立法會
Legislative Council

LC Paper No. CB(1) 1975/99-00
(These minutes have been seen by the Administration and cleared by the Chairman)

Ref: CB1/BC/13/98/2

Bills Committee on
Securities (Margin Financing) (Amendment) Bill 1999

Minutes of meeting held on
Monday, 17 January 2000, at 8:30 am
in Conference Room A of the Legislative Council Building

Members present	**:**	Hon Ronald ARCULLI, JP (Chairman) Hon Albert HO Chun-yan Hon Bernard CHAN Hon FUNG Chi-kin
Member absent	**:**	Hon SIN Chung-kai Hon Jasper TSANG Yok-sing, JP
Public officers Attending	**:**	Mr Bryan CHAN Principal Assistant Secretary for Financial Services Miss Hinny LAM Assistant Secretary for Financial Services Mr William MADDAFORD Senior Assistant Law Draftsman, Department of Justice Ms Vicki LEE Government Counsel, Department of Justice

Attendance by invitation	:	Securities and Futures Commission Mr Andrew PROCTER Executive Director of Intermediaries and Investment Products Mr CHUNG Hing-hing Associate Director of Licensing Mrs Yvonne MOK Associate Director of Intermediaries Supervision
Clerk in attendance	:	Ms Leung Siu-kum Chief Assistant Secretary (1)4
Staff in attendance	:	Mr KAU Kin-wah Assistant Legal Adviser 6 Ms Connie SZETO Senior Assistant Secretary (1)1

I Meeting with the Administration

Outstanding issues arising from previous meetings
(LC Papers No. CB(1) 576/99-00(02))

Members continued to study item 36 of the list of outstanding items provided by the Administration.

Items 36 and 37 - sections 121AA(1) to (4)

2. The Administration briefed members on the provisions under section 121AA which mirrored those under section 81 of the existing Securities Ordinance (SO) (Cap. 333). Subsection (1) specified the basic obligation of a securities margin financier (SMF) to safekeep clients' securities collateral properly. It would apply when collateral was deposited but the collateral had not been on-pledged to an authorized institution (AI) or a securities dealer to secure credits. These scrips might include those which were not accepted by the AI or securities dealers as security for credit facilities provided to the SMF or those kept by the financier for settlement of outstanding liability in case of default of clients. The SMF was required either, under (1)(a), to register the

relevant securities in the name of the client, or under (1)(aa), to register them in the name of the financier or a nominee controlled by the financier or under (1)(b), to deposit them in safe custody in a designated account with an AI, a registered dealer, or some other institution approved by the Securities and Futures Commission (SFC). Subsection (4) specified the ways by which a SMF could dispose of the collateral with client's authorization or SFC's permission. This provision applied to the situation under which collateral was deposited to facilitate the provision of financial accommodation by a SMF.

3. Members further noted that to facilitate trading of securities by active clients, dealers usually maintained separate designated accounts in the Central Clearing and Settlement System operated by the Hong Kong Securities Clearing Company Limited (HKSCC) for depositing street name scrips. They also noted that notwithstanding HKSCC was the only institution at the moment which SFC would consider to approve for the purposes of subsection (1)(b), SMFs could apply to SFC to keep scrips in street names in their own safe deposit boxes in the companies. SFC might grant such approval under subsection (2) if it was satisfied that the SMF concerned could provide adequate security and insurance arrangements for safe custody of the securities.

4. As regards whether securities scrips could be registered in the name of a nominee controlled by an AI, the Executive Director of Intermediaries and Investment Products, Securities and Futures Commission (ED/IIP(SFC)) explained that it would not be necessary as the provision allowing scrips to be deposited with an AI under subsections (1)(b) and (4)(a) had permitted the AI to do so.

5. Mr FUNG Chi-kin considered subsection (3) unreasonable since it required a SMF to ensure that "the relevant securities are not deposited, transferred, lent, pledge, or re-pledge or otherwise dealt with ….." even with the client's written authorization. The provision would actually prohibit pooling and lending of the relevant securities.

6. The Principal Assistant Secretary for Financial Services (PAS/FS) explained that the purpose of subsection (3) was to prevent the scenario whereby the client was misled into signing such authorization without knowing the implications. The provision aimed at providing better protection for clients' assets. He further advised that pooling of securities to facilitate the provision of financial accommodation by SMFs was allowed under subsection (4). Moreover, SFC might make rules in the future, with proper authorization of clients, to allow securities collateral to be used for stocks borrowing and lending purposes. ED/IIP(SFC) supplemented that there was reservation in relieving the obligations imposed on SMFs under subsections (1) and (4) despite obtaining written authority of the clients as this was not in line with the

Admin/ intention of the policy as set out in subsection (3). Nonetheless, the

SFC Administration and SFC would consider improving the drafting of the provision.

7. As to the Chairman's concern that subsection (3) would be too onerous as it required SMFs to ensure that securities collateral was not "re-pledged" to a third party, ED/IIP(SFC) said that the provision was not intended to restrict re-pledging activities by AIs and SMFs. He took note of the Chairman's view and

SFC undertook to review the provision in order to clarify AIs' right to re-pledge the securities collateral to a third party.

8. Members also noted that according to subsection (4), a SMF could only deposit clients' securities collateral with a securities dealer or an AI for obtaining credits to support SMF's margin lending. Credits secured by SMFs without pledging clients' securities collateral would not be governed by the Bill. The Bill would exempt the financial accommodation provided by a company to its directors or employees. These included, inter alia, loans provided by a company to its employees for the purchase of various investments such as shares and property. SFC would have the power to grant exemption to other kinds of activities, apart from those listed in the new Schedule 4, on a case-by-case basis upon application.

9. As regards the pooling of clients' assets in relation to section 121AA(4), PAS/FS said that subject to further views of the Bills Committee and the Hong Kong Association of Banks, the Administration advised that the proposal of limiting the amount of credits facilities that SMFs or securities dealers could obtain from pledging clients' securities collateral would be introduced by way of Code of Conduct and that the position of banks taking security over a client's securities would not be affected by any breach of the relevant Code. As such, no Committee Stage Amendments (CSAs) would be necessary in this respect.

10. Members took note of the Administration's response. They also noted that the Democratic Party was considering the Administration's revised proposal.

11. PAS/FS explained that the proposed sections 121AA(4)(b) and (c) required SMFs to obtain client's written authority before it could dispose of the securities collateral to meet the client's obligation to the SMF. In addressing members' concern about the protection for the right of SMFs to dispose of clients' securities collateral in case of the default of clients, the Administration would make amendments that SMFs would still need to obtain the explicit authority from clients in disposing of the securities collateral to meet clients' obligation in case clients defaulted but such authority would continue to be valid once given and not be subject to annual renewal.

Item 39 - section 121AB(4)

12. The Bills Committee had previously expressed concern about section 121AB(4)(b) providing SFC with excessive power to require the auditor of a SMF to produce all records for SFC's inspection. The records required could include accountants' working papers. PAS/FS said that to allay members' concern, the Administration would move CSAs to clarify that the subsection should only apply when SFC had reasonable belief that there was a breach of the Financial Resources Rules (FRR) as envisaged under subsection (3). As such, SFC's power in this respect would be subject to proper checks and balances.

13. On the Chairman's enquiry about reasons for providing SFC with such power, ED/IIP(SFC) explained that the power stipulated in section 121AB(4) was analogous to that provided under sections 65D(1) and 95(1) of the existing SO. The existing provisions had not damaged the relationship between the auditor and his clients and there had been no complaint about the provisions from the accounting profession so far. ED/IIP(SFC) stressed that it was a reserved power of SFC to be used only under very exceptional cases and the power had not been invoked in the last few years. In ascertaining securities dealers' compliance with FRR, instead of invoking the relevant provisions of SO, SFC would usually ask, through the dealers, their auditors to provide a certificate or a letter confirming the compliance of the dealers with the rules. In the event that, notwithstanding the auditor's confirmation, SFC was firmly of the view that there was a breach of the rules, SFC would ask for more information from the auditor and could demand access to records held by them to make an independent auditor advice. ED/IIP(SFC) added that it was already an existing obligation for auditors to report dealers' non-compliance with certain FRR and accounting requirements which they came across when performing auditing functions for the companies. He further clarified that section 121AB(4) would not allow SFC to access privileged communication.

Item 41 - a new Division 4

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14. Members noted that the Administration was still preparing CSAs for Division 4 and would submit them for consideration of the Bills Committee at its next meeting.

Item 44 - section 121AT(3)

15. Members noted that section 121AT(3) specified the types of persons who were not qualified for appointment as an auditor of a SMF. The provision intended to prevent the SMF from appointing its employees, officers, or any related persons as the auditor. The proposed CSAs aimed at improving the drafting of the provision.

16. The Chairman enquried about the need of the section as SMFs would be subject to similar restriction in the appointment of auditor under the Companies Ordinance (Cap. 32) and an auditing professional had to abide by professional ethics not to act as the auditor for companies to which he was related. ED/IIP(SFC) said that securities dealers had the same obligation under section 87 of the existing SO, although the formulation of the provision was slightly different from that of section 121AT(3). For the sake of maintaining consistency with the existing SO, it would be necessary to provide the section in the Bill.

Item 51 - new section 121BI

17. On the rationale for providing the new section 121BI, ED/IIP(SFC) explained that the new section would enable existing securities margin financing service providers to recover outstanding margin loans granted prior to the commencement of the Amendment Ordinance and to collect interests accrued therefrom without requiring them to register under section 121C provided that they did not engage in any other securities margin financing business. ED/IIP(SFC) said that the majority of the some 100 existing finance companies associated with securities dealer firms were expected to move the margin financing operation back to the securities dealer entity. In order to avoid the more stringent financial regulation, these companies would likely transfer the well-secured margin loans to the dealing firms and leaving themselves with the under-secured ones with a view to recovering these loans in due course. In the absence of the new section, the activities of finance companies to collect repayment of the loans and the interest accrued would be caught by the Amendment Ordinance and operators would be taken as contravening section 121C of carrying on securities margin financing business without registration. Since it would be unreasonable and impractical to require these companies to seek registration merely for recovery of old loans, or to call in under-secured loans immediately, it was necessary to provide the new section with a view to deeming these companies not to be carrying on a business of margin financing. As such, they would not be required to be registered under section 121C. ED/IIP(SFC) stressed that notwithstanding these companies would not be subject to the regulatory regime of SMFs, their activities were regulated by other ordinances, such as the Money Lenders Ordinance (Cap. 163).

18. As regards the existing independent finance companies carrying on a business of securities margin financing, ED/IIP(SFC) advised that these companies were required to apply to SFC for registration within 30 days after the commencement of the Amendment Ordinance as provided in section 121BH. They could continue with their business pending the determination of their application by SFC. Applicants with their applications refused had to cease operation within 14 days, or within a period as specified by SFC after the

notification of the refusal. Where considered appropriate, SFC could specify conditions for the operation of SMFs under the above scenarios. Those service providers decided to close down their business should do so the companies before the expiry of the 30-day period. In the course of unwinding their portfolios, they could also take advantage of the new section to recover under-secured margin loans. They would not be taken as contravening section 121C.

19. The Chairman expressed grave concern about the new section. In view of the absence of a time limit provided in the Bill for these companies to complete recovery of the outstanding loans, the Chairman opined that the provision would actually grandfather the activities of unregistered SMFs. Moreover, as no monitoring mechanism was available for SFC to check on these companies, the proposed new provision could be abused.

20. ED/IIP(SFC) stressed the companies would be prohibited from providing securities margin financing service. In short, they could not extend new loans, vary the terms of the outstanding loans, or facilitate any further transactions for the clients. He added that it would be impractical to set a time limit for these companies to complete recovery of the outstanding loans as any limit would be arbitrary and might not satisfy the need of the companies.

21. As regards concern about how to ensure the compliance with the law, ED/IIP(SFC) stressed that although SFC would not have direct inspection power over these companies, it could continue to monitor the companies' activities through inspection of securities dealer firms which had on-going relationship with these companies. Furthermore, SFC could investigate into the companies if it suspected that they were engaged in unregistered business.

22. Responding to Mr Albert HO's suggestion of putting the provision in the schedule of exempted business of the Bill, the Senior Assistant Law Draftsman remarked that the proposed section was only a transitional arrangement. It would be inappropriate to incorporate it in the schedule of exemption which was meant for on-going activities.

23. On the suggestion of some members and the Assistant Legal Adviser to require these companies to provide periodic reports during the winding down process in order to facilitate monitoring by SFC, ED/IIP(SFC) said that the proposal would put the onus on the companies to determine whether their activities fell within the regulatory net. Moreover, it would be unreasonable to require those companies, which had not been subject to the regulation of SFC, to file return about their activities relating merely to the recovery of old loans. Furthermore, SFC did not have information on all of the companies providing securities margin financing services at the moment. It would be impossible for SFC to enforce a provision imposing a reporting requirement without even knowing the actual population of these companies.

24. The Chairman considered that the Administration's proposal to deal with existing securities margin financing service providers in recovering their outstanding loans unsatisfactory. Nonetheless, he recognized the dilemma of the Administration. Apart from the fact that SFC did not have the information on all of the potential service providers, imposing a reporting requirement on the companies would necessitate SFC's direct inspection and investigative powers into these companies which were not required to be registered under section 121C. Extension of SFC's power over non-registered entities might give rise to controversy.

II Any other business

25. The Chairman reminded members that the next meeting had been scheduled for 19 January 2000, at 10:45 am.

26. There being no other business, the meeting ended at 10:30 am.

Legislative Council Secretariat
21 July 2000