立法會
Legislative Council

LC Paper No. CB(1) 2052/99-00
(These minutes have been seen by the Administration and cleared by the Chairman)

Ref: CB1/BC/2/99/2

Bills Committee on
Exchanges and Clearing Houses (Merger) Bill

Minutes of meeting
held on Wednesday, 8 December 1999, at 8:30am
in Conference Room B of the Legislative Council Building

Members present	**:**	Hon Ronald ARCULLI, JP (Chairman) Hon LEE Kai-ming, SBS, JP Hon NG Leung-sing Hon SIN Chung-kai Dr Hon Philip WONG Yu-hong Hon Jasper TSANG Yok-sing, JP Hon FUNG Chi-kin
Member absent	**:**	Hon CHAN Kam-lam
Public officers attending	**:**	Financial Services Bureau Mr Bryan CHAN Principal Assistant Secretary for Financial Services Ms Gloria LO Assistant Secretary for Financial Services Department of Justice Mr G A FOX Senior Assistant Law Draftsman

Ms Mabel CHEUNG
Government Counsel

Attendance by invitation : Securities and Futures Commission

Mr David STANNARD
Executive Director, Corporate Finance

Mr Gerald D GREINER
Senior Director of Supervision of Markets

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

Clause-by-clause examinations on the Bill
(LC Paper No. CB(1) 549/99-00(01))

Clause 11

Appointment of chairman

Regarding the appointment of the chairman of a recognized exchange controller (the chairman) under clause 11(1), the Principal Assistant Secretary for Financial Services (PAS/FS) advised that the chairman would be elected by the board of directors according to the Articles of Association of the Hong Kong Exchanges and Clearing Limited (HKEC) and be approved by the Chief Executive. Under clause 11(2), CE could remove the chairman from his office. The Chairman suggested that in respect of the removal of the chairman, the terms of removal should be clearly provided in the clause, such as whether compensation would be offered to the chairman upon the removal.

2. Upon the Chairman's enquiry on the duration of the term of service of the chairman, PAS/FS advised that according to the Articles of Association of HKEC, the chairman would be elected once every three years and the service could be extended for one further term of three years.

Consistency in the terms of service

3. The Assistant Legal Adviser 6 (ALA6) pointed out that the terms of service for the directors should tie in with that of the chairman. It would be a problem if a chairman, after being appointed on a three-year term, was not elected as a director or had to retire at the following Annual General Meeting (AGM) during his period of appointment.

4. In response, PAS/FS advised that directors appointed by the Financial Secretary were usually on three-year terms and directors appointed by shareholders could retire at the coming AGM after serving a specified term according to the Articles of Association. The relevant clause was drafted with the intention that the directors appointed by shareholders would be in office for a three-year period instead of one year. Hence, the term of service of a director should tie in with the one of the chairman. The Senior Assistant Law Draftsman (SALD) also drew members' attention to clause 20(1) and clarified that once a person was appointed to be a director by FS, he would continue his term of service notwithstanding any enactment or rule of law until FS revoked the appointment. He said that the obligation of the chairman and his term of service should better be specified in the Articles of Association rather than in the Bill.

5. Some members including Mr SIN Chung-kai, Mr NG Leung-sing and Mr LEE Kai-ming shared the concern of ALA6 that the terms of service of the chairman and the directors elected by shareholders should be clear and should tie in with one another. The Chairman considered this a technical problem and requested the Administration to seek further legal advice for clarification. He reminded the Administration to ensure that the provisions in the Articles of Association and the Bill would be consistent.

Clause 12

Conditions of removal for Chief Executive Officer or Chief Operating Officer

6. Referring to clause 12(2)(b), Mr SIN Chung-kai was concerned whether a Chief Executive Officer (CEO) or Chief Operating Officer (COO) who had performed to the satisfaction of the shareholders could be removed without the proof of faults. Although the Securities and Futures Commission (SFC), with the consent of the chairman, could remove the CEO or COO, Mr SIN took the view that the performance of the CEO and COO should be

best known to the board of directors. It would not be acceptable if the removal had to take place without the support of the board of directors. He therefore queried whether the provision of clause 12(2)(b) was appropriate and justifiable.

7. PAS/FS explained that since clause 12(2)(b) aimed at maintaining stable and proper market regulations, it would be reasonable to remove the CEO or COO if his continuous service would adversely affect regulating the market. While the board of directors might be more concerned with the administrative performance of the CEO or COO, SFC's major concern would be whether his performance would adversely affect public interest, the interest of investors and the market regulation. The Chairman agreed with the Administration that it was reasonable for SFC to have the ultimate power to remove the CEO should there be unsettled differences between SFC and the CEO in the perspectives of market regulations, especially when the CEO rejected SFC's advice which the latter considered would be beneficial to the public and market interest.

8. Upon Mr SIN Chung-kai's enquiry on power of removal in overseas exchanges such as the Stock Exchange in New York, Mr GREINER said that he had yet to research into the relevant information. Mr FUNG Chi-kin pointed out that a good and close relationship between SFC and the CEO or COO could be expected since the appointment of the latter was subject to SFC's approval. Mr SIN expressed worries that the CEO or COO could ignore the directors altogether and merely act upon the instruction of the chairman and SFC. Given that SFC could still have the power to remove a CEO or COO despite majority support for him from the board of directors, Mr SIN queried the role of the board of directors. PAS/FS showed understanding towards the member's concern. He advised that in accordance with the Articles of Association, the board of directors could remove the CEO or COO by passing a resolution supported by a simple majority of directors. In other words, the CEO or COO had to satisfy the SFC in respect of public interest and market regulation as well as at least half of the directors in board. In this regard, the Chairman noted that the CEO or COO could appeal to the Chief Executive in Council against SFC's removal decision according to clause 12(3) whilst there was no channel of appeal for the chairman. Nevertheless, Mr SIN remained unconvinced of the arrangement.

9. In response to Mr SIN Chung-kai's enquiry about the practice in the existing exchanges, Mr GREINER pointed out that according to SFC's legal advice, there was relevant provision in Cap. 1 implying SFC's power of approval for the appointment of CEO of SEHK under certain conditions.

10. Given that currently SFC could exercise its removal power without having to give reasons whereas the new provision had introduced certain conditions such as in the interest of the public interest, investors' interest or for

the stability of market regulation under which SFC could exercise its removal power, the Chairman considered that SFC's scope of power had been narrowed instead of being expanded under the proposed provision.

Clauses 13 and 14

11. PAS/FS advised that clauses 13 and 14 aimed at resolving the conflict of interest that might arise between a recognized exchange controller or its subsidiaries and other listed companies when the former, the market regulator, sought to be a listed company. The clauses also aimed at preventing the listed recognized exchange controller from abusing its power in the capital market when conflict arose with other listed companies of similar business nature.

12. Mr GREINER explained that the arrangement under clause 13 was based on the Australian model. SFC would, on the one hand, make decisions in relation to HKEC as a listed company to ensure its compliance with the listing rules; on the other hand, SFC would give directions in relation to the general conflicts encountered by the recognized exchange controller, such as conflicts with other listed companies. In other words, SFC would monitor the conflicts which might appear at two different levels.

13. The Chairman enquired whether the listing of HKEC would also create conflicts of interest regarding the governance of HKFE, and whether there was a similar provision for the futures exchange. In response, Mr GREINER said that the focus of clause 13 was on listing whereas the mechanism as provided in clause 14 was to enable SFC to give direction to the relevant exchange company such as HKFE, in case of conflict of interests.

14. The Chairman enquired about the need to provide a definition for "Stock Exchange Company" in clause 13. SALD explained that the "Exchange Company" in clause 2(1) referred to the Stock Exchange Company or the Futures Exchange Company throughout the Bill except in clause 13. According to clause 13, the rules made under section 34 of the Stock Exchanges Unification Ordinance (Cap. 361) were rules made by the Stock Exchange Company. A definition for the Stock Exchange Company was thus required in clause 13.

Conflict of roles

15. As HKEC was expected to be listed before mid 2000, the Chairman enquired whether the listing rules for the compliance of HKEC would be subject to the scrutiny of an independent body such as the Legislative Council. In response, SALD pointed out that rules made under section 34 of the Stock Exchanges Unification Ordinance (Cap. 361) including listing rules, were not subsidiary legislation and Mr GREINER also advised that the listing rules for HKEC were primarily the same as those of the SEHK for other listed

companies. SFC would ensure market integrity when making decision on the listing rules.

16. The Chairman enquired whether the governance of other listed companies would still remain under HKEC after it became listed. Mr GREINER advised that the governance of the listed companies would continue to be with HKEC after it had been listed. Clause 14 was designed to resolve the possible conflicts of interest among the listed companies after the listing of HKEC. PAS/FS added that if the listed companies considered themselves being disadvantaged, they could report to SFC direct. HKEC would continue to run the capital raising market as before and the SFC would establish a special team to monitor the listing rules, and to handle cases of conflicts brought up from listed companies. Mr GREINER supplemented information on the Australian Stock Exchange that the regulator in Australia performed all the listing-related functions in relation to the listing of securities on the Australian Stock Exchange. SFC noted that the trend of shifting the listing functions to the regulatory authority had already been taking place in a number of markets such as Australia and UK.

17. The Chairman expressed reservation on the fairness of the two-pronged governance structure with SFC governing HKEC while HKEC and its subsidiaries governing the rest of the listed companies. Mr FUNG Chi-kin shared the view that the two-pronged system was rather confusing. He pointed out that currently listed companies perceived themselves to be regulated both by SEHK and SFC at the same time and usually approached both parties when they encountered problems. A clearer distinction between the two was expected from the trade such as having SFC regulate the listed companies as a whole while SEHK only take care of daily exchange activities. As such, the Chairman enquired about the rationale of not having transferred the whole lot of regulatory duties to SFC.

18. Mr GREINER explained that a regulatory rationalization had been considered. Once the merger became effective, all the regulatory aspects of the brokers would be transferred to SFC. Circumstances such as double regulations and conflicts between SFC and the exchanges would also be sorted out in the course of the transfer. As regards the listed companies, the status quo should be maintained and one set of listing rules would cover all listed companies. In respect of the listing-related matters, SFC was monitoring closely the international trend of moving the listing function to a statutory regulator away from exchanges, just like in Australia and UK.

19. Dr Philip WONG enquired the reason for not having SFC enforce the trading rules for the market participants. Mr GREINER explained that while there were experienced personnel in the exchanges overseeing the trading system, many trading rules and violations were too minor to be taken over by SFC.

20. The Chairman expressed concern whether it was sufficient for clauses 13 and 14 to address solely to the situations of conflict of interest without giving regard to the relationship among HKEC, SFC and other listed companies. He requested the Administration to provide an information paper to enhance members' understanding on both the current and the proposed governance structures and explain the rationale behind clauses 13 and 14 fully. Mr FUNG CHI-kin also took the view that SFC should explain clearly the extent of its monitoring role of the existing listed companies and whether there was any duplication in the regulatory functions of HKEC and SFC. Members also requested the Administration to provide relevant legislation of other countries, such as those of Australia, the Netherlands and Sweden for comparison purpose. Mr GREINER undertook to gather relevant information from the parties concerned for members' reference. The Chairman suggested the Bills Committee come back to clauses 13 and 14 for further examinations at a later stage pending the Administration's information.

Admin

21. As regards the initial listing of HKEC, Dr Philip WONG sought clarification on whether there would be an underwriter upon listing of HKEC. PAS/FS advised that the HKEC would seek to become a listed company by way of introduction and no capital raising would be involved at this stage. Thus, there would not be an offer for sale and there would be no underwriter. Dr Philip WONG was doubtful whether there would be market demand for shares of HKEC. In response, Mr GREINER said that the introduction listing on shares trading was, however, quite successful in Australia.

22. Members noted that the Administration had addressed the comments of the Law Society of Hong Kong (LSHK) on certain clauses of the Bill and no further response had been received from LSHK.

Clause 15

23. PAS/FS advised that the existing fee level would be maintained after the merger. However, HKEC might conduct an overall review on their financial status and examine the fee levels. Noting that HKEC would be operating almost in the absence of competition, Mr FUNG Chi-kin enquired about the purpose of clause 15(2)(a) regarding the level of competition in Hong Kong. As for clause 15(2)(b) concerning the fees imposed on similar products available in other exchanges, he believed the level of fees would already be regulated by the market force. As shareholders and members of HKEC would be very concerned about its operational autonomy, Mr FUNG enquired the reason for seeking SFC's approval for all fee levels and whether the Administration intended to regulate HKEC's profitability.

24. PAS/FS clarified that the Administration did not intend to set any profit goal for HKEC. However, it had to ensure that HKEC would not abuse

its monopolistic position in the market. Although there would not be a competitive exchange company offering listing service in the foreseeable future, the Administration had to set up a mechanism to ensure the fees so charged would be within reasonable range. SFC could relax its monitoring on the fee levels of HKEC when there was sufficient competition in the market. Regarding the fee levels compared with overseas exchanges, although there would be difference in cost and operational environment in different markets, a big discrepancy in fee levels would certainly affect the competitiveness of the local market.

25. Mr FUNG Chi-kin took the view that the cost incurred in different markets was not comparable. The levels of fee should be market-driven rather than under the intervention of the Government. In response, PAS/FS stressed that as the Administration had found that there was still insufficient competition in the market at present to ensure reasonable charge by HKEC, the introduction of a monitoring mechanism for HKEC's fee levels was a responsible act for public investors.

26. Mr FUNG Chi-kin expressed understanding on the Administration's consideration for the interest of the public concerning HKEC's fee levels. However, members of the exchanges supported the merger mainly because of the maintenance of HKEC's monopoly status. He was worried that the Administration would introduce many competitors or new exchanges in future to affect the monopoly status of HKEC. PAS/FS showed understanding towards Mr FUNG's concerns. He clarified that at present SFC was also empowered to approve the fee levels. He stressed that the Administration did not intend to weaken HKEC's profitability. It only aimed at ensuring that the fee levels set by HKEC was reasonable given its monopolistic position in the market.

27. The Chairman noted that at present SFC had been given the power to approve fees in the absence of any guideline. However, in future, SFC had to observe the conditions set under clause 15(2)(a) and (b) when considering approval for fee levels.

Clause 16

28. PAS/FS advised that clause 16 was about the amendment to Schedule 1 to the Bill. SALD explained that the provisions of Schedule I were similar to those of the Banking Ordinance (Cap. 155) and the Insurance Companies Ordinance (Cap. 41). He undertook to provide copies of the relevant ordinances for members' reference.

(*Post-meeting note*: Copies of the relevant provisions were provided by the Administration and circulated to members vide LC Paper No. CB(1)615/99-00(01).)

29. SALD further explained that when someone was found to be an unrecognized exchange controller, SFC would give directions and steps by which he could cease to be a controller. If he resisted or failed to comply with these directions, the provisions in Schedule 1 then applied. Upon the Chairman's enquiry on how Schedule 1 would apply when companies were to issue bonus shares or warrants to shareholders, SALD advised that this issue was not covered in the existing legislation.

30. ALA6 considered that clause 1(2)(a) in Schedule 1 would affect the issuance of shares by a company to individual shareholders as it might have to check on a considerable number of shareholders to ensure that they were not subject to any notices. SALD advised that similar provisions had been given in the Banking Ordinance (Cap.155) for 10 years, and also in the Insurance Companies Ordinance (Cap.41) for a shorter period and no complaints had been received so far. Nevertheless, he undertook to write to the Insurance Authority and the Hong Kong Monetary Authority regarding the implementation of the provisions concerned.

(*Post-meeting note:* The Administration confirmed in writing on 14 December 1999 that they had written to the Insurance Authority and the Hong Kong Monetary Authority regarding the implementation of the relevant provisions.)

31. ALA6 elaborated that when a company issued shares, it might not have known the notice of restriction. Problems would occur upon issuance of the restricted shares by a company for they would, by virtue of clause 1(2)(a) to Schedule 1, be void. The Chairman shared the view of ALA6 and was concerned how a third party dealing with a shareholder could find out whether the shares concerned were subject to restrictions. SALD responded that the holder of any such shares was required to notify the third party of their being subject to these restrictions under clause 2(1)(c) in Schedule 1.

32. The Chairman sought clarification on whether SFC would serve the notice not only on the person concerned but also on the company concerned regarding the restricted shares. Mr GREINER remarked that it would be reasonable to always notify the company on this issue. SALD undertook to discuss with SFC and the policy bureau concerned regarding the issue of alerting all parties concerned including the public about the shares subject to restrictions.

Admin

II Any other business

33. PAS/FS said that the Committee Stage amendments were expected to be finalized before early February 2000 for the Committee's consideration.

The Chairman advised that one more meeting would be held in December 1999 pending further confirmation. The tentative schedule for meetings in January 2000 would be 7, 10, 11 and 12 January 2000.

34. There being no other business, the meeting ended at 10:30 a.m.

Legislative Council Secretariat
18 September 2000