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

List of issues arising from the discussion at the meetings on 28 and 29 June 1999 which the Administration has been requested to respond vide the letter dated 30 June 1999

(1) To reconsider some of the suggestions made by the Law Society of Hong Kong on exemption which were considered acceptable by the Administration, particularly with regard to "loans to a company with paid up share capital of $1 million or foreign currency equivalent and to a listed company or the subsidiary of a listed company;

(2) to clarify the definition of "prospectus" as contained in clause 3 - section 121B(2)(g) of the Bill;

(3) to consider provisions for "unwinding" of margin financiers' business upon suspension of registration (clause 3 - section 121C(3));

(4) to consider the need for the phrase "is prepared to act" in clause 3 - section 121D(1)(b);

(5) to consider the inconsistency in the registration status of a securities margin financier's representative under clause 3 - section 121D(3) and 121U;

(6) to provide the reason for not including any financial penalty in clause 3 - section 121F(4);

(7) to consider the suggestion to recast clause 3 - section 121G(3) and (4) to include the condition stated under section 121G(2)(a);

(8) to provide explanation for the difference between section 121H(5) and section 121G(6) and to consider just having "For the purposes of this section, the Commission may have regard to any information in its possession.";

(9) regarding the provisions under clause 3 - section 121J, to consider proposing a CSA to section 121J(3) such that the Commission would be required to furnish reasons if so requested; and

(10) to consider the actions that could be undertaken against unregistered securities margin financiers conducting margin financing business particularly in respect of protection of clients' assets.

Legislative Council Secretariat
7 July 1999

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來函檔號 YOUR REF.: CB1/BC/13/98

6 July 1999

Ms. Estella Chan
Clerk to Bills Committee
Legislative Council Secretariat
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear

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

Thank you for your letter of 30 June 1999.

We have undertaken to prepare a list of proposed Committee Stage Amendments (CSAs) arising from the previous deliberation of the Bills Committee for Members' reference, which is now at Enclosure A (in English only). Members may however wish to note that this is *not* a complete list as we are still in discussion with the Commission and the Law Draftsman on certain points and we will provide an additional list of proposed amendments as soon as practicable. As regards the items contained in Enclosure A, we aim to issue instructions to the Law Draftsman shortly and provide the draft provisions for Members' reference when ready.

In respect of the outstanding points raised in your letter, our responses are as follows -

responses are as follows -

(1) On reflection, we share Members' concerns and agree that the provision of financial accommodation to a company with paid up share capital of $1 million or foreign currency equivalent and to a listed company or the subsidiary of a listed company should not be exempted from the regulatory regime.

(2) We agree to amend section 121B(2)(g) to clarify the meaning of "prospectus".

(3) We have no principle objection to the suggestion of clarifying in the Bill that a financier under suspension may still be permitted to engage in certain activities to maintain the business and to ensure that their clients will not be unfairly disadvantaged. We are in consultation with SFC on how this should best be achieved.

(4) We are in discussion with SFC as to how section 121D(1)(b) should be amended.

(5) There does not appear to be any inconsistencies between sections 121D(3) and 121U(3)(b). Section 121D(3) only applies where there has been a suspension ordered under another section so, for example, it would operate if a suspension was ordered under section 121U(3)(b). The result under section 121D(3) would be that the person would commit an offence if during the suspension, he acted as a securities margin financier's representative or hold himself out as such a representative.

(6) Please refer to the note at Enclosure B.

(7) Apparently there is no such concept as "eligibility to make an application" and section 121G(2)(b) has already dealt with the application process for registration. As such, it appears that section 121G(2)(a) is redundant and should be deleted. We will confirm with SFC and Law Draftsman accordingly.

(8) We would suggest amending section 121G(6) to read the same as section 121H(5) for the sake of consistency.

(9) We have no objection to the suggestion of amending 121J to require SFC to *provide a reason when requested* for the imposition of a condition or restriction in granting application for registration.

(10) Please again refer to the note at Enclosure B.

The attendance list for the meeting on 7 July 1999 is at Enclosure C.

Yours sincerely,

(Bryan P. K. Chan)
for Secretary for Financial Services

Encl.

c.c. Mr. Andrew Procter, SFC
Mr. William Maddaford, LD
Ms. Vicki Lee, LD

Enclosure A

Proposed Committee Stage Amendments to
Securities (Margin Financing)(Amendment) Bill 1999

	Section	Proposed Amendments[1]
1.	Clause 2 of the Bill	● To introduce definitions for "margin ratio" and "margin value"
2.	Clause 2 of the Bill	● To add "a" before "discounted negotiable instrument" and "guarantee" in the definition of "financial accommodation
3.	Clause 2 of the Bill	● To define "associated company"
4.	121B(2)(g)	● To clarify the meaning of "prospectus"
5.	121B	● To remove subsection (2) to a New Schedule ● To repeal subsection (3) as the reference to "group of companies" will be replaced by "associated company"
6.	121C	● In subsection (1), add "in Hong Kong" at the end of the provision ● To clarify that a person is taken not to be in breach of subsection (1) solely because he conducts any or all of the businesses listed in the New Schedule (i.e. the exemption list) ● To clarify that recklessness will not be accepted as a defence for conducting securities margin financing without registration
7.	121E	● To replace "the company" in subsection (1)(b) and substitute "the person" ● To amend subsection (1) to allow a financier to

[1] The proposed amendments only reflect our policy intention and the final drafting of the CSAs will

be subject to the advice of the Law Draftsman.

	Section	Proposed Amendments[1]
		engage in other businesses incidental to their conduct of business
8.	121F	● To amend subsection (3) to make it consistent with section 24 of the SFC Ordinance
9.	121H	● To amend subsection (5) to tally with section 121G(6)
10.	121J	● To amend subsection (3) to require SFC to provide a reason when requested for imposition of a condition or restriction in granting application for registration
11.	121S	● In subsection (4), repeal "impose a penalty under this section" and substitute "take any action under sub-section (3)"
12.	121Y (and s. 75A of SO)	● In section (4)(b), repeal the word "give" and substitute "provide"; same for ss2, 3(b) and 5(b) ● To amend subsection (1) to clarify that a financier is not required to provide a statement of account solely for the purpose of indicating interest charges
13.	121AA (and s.81A of SO)	● In subsection (1), insert a new subparagraph to allow securities collateral be registered in the name of a financier or a nominee controlled by the financier ● To repeal section (1)(c) as the policy intent should have been adequately covered by subparagraph (b)
14.	121AC	● To ensure that the section will not capture persons conducting business listed on the New Schedule

	Section	Proposed Amendments[1]
15.	121AS	● In subsection (1), repeal "(and without intent to defraud)"
16.	121AT	● To amend subsection (3)(a) to clarify the meaning of "employee of such employee"
17.	New Schedule	To move section 121B(2) to this Schedule (but repeal subparagraph (e) as this has now been replaced) whilst adding the following: ● the provision of financial accommodation by a company to its directors or employees to facilitate acquisitions or holdings of its own securities; ● the provision of financial accommodation to a registered securities margin financier, registered securities dealer or an authorized financial institution; ● the provision of financial accommodation to facilitate acquisition of 5% or more of the issued shares of a listed company; ● the provision of financial accommodation to an associated company to facilitate acquisitions or holdings of securities; ● the provision of financial accommodation by an individual to a company in which the person holds 10% or more of its issued share capital; ● the provision of financial accommodation by a company to an individual who holds 10% or more of the company's issued share capital
18.	Items 5 and 6 of Schedule 1 (sections 55 and 56 of SO)	● In subparagraph (c), repeal ""registered person" （註冊人）" and substitute ""registered"（註冊）person"

	Section	Proposed Amendments[1]
19.	Section 3 of Banking Ordinance	● To exempt securities margin financiers from section 3 of the Ordinance concerning the deposit of money into trust accounts

Financial Services Bureau
6 July 1999

Enclosure B

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

This short note seeks to address the queries raised by the Members during the Bills Committee meeting on 29 June 1999.

Section 121F(4)

2. Section 121F(4) concerns the making of false statements upon an application for registration. The Committee expressed surprise at the penalty and the apparent absence of a fining power. However, it does appear that the gap is filled by another statute.

3. The provision in section 121F is similar to section 62 of the Securities Ordinance ("SO"). Section 62 of the SO creates an offence for false representation for the purpose of obtaining a certificate of registration. It is an indictable offence with a maximum penalty of 5 years imprisonment. In comparison, a similar offence under the Leveraged Foreign Exchange Trading Ordinance (section 10) provides for both a summary and indictable route with both imprisonment and fines, and under the Commodities Trading Ordinance (section 40) to an indictable route with both imprisonment and fine. The question posed is how can a Magistrate fine under section 62 of the SO or, indeed, hear a case that is solely indictable. There are two possibilities.

4. First, if a prosecution is brought by the Securities and Futures Commission ("SFC") for any offence under the relevant ordinances it may do so in its own name, but the offence will be tried summarily before a Magistrate (section 62 of SFC Ordinance).

5. Secondly, the matter might be dealt with by the Police but nonetheless dealt with summarily. Sections 91 and 92 of the Magistrate's Ordinance allow a special Magistrate/permanent Magistrate to hear indictable offences summarily. A special magistrate is empowered to sentence the accused to imprisonment for 6 months and to a fine of $50,000; a permanent Magistrate is empowered to sentence to imprisonment for 2 years and to a fine of $100,000. Certain offences are excluded but none under the relevant ordinances. In nearly all cases those charged have been convicted and fined.

6. But it should however be noted that false representation cases are not dealt with by the SFC but by the Police. This was a policy decision taken some years ago by the SFC. It was thought more appropriate, considering the victim is the SFC, and also the majority of cases concern a failure to report a conviction which we are not easily able to prove (it requires finger printing and formal production of a criminal record).

Unregistered Dealing

7. The Committee had also expressed concerns on the conduct of unregistered dealing cases.

Investigation of unregistered dealing

- if a reason to believe unregistered dealing has occurred then section 33 of the SFCO;
- surveillance of suspect premises is conducted to ascertain if unregistered dealing is apparent;
- a search warrant may be sought from a Magistrate under section 36 of SFCO;
- premises are searched and relevant evidence seized;
- interviews are conducted with potential witnesses/suspects to establish case;
- prosecution is mounted if sufficient evidence available;

Protection of assets

on only two occasions has the SFC sought to appoint administrators and concurrently seek injunctions in unregistered dealing cases under section 144 of the Securities Ordinance. In both cases, they were boiler room operations manned by overseas residents and targeting overseas clients. There were exceptional cases as:

- they had international implications that could affect Hong Kong's reputation as a financial centre;

- as the shares under offer were not Hong Kong shares and were not settled on T+2, there were significant funds and scrip in transit; and

- the assets available gave economic justification to appoint an administrator.

- in comparison, experience has shown Hong Kong based unregistered businesses are very small, cash transactions are involved, and the majority have to ultimately place orders with a registered entity. Assets in these cases have a tangible value (unlike shares offered by boiler rooms which often involve fraud) and immediate possession is taken of both scrip and funds by their clients.

- In cases where a company should be wound up in the public interest or an individual should be bankrupted in the public interest, we have power to apply under sections 45 and 46 of the SO.

8. That leaves the possibility that, in the interests of investor protection, some lower threshold should be set for the SFC to seek injunctions or the appointment of receivers over the assets of unregistered persons. That possibility is being considered in the preparation of the Draft Composite Bill. The proposal is likely to be controversial and we do not think that it should be considered in isolation.

9. Finally, we should again note the provisions in the Bill allowing for rescission or application to a Court to avoid a contract where the other party is unregistered.

Financial Services Bureau
6 July 1999