香港特別行政區政府財經事務局的信頭

Letterhead of FINANCIAL SERVICES BUREAU, GOVERNMENT OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION

電　　話 TEL.: 2528 9161
圖文傳真 FAX.: 2861 1494

本函檔號 OUR REF.: SUB49/99 XIII　　CB(1)1959/98-99(01)
來函檔號 YOUR REF.: CB1/BC/13/98

24 September 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

As undertaken at the meeting held on 17 September 1999, I enclose herewith a master list of all items which have been raised at previous meetings of the Bills Committee and their latest positions for Members' reference (Enclosure A). You would note that most of the items have been reflected in the draft CSAs whereas the remaining ones are being formulated. In addition, a few more issues were raised at the last meeting which are now under consideration by the Administation and the SFC. We will revert to the Bills Committee with draft CSAs (if applicable) as soon as possible.

Separately, during the previous deliberation of the Bills Committee, some of the Members remain concerned as to whether there are sufficient safeguards to protect the interests of the clients if pooling of clients' assets is to be allowed. Particularly, the Democratic Party has invited the Administration to consider imposing a cap on the amount of monies that can be borrowed by the financier/dealer from authorized institutions by pledging the pooled securities of clients. We in

consultation with the SFC have examined the proposal very carefully and our response is now at Enclosure B for Members' consideration.

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

Proposed CSA to the Securities (Margin Financing) (Amendment) Bill 1999 **Enclosure A**

	Section	Details	Purpose and justifications	Present Position
1.	2	• To delete the definition of "agent".	• Technical amendment. • Also for consistency with existing provision in the Ordinance.	• Reflected in the CSA (clause 2(a) refers).
2.	2	• To define "associated company".		• Under consideration if it is necessary to include such a definition.
3.	2	• In the definition of "financial accommodation", to add "a" before "discounted" and "guarantee" respectively.	• Technical amendment.	• Reflected in the CSA (clause 2(b) refers).
4.	2	• To add the definition of "margin ratio" and "margin value".	• Technical amendments.	• Reflected in the CSA (clause 2(c) refers).
5.	2	• To consider whether amendment to the definition of "record" is necessary in order to ensure that records in electronic form will also be covered.	• To cope with latest technological development. • Our legal advice confirms that the present formulation of the definition of "record" together with that of "document" are broad enough to cover electronic record as well. Therefore no CSA is proposed.	• No CSA is proposed.

	Section	Details	Purpose and justifications	Present Position
6.	2	• In the definition of "securities margin financier's representative", to delete "an employee or agent of" and substituting "a person in the employment of, or acting for or by arrangement with,".	• Technical amendments. • Consequential to the deletion of definition of "agent" (please see also item 1 above).	• Reflected in the CSA (clause 2(d) refers).
7.	2	• To consider if separate definitions for "registered financier" and "registered financier's representative" are necessary	• We are advised that the present approach of using "registered financier" and "registered financier's representative" is in order and necessary in the structure of the Bill.	• No CSA is proposed.
8.	121B	• To delete subsection (3). • To provide the exemption list now listed in section 121B(2) under a new Schedule 4 of the Ordinance which may be amended by the Commission by way of subsidiary legislation. • Also to clarify that Part XA applies to all business (including any of the kinds of business listed in the new Schedule 4) carried on by a registered financier.	• Subsection (3) is no longer necessary given the reference to "group of companies" has been removed. • The exemption list will be amenable by the Commission by way of subsidiary legislation, providing greater flexibility to the SFC to cope with market changes.	• Reflected in the CSA (clause 3(a) and the new clause on p.9 refer).
9.	121C	• To add "Subject to section 121B(2)" in subsection (1). • Also to clarify that the registration requirement is only applicable to securities margin financing carried on in Hong Kong.	• For clarity (please also see item 8 above). • The purpose of the new subsection is to ensure that recklessness cannot be deployed as a defence for	• Reflected in the CSA (clause 3(b) refers).

	Section	Details	Purpose and justifications	Present Position
		• To add a new subsection to provide that if a person who provides financial accommodation and has a reasonable belief that it is not to be used to facilitate acquisition or the continued holding of securities listed on a stock exchange, that person does not contravene section 121C.	• contravention of section 121C.	
10.	121C(3) and D(3)	• The Bills Committee wondered if there would be any conflicts between sections 121C(3) and 121D(3), and 121S and 121U, if persons under suspensions would be deemed as unregistered.	• As explained in our letter dated July 6, we believe there is no conflict between the sections. 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 held himself out as such a representative. Similar explanation in the case of section 121C(3). No CSA is proposed.	• No CSA is proposed.
11.	121D(1)	• In section 121D(1)(b), repeal "is prepared to act".	• Technical amendment	• Reflected in the CSA (clause 3(c) refers).
12.	121E(1)	• To replace "company" in section 121E(1)(b) and substitute "person".	• Technical amendment • To allow a financier to engage in other businesses incidental to their	• Reflected in the CSA (clause 3(d) refers).

	Section	Details	Purpose and justifications	Present Position
		• In section 121E(1)(b) to enable a registered financier to conduct business that is incidental to his carrying on business of securities margin financing.	conduct of business, e.g. trading in futures and options for hedging purposes	
13.	121F(3)	• To amend section 121F(3) to make it consistent with section 24 of the SFC Ordinance.	• To specify the types of information that the Commission may require an applicant to furnish in relation to the application for registration.	• Reflected in the CSA (clause 3(e) refers).
14.	121F(4)	• The Bills Committee questioned why there was no pecuniary penalty for contravention of that section, i.e. making false statements upon an application for registration.	• As explained in our letter of 6 July 1999, the apparent gap is filled by the Magistrate's Ordinance. The relevant note is repeated at Appendix A for easy reference.	• No CSA is proposed.
15.	121F(6)	• We are asked to consider if it is necessary to amend the provision to put it beyond doubt that any proceedings for offence under that section cannot be brought more than 6 months after the discovery of the offence.	• Our legal advice confirms that the present drafting already clearly implies that proceedings cannot be brought after 6 months of the discovery of the offence and similar drafting has been used in many other legislation. We therefore do not propose any amendment.	• No CSA is proposed.
16.	121G(2)	• To delete section 121G(2)(a) as the concept of ineligibility to make application does not exist in the Bill. • It has separately been suggested that sections 121G(3) and (4) be grouped together, under which the Commission must refuse the	• Technical amendment. • We do not propose any amendment in latter respect as the Law Draftsman confirms that the present drafting is in order.	• Reflected in the CSA (clause 3(f) refers).

	Section	Details	Purpose and justifications	Present Position
		application.		
17.	121H(2)	• To delete section 121H(2)(a) as the concept of ineligibility to make application does not exist in the Bill.	• Technical amendment • It was separately suggested that sections 121H(3) and (4) be grouped together. For the same reason as item 16 above, we do not propose any amendment in this respect.	• Reflected in the CSA (clause 3(g)(i) refers).
18.	121H(5)	• To specify that the Commission may take into account any relevant information in its possession whether provided by the applicant or by some other person.	• For consistency with section 121G(6).	• Reflected in the CSA (clause 3(g)(ii) refers).
19.	121J(3)	• To specify that if the Commission imposes any condition and restriction in granting application for registration, it should provide reasons for its decision to the relevant person if so requested.	• To ensure procedural fairness to the registrants.	• Reflected in the CSA (clause 3(h) refers).
20.	121R(2)	• In section 121R(2)(h), to repeal "(whether convicted of the contravention or not)".	• The clause in parentheses seems to be redundant	• To be included in the CSA.

	Section	Details	Purpose and justifications	Present Position
21.	121R(5) and 121T(5)	• It has been suggested that sections 121R(5) and 121T(5) should be amended to provide that the Commission cannot suspend the registration of a registered financier or representative without first giving the financier or representative an opportunity of being heard.	• Given that the same language has been used in the existing Ordinance, for the sake of consistency, it is proposed not to amend the two sections. That apart, it may be worth noting that section 121W of the Bill provides that the Commission must give to the financier or the representative a written notice of the decision and an explanation of the grounds that lead to the decision. We believe the procedural fairness is ensured.	• No amendment is proposed.

	Section	Details	Purpose and justifications	Present Position
22.	121S(1)	• It has been suggested that section 121S(1) be amended to ensure that the Commission has the power to inquire into any of the matters listed in 121R(2)(a)-(h).	• Our legal advice confirms that given section 121S(1)(a)(iv) enables the SFC to conduct inquiries to ascertain whether a financier remains fit and proper to be registered and in that connection, SFC can have regard to the financier's financial integrity and reliability, the scenarios listed in section 121R(2) should have been covered. Therefore no amendment is necessary.	• No CSA is proposed.
23.	121S(4)	• To repeal "impose a penalty under this section" and substitute "take any action under subsection (3)".	• Technical amendment.	• Reflected in the CSA (clause 3(i) refers).
24.	121U(4)	• To repeal "impose a penalty under this section" and substitute "take any action under subsection (3)".	• Technical amendment.	• Reflected in the CSA (clause 3(i) refers).
25.	121V(3) and (4)	• To delete "cancel" and substitute "revoke".	• Technical amendment.	• To be included in the CSA.
26.	121W(1) and (2)	• To delete "impose any other penalty on" and substitute "take any other action against".	• Technical amendment.	• Reflected in the CSA (clause 3(j) refers).
27.	121Y(1)	• To repeal (d) and (e) and substitute • "(d) an adjustment of the amount of financial accommodation provided to the client by the	• Technical amendments to streamline the statement of account requirement, specifically to clarify that a financier should not be	• Reflected in the CSA (clause 3(k)(i) refers).

	Section	Details	Purpose and justifications	Present Position
		financier (except as a result of interest charged by the financier) an adjustment of the terms on which financial accommodation is provided to the client, whether by extension, reduction, credit or debit (except as a result of change in market value of securities collateral provided by the client)"	required to provide a statement of account solely for the purpose of indicating interest charges.	
28.	121Y(3)	• In section 121Y(3)(d), to add "together with the interest rate and basis of interest calculation" after "financial accommodation"' • To add "initiated" after "all disposals" in section 121Y(3)(h). • To delete section 121Y(3)(i).	• Technical amendments.	• Reflected in the CSA (clause 3(k)(ii) refers). • 3rd bull point to be included in the CSA.
29.	121Y(4)	• In section 121Y(4)(b), to repeal the word "give" and substitute "provide".	• For clarity.	• Reflected in the CSA (clause 3(k)(iii) refers).
30.	121Y(5)	• In section 121Y(5)(h), to add "initiated" after "disposal".	• Technical amendment.	• Reflected in the CSA (clause 3(k)(iv) refers). •

	Section	Details	Purpose and justifications	Present Position
31.	121Y(6)	• To add "without reasonable excuse" after "who".	• For clarity.	• To be included in the CSA.
32.	121Z(3)	• In section 121Z(3)(a), to delete "2 years" and substitute "3 months".	• The information contained in the statement of accounts referred to in section 121Y(2) should have been reflected in that referred to in section 121Y(4). It is therefore proposed that financier should keep record of the former for 3 months only. • The Bills Committee also questioned the reasonableness to require keeping of statement of accounts referred to in section 121Y(4) for 6 years respectively. The requirement is in fact consistent with section 83(5) of the existing Ordinance, which is comparable to the 7-year record keeping requirement under the Inland Revenue Ordinance. This anomaly will be redressed under the composite Securities and Futures Bill when all licenced persons will be required to maintain records for a minimum of 7 years. No CSA is proposed in this regard.	• Reflected in the CSA (clause 3(1) refers).
33.	121AA(1)	• In section 121AA(1), to add "(aa) registered in the name of a nominee controlled by the	• To allow financiers and dealers to register client's securities collateral in their names or their nominees'	• Reflected in the CSA (clause 3(m) refers).

	Section	Details	Purpose and justifications	Present Position
		financier". • To repeal section 121AA(1)(c)	names for purpose of providing better protection of their collateral interest. • Section 121AA(1)(c) is redundant as the policy intent should have been adequately covered by section 121AA(1)(b).	
34.	121AA(4)	• To amend section 121AA(4)(a) to impose a condition that credit facilities obtained by pledging margin clients' securities collateral by a securities margin financier should only be available for financing client's margin loans. • To amend section 121AA(4)(b) and (c) so that financiers may dispose of the securities collateral in case of client default if client's authority is obtained and such authority will not be subject to the annual renewal.	• The amendment to section 121AA(4)(a) is for the purpose of better investor protection by limiting the extent to which the financiers can borrow from authorized institutions/registered dealers by pledging clients' securities collateral. • Regarding the other one, as an effective security for financial accommodation, the securities collateral should be permitted to be disposed of freely.	• Draft CSA under formulation.

	Section	Details	Purpose and justifications	Present Position
35.	121AB(4)	• To clarify that the obligation imposed under section 121AB(4)(b) should only be triggered whenever the Commission has a reasonable belief that there is a breach of the financial resources rules, as envisaged under section 121AB(3)	• For market certainty	• Draft CSA under formulation.
36.	Division 4 121AC to 121AH	• To give further consideration as to whether the rescission provisions in the Bill should be amended to make our policy intent clear.	•	• Draft CSA under formulation.
37.	121AS(1)	• To repeal "(and without intent to defraud)"	• For consistency with existing SO.	• Reflected in the CSA (clause 3(n) refers).
38.	121AT(3)	• In section 121AT(3)(a), to amend "employee of such employee". • To add a new section to provide that a registered financier may appoint its general auditor appointed for the purposes of the Companies Ordinance (Cap. 32) to act as an auditor under this section.	• To clarify the meaning of "employee of such employee". • To put it beyond doubt that it is not necessary for a registered financier to appoint an auditor in addition to the one appointed under the Companies Ordinance	• To be included in the CSA.
39.	121AY(2)	• To repeal the word "section" and substitute "division".	• To clarify that the expenses incurred by appointing an auditor upon request of a client would also be	• To be included in the CSA.

	Section	Details	Purpose and justifications	Present Position
			borne by the registered financier.	
40.	121BD(3), (4) and (6)	• To amend the subsections along the line of section 95(2) and (3) of the existing Securities Ordinance.	• It was suggested by the Bills Committee that the provisions should be made more specific to ensure legislative certainty.	• To be included in the CSA.
41.	Suspension	• To add a new section to enable the Commission to make an order specifying the manner in which an existing business is to be carried on and make it an offence for non-compliance with the suspension order.	• To ensure that a financier under suspension may still carry on activities such as winding down their positions.	• Draft CSA under formulation.
42.	Penalty levels	• To raise the penalty levels of certain provision to increase the deterrence. Details are given in Appendix B.	• The Bills Committee has asked the Administration to review the penalty levels in the Bill to ensure that they carry sufficient deterrence against breach of the law.	• To be included in the CSA.

	Section	Details	Purpose and justifications	Present Position
43.	New clause 3A	• To add a new Schedule 4 as referred to in the proposed revised section 121B(2).	• Please also see item 8 above . • On the rationale of the proposed additional exemptions, please refer to the Administration's response to the Bills Committee dated 25 June and 16 July 1999. Extracts of the relevant parts are repeated at Appendix C for easy reference.	• Reflected in the CSA (new clause 3A refers).
44.	Schedule 1 Item 1	• To consider if the proposed subparagraph (d) in the definition of "dealer" should be expanded to cover activities conducted by registered financiers that may be regarded as "dealing in securities".	•	• Under consideration.
45.	Schedule 1 Item 1	• To redefine "authorised financial institutions" as "authorised institutions".	• Technical amendment.	• To be included in the CSA.

	Section	Details	Purpose and justifications	Present Position
46.	Schedule 1 Items 5 and 6 Section 55 and 56	• In section 55(c) and 56(c), to repeal ""registered person"（註冊人）"and substitute"" registered"（註冊）person"	• For clarity.	• To be included in the CSA.
47.	Schedule 1 Item 10	• The Bills Committee queried if it is appropriate to elaborate on the meaning of "prescribed".	• The Law Draftsman responded that the intention might be to avoid any confusion with any possibility of matters prescribed under 146A by Chief Executive.	• Under review.
48.	Schedule 1 New item 19A Section 75	• In section 75(3), to add "without reasonable excuse" after "who".	• For clarity.	• Reflected in the CSA (p.11 of the 3rd draft refers).
49.	Schedule 1 Item 20 Section 75A(1)	• In section 75A(1), to repeal (d) and (e) and substitute • "(d) an adjustment of the amount of financial accommodation provided to the client by the financier (except as a result of interest charged by the financier) • an adjustment of the terms on which financial accommodation is provided to the client, whether by extension, reduction, credit or debit (except as a result of change in market value of securities collateral provided by the client)"	• Technical amendments to streamline the statement of account requirement (specifically to clarify that a financier should not be required to provide a statement of account solely for the purpose of indicating interest charges)	• Reflected in the CSA (p.11 of the 3rd draft refers). • It was raised at the Bills Committee meeting on 17 September 1999 on whether section 75A should simply refer to the requirements set out in section 121Y. The matter is now under review.

	Section	Details	Purpose and justifications	Present Position
50.	Schedule 1 Item 20 Section 75A(3) to (5)	• In section 75A(3)(d), to add "together with the interest rate and basis of interest calculation thereon" after "financial accommodation" • To add "initiated" after "all disposals" in section 75A(3)(h). • To delete section 75A(3)(i). • In section 75A(4), to repeal the word "give" and substitute "provide". • In section 75A(5)(h), to add "initiated" after "disposal".	• Technical amendments.	• Reflected in the CSA (p.12 of the 3rd draft refers). • The 3rd and last bull points to be included in the CSA.
51.	Schedule 1 Item 22 Section 77	• In section 77(4)(a), to delete "2 years" and substitute "3 months".	• The information contained in the statement of accounts referred to in section 75A(2) should have been reflected in that referred to in section 75A(4). It is therefore proposed that financier should keep record of the former for 3 months only. • The Bills Committee also questioned the reasonableness to require keeping of statement of accounts referred to in section 75A(4) for 6 years respectively. The requirement is in fact consistent	• Reflected in the CSA (p.12 of the 3rd draft refers).

	Section	Details	Purpose and justifications	Present Position
			with section 83(5) of the existing Ordinance, which is comparable to the 7-year record keeping requirement under the Inland Revenue Ordinance. This anomaly will redressed under the composite Securities and Futures Bill when all licenced persons will be required to maintain records for a minimum of 7 years. No CSA is proposed in this regard.	
52.	Schedule 1 Item 79	• The Bills Committee has requested the Administration to consider if it is tidier to provide for the rule making power under section 146 rather than under section 79(9).	•	• Under review.
53.	Schedule 1 Item 25 Section 81	• To amend section 81 to ensure that securities deposited by a securities margin financier with a securities dealer for safe custody purpose are also subject to the protection given under that section. • To amend section 81 so that dealers may dispose of the securities deposited by a client for the purpose of settling any liability owed by the client but only with the written authority of the client or as permitted by Commission Rules. • The Bills Committee at the meeting on 17 September 1999 requested the Administration to	• Since most securities margin financiers will not in there own right maintain an account at CCASS, it is quite common in practice for these financiers to deposit the securities collateral on CCASS via a dealer being CCASS participants. These financiers normally do not effect securities transactions through the dealers and therefore will not be regarded as the "client" of the dealer. It is therefore necessary to ensure that such securities will be subject to the same level of protection given under	• Draft CSA under formulation. • The points raised by the Bills Committee on 17 September are now under review.

	Section	Details	Purpose and justifications	Present Position
		reflect further on the following points - - It is unclear whether the exceptions provided for in the Commission Rules can override the requirements set under section 81(2). - It may be helpful to require that client agreements should be counter-signed by the dealer or designated officer to ensure that the terms and risks are clearly explained and disclosed to the clients.	section 81. • The other amendment is to enable dealers to set off different accounts maintained by the same client, provided that client's written authority is obtained.	
54.	Schedule 1 Item 25 Section 81A	• To amend section 81A to ensure that securities deposited by clients with a securities dealer as security for purposes other than the provision of financial accommodation are subject to the protection given under that section. • To amend section 81A so that dealers may dispose of the securities deposited by a client for the purpose of settling any liability owed by the client but only with the written authority of the client or as permitted by Commission Rules. • To amend section 81A to impose a condition that credit facilities obtained by pledging margin clients' securities collateral by a securities dealer should only be available for financing client's	• Other than the scenario described in item 53 above, it is also a common practice that a financier may repledge clients' securities collateral with a dealer as security for the financial accommodation provided by the dealer in pursuance with section 121AA(4). It is therefore necessary to ensure that such securities collateral is dealt with in accordance with the proposed section 81A. • The second amendment is to enable dealers to set off different accounts maintained by the same client.	• Draft CSA under formulation.

	Section	Details	Purpose and justifications	Present Position
		margin loans.	• The last one is for the purpose of better investor protection by limiting the extent to which the dealers can borrow from authorized institutions by pledging clients' securities collateral.	
55.	Schedule 1 Item 25 Section 81A(2)	• In section 81A(2), add "(aa) registered in the name of the dealer or a nominee controlled by the dealer".	• To allow financiers and dealers to register client's securities collateral in their names or their nominees' names for purpose of providing better protection of their collateral interest.	•
56.	Schedule 3 Item 3 Section 15(b) of SEUO	• It has been suggested that section 15(b) of the Stock Exchange Unification Ordinance be amended by repealing "section 65B and any".	• Upon consultation with the Department of Justice, we take the view that the expression of "any financial resources rules" still makes sense in the context and therefore no further amendment is considered necessary.	• No CSA is proposed.
57.	Schedule 3 New item Section 3 of Banking Ordinance	• In section 3(1) of the Banking Ordinance (Cap. 155), to add "(ja) a person who is a registered securities margin financier within the meaning of the Securities Ordinance (Cap. 333), where section 121AM of that Ordinance applies to such a deposit".	• To exempt securities margin financiers under section 3 of the Ordinance in respect of deposit of client's money into trust accounts.	• Reflected in the CSA (p.12 and 13 of the 3rd draft refer).

	Section	Details	Purpose and justifications	Present Position
58.	Schedule 4 Item 3	• To amend the clause to allow securities dealers to have 3 months transitional period to bring themselves into compliance with the new sections 81 and 81A, i.e. client authorization made under the old section 81 will remain in force during the transition.		• Draft CSA under formulation.
59.	121C(?)	• To exempt finance companies whose securities margin financing business is for the sole purpose of servicing of old loans from the registration requirement	• Need to ensure that finance companies transferring the good margin loans the dealing firms but left with the under secured ones will not trigger the registration requirement.	• Draft CSA under formulation.
60.	Unregistered dealing and margin financing activities	• The Bills Committee has expressed concerns as to whether the Commission has adequate means to deal with unregistered dealing (and margin financing) cases.	• As explained in our response of 6 July 1999, the SFC is enabled to investigate and seek injunctions in respect of unregistered dealing (and margin financing) under the various sections under the Securities Ordinance and the SFC Ordinance. The relevant note is repeated at Appendix A for easy reference. The regime has been worked well so far and we believe no further amendment is necessary.	• No CSA is proposed.

Financial Services Bureau

21 September 1999

Appendix A

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

Appendix B

Bills Committee on Securities (Margin Financing)(Amendment) Bill 1999
Review on the Penalty Levels for Various Offences in the Securities (Margin Financing)(Amendment) Bill 1999

	Offence	**Penalty on Conviction** (existing Securities Ordinance)	**Penalty on Conviction** (in the Amendment Bill)	**Proposed CSAs and Justifications**
1.	Acting or holding out as a dealer or as a securities margin financier without registration	$. 48(2) $50,000($500/day for continuing offence)	S.121C(2) Summary: level 5 (i.e. $50,000) and imprisonment for 6 months ($500/day for continuing offence) Indictment: $200,000 and imprisonment for 2 years ($2,000/day for continuing offence)	• **Proposed to further increase the penalty levels to -** **Summary: level 6 (i.e. $100,000) and imprisonment for 6 months** **Indictment: $1 million and imprisonment for 5 years** • The proposed change is to increase deterrence and is in line with the penalty levels provided for in the Banking Ordinance (Cap. 155)
2.	Act as a representative without licence	S.50(2) $10,000($100/day for continuing offence)	S.121D(2) Level 4 (i.e.$25,000)($500/day for continuing offence)	• No amendment proposed.

	Offence	Penalty on Conviction (existing Securities Ordinance)	Penalty on Conviction (in the Amendment Bill)	Proposed CSAs and Justifications
3.	False representation for the purpose of obtaining the certificate of registration	S.62(1) Indictment: Imprisonment for 5 years	S.121F(4) Indictment: Imprisonment for 5 years	• No amendment proposed.
4.	A financier carrying on a business of securities margin financing without an approved director or a dealer (which is a corporation) carrying on a business of securities dealing without a dealing director	$48(2) $50,000($500/day for continuing offence)	S.121I Summary: level 5 (i.e. $50,000)($500/day for continuing offence) Indictment: $200,000($2,000/day for continuing offence)	• No amendment proposed.
5.	Contravention of the requirements relating to information to be provided by dealers/financiers (concerning particulars appeared on the certificate of registration)	S.63 $2,000	S.121Q Level 2 (i.e. $5,000)	• No amendment proposed.
6.	Failure to issue contract notes/statement of accounts to clients after each transaction/at the end of the month	S75(3) $5,000	S.121Y(6)[S.75A(6)] Level 4 (i.e. $25,000)	• No amendment proposed.

	Offence	Penalty on Conviction (existing Securities Ordinance)	Penalty on Conviction (in the Amendment Bill)	Proposed CSAs and Justifications
7.	Failure to provide clients with a copy of the statement of account or keep available for inspection by the client	S.77(4) $2,000	S121Z(5)[S.77(6)] Level 4 (i.e. $25,000)	• No amendment proposed.
8.	Failure to comply with the requirement on handling of clients' securities held for safe custody	S.81 $2,000	S.121AA(6)[S.81(6) and S.81A(7)] Level 3 (i.e. $10,000)	• No amendment proposed.
	Disposition of client's securities without client's authorisation	S.81 $20,000 and imprisonment for 2 years	S.121AA(7)[S.81(7) and S.81A(8)] Summary - level 5 (i.e. $50,000) Indictment - $200,000	• **Proposed to raise the penalty levels to increase deterrence -** **Summary: level 6 (i.e. $100,000)** **Indictment: $200,000 and imprisonment for 2 years**

	Offence	Penalty on Conviction (existing Securities Ordinance)	Penalty on Conviction (in the Amendment Bill)	Proposed CSAs and Justifications
9.	Failure to comply with the FRR			
	a) Failure to notify SFC	a) S.65C(4)	a) S.121AB(6)	
		$25,000 ($250/day for continuing offence)	level 4 (i.e. $25,000) ($250/day for continuing offence)	• **Proposed to raise the penalty to level 6 (i.e. $100,000) and $1,000/day for continuing offence to increase deterrence.**
	b) Failure to produce information requested by SFC for purpose of ascertaining whether the FRR is fully complied with	b) S.95(1)	b) S.121AB(7)	
		$10,000 and imprisonment for 2 years	level 5 (i.e. $50,000) and imprisonment for 2 years	• No amendment proposed.
10.	Falsification of records	S.83(7)	S121AI(11)	
		$10,000 and imprisonment for 6 months	Level 5 (i.e. $50,000) and imprisonment for 2 years	• No amendment proposed.
11.	Failure to lodge auditor's report/annual financial statement before a specified time	S.88(4)	S.121AK	
		$5,000	Level 2 (i.e. $5,000)	• **Proposed to raise the penalty to level 3 (i.e. $10,000) to increase deterrence.**

	Offence	Penalty on Conviction (existing Securities Ordinance)	Penalty on Conviction (in the Amendment Bill)	Proposed CSAs and Justifications
12.	Unlawful disposition of money deposited in trust account	S.84(7) $10,000 With intent to defraud, $50,000 and imprisonment for 5 years	S.121AS Level 3 (i.e. $10,000) With intent to defraud, $200,000 and imprisonment for 5 years	• **Proposed to raise the penalty to level 5 (i.e. $50,000) to increase deterrence.** • No amendment proposed.
13.	Failure to notify SFC of change of auditors	S.87B(2) $5,000	S.121AU(2) Level 4 (i.e. $25,000)	• No amendment proposed
14.	Failure to observe the confidentiality requirement by auditor and auditor's employee	S.94 Nil	S.121BC [revised S.94(2)] Level 6 (i.e. $100,000) and imprisonment for 6 months	• No amendment proposed.
15.	Failure to produce accounting records on demand by SFC	S.95(3) $10,000 and imprisonment for 2 years	S.121BD [revised S.95(3)] Level 5 (i.e. $50,000) and imprisonment for 2 years	• No amendment proposed.

	Offence	**Penalty on Conviction** (existing Securities Ordinance)	**Penalty on Conviction** (in the Amendment Bill)	**Proposed CSAs and Justifications**
16.	a) Destroying, concealing or altering records or send records or other property outside HK; or b) the person attempting to leave HK	S.96(1) $50,000 and imprisonment for 2 years	S.121BE and S.121BF Level 5 (i.e. $50,000) and imprisonment for 2 years	• **Proposed to raise pecuniary penalty to level 6 (i.e. 100,000) to increase deterrence.**
17.	CE-in-Council may make regulations to provide for a penalty of contravention of the rules made by Commission under section 146	S.146(2) $2,000 and imprisonment for 3 months	Revised S.146A Level 1 (i.e. $2,000) and imprisonment for 3 months	• (The purpose of the amendment now contained in the Bill is to rearrange the existing sections 146 and 146A and no policy changes have been introduced.)

	Offence	**Penalty on Conviction** (existing Securities Ordinance)	**Penalty on Conviction** (in the Amendment Bill)	**Proposed CSAs and Justifications**
18.	Failure to comply with the order made by SFC in relation to the application of registration by existing financiers during the transition period	Not applicable	S.121BH(4) Level 6 (i.e. $100,000)	• **Propose to raise the penalty levels to -** **Summary: level 6 (i.e. $100,000) and 6 months imprisonment** **Indictment: $1 million and imprisonment for 5 years** • This is to match the penalty for contravention of section 121C(2) for conduct of unregistered securities margin financing.

Financial Services Bureau
21 September 1999

Appendix C

Extracts of Administration's Response dd 25.6.99

Administration's Response to the Further Submission of the Law Society

14. Principle for Granting Exemption

The main purpose of the present Bill is to provide better protection to investors engaged in securities margin financing and to ensure that the market is not exposed to excessive and undue risks arising from the activity. As a general principle, therefore, any exemption granted under

the Bill should be consistent with and will not undermine these policy objectives. In implementing the proposed regulatory regime, the SFC will in the interest of market certainty and transparency and as a matter of good regulatory practice, clearly explain to the industry and the market of how applications should be made and what information is required. In addition, SFC will also observe procedural fairness and notice of concerns and reasons will be given to the parties involved.

15. Areas of Exemption

As pointed out in our previous responses, we have agreed to put the types of activities which are clearly not intended to be covered by the present regime and therefore to be exempted from the registration regime, under a Schedule, as opposed to the present approach of listing them in section 121B. The Schedule can be amended by the SFC subject to the negative vetting of the Legislative Council. However, there may be situations where the experience in regulation may prove it justified to exempt cases in addition to the Schedule. We therefore see merit to continue to provide the flexibility to SFC to grant class exemption to specific types of persons by way of Commission rules, as provided for in section 146(3) in the Bill. Such exemptions may be subject to terms and conditions as prescribed by the SFC as deemed appropriate. SFC will also be empowered to waive or modify certain specific provisions on a case-by-case basis under the Bill upon application.

16. Exemption Suggested by the Law Society

Keeping the above general principles in mind, we have carefully considered the further suggestions made by the Law Society. In general, we are agreeable to extending the exemption list to include -

- 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;

- Loans to its directors or employees from a company to purchase securities in that company;

- Loans to registered securities margin financiers, authorised institutions under the Banking Ordinance and securities dealers;

- Loans to facilitate the acquisition of 5% or more of the issued share capital of a listed company;

- Loans to associated company; and

- Loans by individuals to companies in which they have substantial shareholdings of 10% or more and vice versa.

It should however be clarified that once a company is registered as a securities margin financier, all relevant activities carried on by it should be covered by the relevant requirements under the law.

For the remaining cases, we consider it more prudent to consider them individually and grant exemption by way of class exemption or on a case-by-case basis -

- Loans to professionals. Apart from the difficulty of how "professionals" should be defined, we are concerned of the possibility of circumvention.

- Loans to investment advisers and insurance companies. We do not believe that investment advisers and insurance companies will be affected in any way under the present Bill.

- Transactions of which the provision of financial accommodation is not the principal or dominant purpose. From its past experience, SFC is not aware of the practice of providing financial accommodation in the form of vendor financing or sales on deferred terms. In addition, it would be difficult to attempt to determine the principal or dominant purpose of a particular transaction.

- Loans to finance off-exchange transactions. The similar problems now encountered in unregulated securities margin financing activities will still prevail and therefore we believe off-exchange transactions should not be exempted from regulation.

17. Costs of Exemption

We concur with the view that we should try to keep costs to a minimum. This is precisely the reason for including an exemption list in the Bill itself and for giving a general class exemption power to the SFC. It is not our

general intention that the SFC should grant exemption to single loans and to the extent possible, the SFC will seek to do so by way of class exemption. Generally speaking, the SFC will expect the applicant to describe its nature of business in considerable detail and provide any other explanation necessary for it to assess whether such business should be regulated, on the basis of the general principles set out above.

Financial Services Bureau
25 June 1999

Extracts of letter dd 16.7.99 to Clerk to Bills Committee, LegCo

Separately, Members may wish to note that on reflection, we consider it inappropriate to extend the exemption list to include the provision of financial accommodation to facilitate the acquisition of 5% or more of the issued share capital of a listed company in view of practical difficulties explained below.

It has been pointed out by the Chairman of the Committee that since a prospective purchaser will often require some time to acquire a stake of 5% or more in any listed company (particularly when acquired on market), a financier providing the necessary funding to this purchaser will not be exempted from registration until such time as the accumulated stake reaches 5%. Given that it will not be realistic to require registration of a financier for a short time but not subsequently, we have given further consideration to the possibility of expanding the exemption list to permit acquisition, whether in a single transaction or a series of transactions, as suggested by the Law Society. By this approach, any series of transactions must be completed within some reasonable timeframe in order to safeguard against potential abuses. We believe that it would be inappropriate to set an arbitrary time limit, nor would it be acceptable to leave it as an "acquisition of 5% or more of the issued share capital of a listed company *within a reasonable period of time.*"

Against the above, we believe that such financier should consult the SFC for a ruling on a case-by-case basis upon being approached by the prospective purchaser. In any event, we do not envisage major difficulties for the practitioners as it is unlikely that a person would carry on an exclusive business on providing this type of financial accommodation.

Enclosure B

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

Note on Pooling of Clients' Assets

Background

Under the Securities (Margin Financing)(Amendment) Bill 1999, securities dealers and securities margin financiers, with the written authority of the clients may deposit clients' securities with an authorized financial institution as collateral for financial accommodation provided to the dealer/financier, an arrangement usually referred to as "pooling of client assets". The matter was extensively discussed at the meetings of the Bills Committee on the aforesaid Bill.

2. While Members in general recognise that pooling is crucial for securities margin financing business to remain commercially viable, there have been concerns if adequate safeguards are put in place to protect the interest of the clients. Particularly, the Democratic Party (DP) has proposed to impose some further condition under which pooling could be allowed.

The Proposal

3. To render even better protection to investors, the DP invites the Administration to consider imposing a condition that credit facilities obtained by pledging margin clients' securities collateral by a securities dealer or a securities margin financier should only be available for financing client's margin loans.

4. The proposed requirement seeks to strike a balance between the outright banning of pooling of clients' assets of any kind and allowing the dealer or financier certain flexibility to ensure commercial viability. This requirement effectively imposes a limit on the amount which can be drawn down on the facility lines which are secured by margin clients' securities collateral - which cannot exceed at any time the total gross margin loans due from clients.

Industry's Reaction

5. The Securities and Futures Commission (SFC) has consulted the industry on a limited basis and the initial responses of the industry are summarised as follows -

(a) The present arrangement has worked well for many years without any major defaults (it may be worth noting that C. A. Pacific and Ming Fung are cases of different nature, with the former involving an unregulated entity and the latter involving misappropriation of funds by top management) and investors have so far not suffered any losses even though dealers are free to apply funds secured by clients' securities.

The proposed requirement may add to compliance costs as registrants will need to modify their accounting system for capturing the necessary information and maintaining an audit trail. Developing and maintaining such a system is likely to result in additional costs.

(b) The Financial Resources Rules (FRR) already restrict how a dealer or financier can apply these funds. Given that the amounts borrowed will always be included in liabilities, where they have been used to acquire non-qualifying assets, the dealer or financier will have to make good the difference with its regulatory capital.

Administration's Response

6. The Administration in consultation with SFC has carefully examined the proposal. We are sympathetic to the concerns of the industry that the proposal may add to the compliance costs but we consider that it does not necessarily require extensive modification of their present systems. On balance of the merits and possible demerits of the proposal, we believe the proposal is not unreasonable and strikes a balance between outright banning of pooling and giving the dealer or financier a free hand to make use of such money. We therefore agree to propose amendments to sections 81A and 121AA of the Bill at the committee stage to give effect to the proposal. Draft provisions will be submitted to the Bills Committee for consideration when they are available.

Financial Services Bureau
24 September 1999