571); and

(ii) in the opinion of the Monetary Authority, is or is likely to be prejudicial to the interest of the investing public or to the public interest.”¹⁴

¹⁴ Under section 58A of the Banking Ordinance (“BO”), the MA has the power to take disciplinary action against a relevant individual where the relevant individual is guilty of misconduct. As the Bill amends the definition of “misconduct” in section 193(1) of the SFO to include an act or omission relating to the carrying on of certain activity for an OFC (c.f. clause 9(3)), the proposed amendments aim to amend the definition of “misconduct” in the BO accordingly to ensure that the MA has the power to take disciplinary action against a relevant individual guilty of

(4) Section 58A(7)—

Repeal

“paragraph (b)”

Substitute

“paragraphs (b) and (c)”.

(5) Section 58A(7), before “399”—

Add

“112ZR or”.¹⁵

33B. Section 71C amended (executive officers of registered institutions require Monetary Authority’s consent)

(1) Section 71C(12), definition of *misconduct*, paragraph (b)(ii)—

Repeal

“; or”

Substitute a semicolon.

(2) Section 71C(12), definition of *misconduct*, paragraph (c)(ii)—

Repeal

“public interest,”

Substitute

“public interest; or”.

(3) Section 71C(12), definition of *misconduct*, after paragraph (c)—

Add

“(d) an act or omission of the officer that—

(i) relates to the carrying on of any activity—

(A) that is not a regulated activity; and

(B) that the registered institution, in relation to which the officer is an executive officer, may carry on for an open-ended fund company under the Securities and Futures Ordinance (Cap. 571); and

misconduct in relation to an OFC. A relevant individual is an individual who performs any regulated function in a regulated activity for a registered institution.

¹⁵ Under section 112ZR of the Bill, the SFC may publish codes and guidelines for matters related to OFCs. The amendment is proposed to ensure that the MA shall not form any opinion that any act or omission by a relevant individual relating to an OFC is prejudicial to the interest of the investing public or to the public interest, unless he has also had regard to such of the provisions set out in the codes and guidelines published under section 112ZR.

(ii) in the opinion of the Monetary Authority, is or is likely to be prejudicial to the interest of the investing public or to the public interest.”¹⁶

(4) Section 71C(13)—

Repeal

“or (d)”

Substitute

“, (d) or (e)”.

(5) Section 71C(14)—

Repeal

“paragraph (c)”

Substitute

“paragraphs (c) and (d)”.

(6) Section 71C(14), before “399”—

Add

“112ZR or”.”¹⁷

¹⁶ Under section 71C of the BO, the MA has the power to take disciplinary action against an executive officer of registered institutions where the executive officer is guilty of misconduct. As the Bill amends the definition of “misconduct” in section 193(1) of the SFO to include an act or omission relating to the carrying on of certain activity for an OFC (c.f. clause 9(3)), the proposed amendment aims to amend the definition of “misconduct” in the BO accordingly to ensure that the MA has the power to take disciplinary action against an executive officer guilty of misconduct in relation to an OFC.

¹⁷ The amendment is proposed to ensure that the MA shall not form any opinion that any act or omission by an executive officer relating to an OFC is prejudicial to the interest of the investing public or to the public interest, unless he has also had regard to such of the provisions set out in the codes and guidelines published under section 112ZR.

**Related amendments to the Financial Reporting Council Ordinance
(Cap. 588)**

New Clause

By adding —

**“Division 7A—Amendment to Financial Reporting Council Ordinance
(Cap. 588)**

43A. Section 2 amended (interpretation)

Section 2(1)—

Repeal the definition of *relevant code*

Substitute

“*relevant code* (有關守則) means—

- (a) a code or guideline published under section 112ZR of the Securities and Futures Ordinance (Cap. 571), as in force at the material time; or
- (b) a code or guideline published under section 399 of that Ordinance for providing guidance in relation to the operation of section 104 of that Ordinance, as in force at the material time;”.¹⁸

¹⁸ The term “relevant code” is now defined in section 2(1) of the Financial Reporting Council Ordinance (“FRCO”) as a code or guideline published by the SFC under section 399 of the SFO for providing guidance in relation to the SFC’s authorisation of collective investment schemes (“CISs”). As OFCs will be CISs, and may be opted for as a new structure of listed CISs, the amendment to the definition of “relevant code” in section 2(1) of the FRCO to include the new OFC Code published under section 112ZR of the SFO is proposed so that the Financial Reporting Council will be able to investigate into possible auditing and reporting irregularities as well as to enquire into possible non-compliance with accounting requirements in relation to a listed OFC.