# 立法會
# *Legislative Council*

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**Paper for the House Committee meeting on 6 November 1998**

**Report of the Bills Committee on Securities (Amendment) Bill 1998**

## Purpose

This paper reports on the deliberations of the Bills Committee on Securities (Amendment) Bill 1998.

## Background

2. Under Part X of the Securities Ordinance (Cap. 333), any person who has suffered pecuniary loss as a result of default on the part of a broker member of the Stock Exchange of Hong Kong (SEHK) is entitled to claim compensation against the Unified Exchange Compensation Fund (the Fund) managed by the Securities and Futures Commission (SFC). Once the committee of the SEHK has determined that a default has occurred and claims for compensation may be allowed, it will notify the SFC of the allowance or partial allowance of a claim.

3. Section 109(3) of Cap. 333 imposes a compensation limit of $8 million in respect of all claims against any one defaulting broker allowed by the SEHK or the Court. If the total of all allowed claims for compensation exceeds that limit, section 120(2) provides that the $8 million should be apportioned amongst the allowed claims equitably. This normally means a pro rata distribution according to the amount of each of the claims. On payment of such compensation, whether in full or in part, these claims will be considered absolutely discharged. Owing to the need for apportionment in such circumstances, payments from the Fund cannot be effected until all claims submitted have been determined, which usually takes a long time.

4. After a payment is made to a claimant, the SFC is subrogated to the claimant's rights against the defaulting broker to the extent of the payment made under section 118 of Cap. 333. The SFC pursues its rights against the broker, for example by filing a proof of debt in a winding-up or bankruptcy proceeding involving the defaulting broker. If the SFC recovers money in this way and the claimants have not been paid the full amount of their allowed claims, the recoveries are paid to the claimants. Such further payments are normally apportioned among the outstanding

claims on a pro rata basis.

5. Following the collapse of the C.A. Pacific Group with more than 10,000 investors affected, the Administration, having considered the market conditions and the size of the possible claims against the broker company, announced on 25 January 1998 that a flexible approach would be adopted in relation to the compensation arrangements for C. A. Pacific Securities clients. The principle was that so far as the trading records and account statements of the clients had not indicated the use of margin facilities, they would be regarded as cash clients and would be entitled to claim compensation under the Fund. Given the compensation limit of $8 million, the compensation that each client might receive from the Fund would be very limited. The Government therefore agreed to introduce a fixed per claimant level of compensation. To enable the Fund to meet the claims, the SEHK and the SFC each agreed to inject $150 million and if necessary, another $150 million. The Government also undertook to apply to the Finance Committee for a loan to top up the Fund should it fall below the prudential level.

6. The SEHK received 5,212 claims with a total size of $2,412 million upon the closing of the three-month period for submission of claims on 1 May 1998. On 10 June 1998 the SFC and the SEHK made a joint press release on the detailed arrangements for the compensation scheme. The Council of the SEHK resolved that it would allow a sum of not more than $150,000 per client. Cash clients and clients who had signed margin agreements with C.A. Pacific Finance but had not used the facilities will be eligible. In determining whether margin clients had ever used the margin facilities, the relevant period to be looked at would be from 1 June 1997 to 19 January 1998.

**The Bill**

7. Implementation of the announced compensation arrangements requires legislative amendments to Cap. 333. The Bill aims -

(a) to enable the SFC to inject money into the Fund;

(b) to empower the SEHK to authorize under certain circumstances discretionary payments to claimants against the Fund before the normal apportionment procedure takes place ;

(c) to exclude the discretionary payments from the calculation of the statutory compensation limit of $8 million;

(d) to restrict the amount of money recouped by the SFC in exercise of its subrogation rights that may be recycled for compensation to $8 million; and

(e) to clarify beyond doubt that the claim of a claimant who has been paid a discretionary sum is absolutely discharged on distribution of the $8

million under the apportionment procedure whether or not he receives any payment under that procedure.

8. The proposed legislative amendments are intended to take retrospective effect from 27 January 1998.

**The Bills Committee**

9. Members agreed at the House Committee meeting on 4 September 1998 to form a Bills Committee to study the Bill. Hon Ronald ARCULLI was elected Chairman of the Bills Committee. The Bills Committee has held three meetings with the Administration, met representatives of claimants of C.A. Pacific Securities Limited, Foreluxe Securities Limited and Chark Fung Securities Limited, and received four submissions. The membership list of the Bills Committee is at **Appendix I**.

**Deliberations of the Bills Committee**

Compensation limit

10. The Bills Committee notes that although the Bill aims to provide the legislative framework to enable the implementation of the compensation arrangements for C.A. Pacific Securities clients, a per claimant compensation limit of $150,000 as announced by the SFC and the SEHK on 10 June 1998 has not been specified in the Bill. Members are aware that clause 5 of the Bill empowers the SEHK to authorize under certain circumstances discretionary payments to claimants against the Fund before the normal apportionment of the compensation limit of $8 million under the existing law. They are concerned about the way SEHK would exercise this power, in particular in determining the amount of discretionary payment. Members therefore have examined the desirability of specifying a compensation ceiling in the Bill.

11. In addressing members' concern, the Administration has pointed out that clause 5 of the Bill already sets out the conditions under which the SEHK may exercise its power. Amongst the conditions specified, the Compensation Committee of the SEHK has to take into account all the ascertained and contingent liabilities of the Fund and is satisfied that the assets of the Fund permit it to give discretionary payments. In the Administration's view, it is inappropriate to stipulate a definite amount of compensation in the law, be it the minimum or the maximum compensation amount. Fixing an amount of compensation will limit the flexibility of the Compensation Committee of the SEHK and may not be conducive to the interest of the claimants at large. Although the per claimant compensation limit of $150,000 has not been specified in the Bill, the Administration has assured members that since the compensation arrangements have been endorsed by the Council of the SEHK and made known to the public, there should not be any doubt on the SEHK's commitment in implementing such arrangements.

12. Notwithstanding the Administration's undertaking that the SEHK will make

reference to the compensation arrangements for C.A. Pacific Securities clients in working out the compensation rules and compensation limit in respect of other defaulting cases, members are still concerned about the possibility of the SEHK deciding on an unreasonable amount of compensation to claimants. Whilst members take note of the existing section 50 of the SFC Ordinance (Cap 24) which empowers the SFC to serve restriction notices on the SEHK requiring it to take or prohibit it from the SFC to take certain actions when the SFC considers it in the public interest to do so, the Bills Committee suggests and the Administration agrees that to provide sufficient checks and balances on the power of the SEHK in respect of discretionary payments, section 121A of Cap. 333 should be amended to the effect that the SFC may act if it is satisfied that the SEHK has unreasonably exercised its power under clause 5. Having regard to this proposed amendment, the majority members of the Bills Committee agree that it is inappropriate to enshrine in the law a compensation limit.

13. Some members however still consider it necessary to specify a per claimant compensation limit of $200,000 into the Bill because the former Chairman of the SFC has mentioned such an amount in a press conference held after the collapse of the C.A. Pacific Group. Hon Albert HO Chun-yan has indicated that he might consider moving an amendment to the Bill in this respect. The Administration has clarified that the $200,000 compensation limit was the per claimant compensation limit the former Chairman of the SFC had hoped to achieve but the actual figure would have to depend on the total amount of the claims and the assets of the Fund. After reviewing the claims received and cross checking with the provisional liquidator the books and records of the C.A. Pacific Group, the SEHK recommended and the SFC endorsed a per claimant compensation limit of $150,000 based on the consideration that this had struck a reasonable balance among the interests of the parties concerned and the need to preserve a prudential level of the Fund and to protect small investors. About 70% of C.A. Pacific Securities clients will be fully compensated under the endorsed per claimant compensation limit.

Apportionment of fund to allowed claims

14. To ensure that claimants would not receive less than what they would have under the current compensation arrangements, members have examined the methods of apportionment under the current and the proposed arrangements. According to the proposed compensation arrangement, each successful claimant will be given a discretionary compensation up to $150,000 without having to wait for the completion of the verification exercise and apportionment for all the claims. Where the aggregate of the allowed claims against the Fund exceeds the limit of $8 million, the SEHK shall apportion the sum amongst the allowed claims in such manner as it thinks equitable. In apportioning the $8 million, SEHK has in the past adopted a pro rata distribution according to the amount of the allowed claims. Claimants whose allowed claims exceed $150,000 will receive the balance of the discretionary payment and what can be apportioned from the $8 million. Those claimants whose pro-rata share of the $8 million is not more than $150,000 will not be given any further payment. Since about 70% of the C.A. Pacific Securities claims will have been fully compensated by the discretionary payment, these claimants will not receive any further payment under the apportionment procedure. This being the case, some members

have questioned the appropriateness of apportioning the $8 million on the basis of the full amount of allowed claims. Given the large size of the total allowed claims, the pro rata share of the $8 million of even large claims will be small and the actual payouts from the $8 million will be limited as the majority of claims will have already been discharged under the discretionary payment. Hon Jasper TSANG Yok-sing suggests that the $8 million should be apportioned pro rata to the amount of the outstanding claims, i.e. disregarding those claims which have been fully compensated by the discretionary payment. Such an approach will ensure that the $8 million will be fully distributed.

15. The Administration notes the suggestion but considers the method of apportioning the $8 million on the basis of the total amount of allowed claims fair and that it has worked well in the past. The Administration holds the view that although the $8 million may not be fully distributed under the proposed apportionment method, smaller claims, which constitute the majority of claims received in respect of the C.A. Pacific Securities default, will receive significantly more than what they could be paid under the current compensation arrangement.

16. Hon Jasper TSANG Yok-sing has reservations over the Administration's proposed method of apportionment. The Bills Committee takes note that the ultimate responsibility for apportionment rests with the SEHK and the existing provisions of Cap. 333 do not provide for the power of the SFC to intervene in this aspect.

Subrogation right of the SEHK

17. Section 118 of Cap. 333 enables the SFC to recover the payments made from the Fund through subrogation of the claimants' rights and remedies against the defaulting broker under for instance the liquidation process. Members of the Bills Committee note that clause 4 limits the amount of monies which the SFC will recycle (i.e. pay to claimants) in such a process up to $8 million. All other recoveries will be returned to the Fund. Members of the Bills Committee consider the arrangement acceptable on ground of resources. Members however have different views on the existing section 118 which provides that the subrogation rights of the SFC precede the rights of the claimants in insolvency distribution. Some members consider the existing provision reasonable as it ensures that the claimants will not receive from both the Fund and the liquidation process more than what they are entitled to; and it at the same time preserves the prerogative of the Fund over its resources. Other members however hold the view that on the ground of equity, the subrogation right of the SFC and the right of the claimants in insolvency distribution should be accorded equal priority. They are of the view that the assets of a defaulting stockbroker available for distribution in the liquidation process are always limited. After the subrogation right of the SFC has been exercised, there may be no more assets left for distribution to the claimants. Hon Albert HO proposes to amend section 118 of Cap. 333 to the effect that the SFC and claimants be accorded equal priority in insolvency distribution and that the SFC's subrogation right is limited to the statutory compensation of $8 million and does not apply to discretionary compensation payment made under clause 5. The Bills Committee notes the Administration's objection to Mr HO's proposed amendment.

Compensation mechanism

18. In the course of deliberation, the Bills Committee has examined whether it is appropriate to revamp the present compensation mechanism in the context of the Bill. Some members are concerned about a possible conflict of interest on the part of the SEHK in exercising its power in relation to the claims as the SEHK is required to contribute to the Fund and to replenish the Fund for the compensation made under the existing provisions. In their view an independent compensation committee should be set up to handle compensation matters and the composition of which shall not include members of the SEHK.

19. The Administration has clarified that the major part of the Fund comes from the surplus from the transaction levy income of the SEHK between 1991 and 1994. As at July 1998, the Fund had a reserve of about $490 million and the total contributions from members of the SEHK as required by the law made up only $46 million. The percentage of contributions from members of the SEHK to the Fund is relatively small. The Compensation Committee of the SEHK includes lay Council Members who are independent third parties and all along it has processed and determined claims fairly. Moreover, any claimant whose claim has been disallowed or only partially allowed may resort to the Court.

20. Members note the issue of "A Consultation Paper on New Investor Compensation Arrangements for Hong Kong" at the end of September 1998. As the subject of the overhaul of the compensation mechanism including the introduction of a per claimant compensation limit is addressed therein and having considered the Administration's advice that the whole consultation process, together with any ensuing proposed legislative changes, would take about two years to complete, the Bills Committee agrees not to tackle the matter in the context of the Bill in order that compensation could be made to the C.A. Pacific Securities clients as early as possible.

Retrospectivity of the Bill

21. Members take note that the Bill will take retrospective effect from 27 January 1998. This is the date on which the SEHK published a notice under section 112 of Cap. 333 calling for claims for compensation from the Fund in connection with the default of the C.A. Pacific Group.

**Recommendation**

22. Subject to the amendment to section 121A and a technical amendment to be moved by the Administration, the Bills Committee recommends the resumption of the Second Reading debate on the Bill at the Council Meeting on 18 November 1998.

**Committee Stage amendment**

23. The Committee Stage amendments to be moved by the Administration is at **Appendix II**.

**Advice sought**

24. Members are requested to support the recommendation of the Bills Committee in paragraph 22 above.

Legislative Council Secretariat
5 November 1998

**Appendix I**

**Bills Committee on**
**Securities (Amendment) Bill 1998**

**Membership list**

Hon Ronald ARCULLI, JP (Chairman)

Hon Cyd HO Sau-lan

Hon Albert HO Chun-yan

Dr Hon Raymond HO Chung-tai, JP

Hon Margaret NG

Hon Bernard CHAN

Hon CHAN Kam-lam

Hon LEUNG Yiu-chung

Hon SIN Chung-kai

Dr Hon Philip WONG Yu-hong

Hon Jasper TSANG Yok-sing, JP

Hon Ambrose LAU Hon-chuen, JP

Hon TAM Yiu-chung, JP

Total : 13 members

**Appendix II**

Securities (Amendment) Bill 1998

**COMMITTEE STAGE**

Amendments to be moved by Secretary for Financial Services

| Clause | Amendment Proposed |
|---|---|
| 5 | In the proposed section 113(5A), by adding "committee of the" after "allowed by the". |
| New | By adding - |

**"6A. Commission may act where committee fails to do so**

Section 121A is amended -

(a) in paragraph (a), by repealing "or" at the end;

(b) in paragraph (b), by repealing the comma and substituting "; or";

(c) by adding -

"(c) unreasonably exercised its power under section 113(5A),"."