

## Strengthening regulation of intermediaries

### Joint consultation on regulation of sponsors and IFAs

Companies seeking listing and listed issuers should make full, accurate and timely disclosure of information. This is a fundamental premise of the disclosure-based regime.

In the process, the SFC and Hong Kong Exchanges and Clearing Limited (HKEx) both hold high expectation that sponsors would do their utmost to make sure that happens. They must exercise due diligence in ensuring a high standard of disclosure is met, and they should be held responsible for failing to do so.

See also "Dual filing runs smoothly" on page 3.

Similarly, much reliance is placed on independent financial advisers (IFAs) and they should also be held accountable for their work.

To strengthen regulation of sponsors and IFAs of listing applicants or listed issuers on the Main Board or Growth Enterprise Market (GEM), the SFC and HKEx have published proposals for consultation.

The consultation paper, released on 30 May, sets out the following proposals:

- a common regime, administered by HKEx, to establish the acceptability of corporate finance advisers who wish to act as sponsors or IFAs;
- enhancements and further guidance to clarify the responsibilities of sponsors and IFAs;

- a declaration in a prospectus by the sponsor and lead underwriter about the due diligence work they have performed in providing HKEx with assurances on the completeness and accuracy of the prospectus;
- a declaration in a report by the IFA on the due diligence work it has performed in reaching its recommendations;
- a personal undertaking given by key individuals (called eligible supervisors) of sponsor firms and IFA firms, in addition to that made by the firms, to HKEx to comply with the Listing Rules;
- further guidance to clarify when a proposed sponsor or an IFA may not be regarded as independent of a new applicant or listed issuer and therefore be unable to act in such capacity; and
- a requirement for a sponsor to be appointed with responsibilities equivalent to those applicable at IPO where a listed issuer is otherwise producing a listing document.

*The consultation paper may be downloaded from the SFC website or HKEx website (www.hkex.com.hk). Copies are also available at the offices of the SFC and HKEx free of charge.*

*The SFC and HKEx provide a hotline enquiry service during the consultation period (at 2283 6815 for the SFC, and 2840 3800 and 2840 3400 for HKEx).*

## Annual Report published

### New regulatory framework, better quality of market

The SFC published its latest Annual Report in May to give an up-to-date account of its operations and financial results.

The Report was laid before the Legislative Council on 14 May after it was submitted to the Financial Secretary.



On the cover of the Annual Report for the year ended 31 March 2003 is an "equal" symbol which represents fairness, openness and transparency. The SFC follows these principles when it is carrying out its regulatory functions.

The theme of this year's Annual Report is "New Regulatory Framework - Better Quality of Market". The SFC believes that with the Securities and Futures Ordinance (SFO) having come into force in April, market quality will improve.

### More disclosure

To further improve accountability and transparency, the Annual Report, for the first time, has published the individual attendance rates of members of the Commission and of other internal committees.

The pay package of the top three tiers of senior executives is also disclosed in line with the recommendations of the Government-commissioned Hay Report published in mid-2002.

A chapter on the SFO highlights all the positive changes the new law brings to the market. Extensive discussions of the SFO also appear in various chapters.

### Expenditures cut by 5%

The Report also gave audited figures on the financial results. Total revenue dropped by 7% to \$337.2 million last year owing to market conditions. As a result of the tight cost controls which have been introduced since the second half of 2001, the SFC was able to cut its total operating expenditure after depreciation by 5% to \$395.6 million.

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**CHANGE OF ADDRESS**  
遷址通知

Please be advised that as of 30 June 2003, our new office will be at:

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Website: <a href="http://www.hkex.org.hk">http://www.hkex.org.hk</a>	網址 : <a href="http://www.hkex.org.hk">http://www.hkex.org.hk</a>

# Creating a better business environment for brokers

Wide-ranging measures include enhancing transparency of fees and charges by banks and brokers

Wide-ranging measures are being implemented to improve the business environment of the stockbroking industry and enhance the industry's services to investors.

The measures were recommended by the Working Group on the Business Environment of the Stockbroking Industry in a report released in April. It was led by the Government and included representatives from the SFC and HKEx. The group examined with the stockbroking industry ways to enhance the competitiveness of the small and medium sized brokerage firms which are hard hit in the present business environment. The SFC has actively taken forward the recommendations in which the SFC has a principal or significant role. The following is a summary of some of the Working Group's important recommendations and actions taken by the SFC:

- **Enhancing the transparency of brokerage commission and other service fees by brokers and banks:** the SFC has formed a working group with industry representatives. After two meetings in May, the group has agreed that brokerage fees and charges would be grouped under six broad categories: trade-related; e-transaction-related; settlement-related; account maintenance; nominee services/corporate actions; and other fees such as banking service charges. The SFC will work with the Hong Kong Monetary Authority (HKMA) and, through HKMA, consult the banking sector. A market-wide consultation is hoped to be conducted in the third quarter of 2003. The categorisation is expected to be implemented before the end of the year.
- **Levelling the playing field between brokers and banks:** the SFC has been working closely

with the HKMA to ensure effective enforcement of cold calling restrictions and consistency in regulation. It will explore with the HKMA the possibility of rationalising the regulatory fees on banks according to the size of their securities business.

- **Reviewing of HKEx fees:** the SFC and HKEx will as a priority rationalise and simplify the fees for exchange participants.
- **Minimising the compliance burden on small and medium-sized brokers:** the SFC is prepared to be flexible in processing applications to modify or waive any requirements where an intermediary has genuine compliance difficulty, provided investor protection is not compromised.

The Working Group report is available on the website of the Government at [www.info.gov.hk/fstb/fsb/info/stockbroking2.htm](http://www.info.gov.hk/fstb/fsb/info/stockbroking2.htm).

## Brokerages' business improves amid SARS

The transaction volume of brokers has increased despite the outbreak of the severe acute respiratory syndrome (SARS).

The SFC analysed the Stock Exchange transaction volume and found that the daily averages for the three Exchange Participant categories had risen both in April and May. The increases of the three categories in the two months were 16.5% to 41.8%.

After the outbreak of SARS, there had been concerns that the Category C participants might be badly affected because their clients were accustomed to visit their offices in person to place orders, and they were likely to have stopped this because of SARS.

However, the survey found that Category C transactions also increased in volume.

The outbreak of SARS was reported in late March. The World Health Organisation issued advice against travel to Hong Kong in early April and lifted it in late May.

	Category A	Category B	Category C	Total
Daily Average in March	\$6.89 billion	\$4.11 billion	\$1.98 billion	\$12.99 billion
Daily Average in May (Increase over March)	\$8.03 billion (+16.5%)	\$5.47 billion (+33.1%)	\$2.81 billion (+41.8%)	\$16.31 billion (+25.6%)
Daily Average in June until 9 June (Increase over May)	\$9.19 billion (+14.4%)	\$5.54 billion (+1.3%)	\$2.93 billion (+4.3%)	\$17.66 billion (+8.3%)

The figures here count the buy and the sell of the same transaction compared to the turnover figures reported by the Stock Exchange which only count one side of a transaction.

## New appointments

### Directors of the SFC

For two years until 25 May 2005: Executive Director and Chief Operating Officer: Peter Au-Yang  
Non-Executive Director: Dr York Liao

### Takeovers and Mergers Panel

For one year until 31 March 2004: John Maguire.

### Takeovers Appeal Committee

For one year until 31 March 2004: (chairman) Timothy Freshwater, (deputy chairman) Rajat Jindal.

### Dual Filing Advisory Group (newly established under the SFO)

For one year until 31 March 2004: Dennis Cassidy, Teresa Ko, W Gage McAfee, Mike Scales, Frank J Slevin, Carlson Tong, Peter P W Tse, Tony Tsoi and V-Nee Yeh.

### SFC Advisory Committee

For two years until 31 May 2005: Roger Luk and Eddy Fong.

### Shareholders Group

For one year until 16 June 2004: Albert Cheng, David Cheung and Richard Mak.

Apart from these new members, some other members have been reappointed. Full lists of membership can be found on the SFC website.

## Proper procedures confirmed

In its second annual report released in May, the Process Review Panel, an independent panel appointed by the Chief Executive of the HKSAR to review the SFC's internal procedures, found that in this regard appropriate checks and balances were in place.

The Panel reviewed 48 completed cases covering the inspection and registration of intermediaries, authorisation of collective investment schemes, approval of prospectuses, granting of exemptions under the Companies Ordinance and the Securities (Disclosure of Interests) Ordinance, the handling of takeover and merger transactions and complaints.

The Panel also examined the SFC's existing procedures for handling complaints from the public about the conduct of SFC registrants, public consultations, appointment of auditors under the SFO and communications with the industry.

The Panel concluded that there were no serious deficiencies in the SFC's internal procedures. However, acknowledging that there was room for improvement the Panel made recommendations on 34 items and almost all of them were accepted by the SFC. Where the SFC could not accept a recommendation, detailed explanations were given to the Panel.

The report is available from the Government Publications Centre at G/F Queensway Government Office (Low Block). It can also be downloaded from the Government website ([www.info.gov.hk/fstb/fsb/topical/prep02.htm](http://www.info.gov.hk/fstb/fsb/topical/prep02.htm)).

# Proposal to empower SFC to bring derivative actions

A joint consultation paper seeking the views of the public on a proposal to empower the SFC to initiate derivative actions was jointly released by the Government and the SFC on 26 May.

A normal derivative action is a civil action brought by minority shareholders on behalf of the company. Any damages awarded by the Court go to the company, not the shareholders. The proposal suggests that the SFC be enabled to bring such an action instead of the minority shareholders on grounds including fraud, negligence, default in relation to any legislation or breach of any fiduciary or statutory duty. According to the proposal, the SFC would only be able to exercise such a statutory power where it was in the interest of the public and the company concerned.

The proposal is one of five recommendations made by the Standing Committee on Company Law Reform (SCCLR) in July 2001 as part of its ongoing review of corporate governance. The SCCLR also recommended that minority shareholders should have a similar statutory right to initiate derivative actions (they already have such a right under common law).

Also, the SCCLR proposed that there should be an enhancement of existing remedies for minority shareholders in the Companies Ordinance, by enabling them to seek damages for themselves e.g. in relation to unfair prejudice. The Government has accepted these recommendations and amendments to the Companies Ordinance are being introduced to the Legislative Council.

The joint consultation paper is in two parts. The first part discusses the principle of whether or not the SFC should have such a power and invites the views of the public on this question. The main factor cited in favour of the proposal is that there may be circumstances where minority shareholders are unable to pursue action on their own. The argument is that the SFC should step in as a last resort and so provide a deterrent to corporate misconduct.

Factors cited against pursuing the proposal include the following:

- the international norm is for self-help by shareholders and, generally, it is inappropriate for a regulator to expend public resources on private commercial disputes;

- the range of new powers both for minority shareholders in the Companies Ordinance and for the SFC in the SFO is extensive and untried and it might be prudent to see whether these new provisions work in practice before introducing further legislative change; and
- the judiciary is currently considering the viability of class actions and "no win no fee" arrangements for Hong Kong as part of the Civil Justice Reform process (damages would go to the minority shareholders in the class, not to the company) so it might be better to await their final report later this year before deciding on the next step forward.

The second part of the consultation paper invites the views of the public on several detailed aspects of how such a derivative action power might be exercised if it were decided to pursue the proposal.

*The consultation paper is available on the website of the SFC under the section of "press releases, publications and speeches". The consultation period will end on 26 July 2003.*

## Dual filing runs smoothly

### Listing process is not lengthened

Market participants need not worry that the dual filing regime will incur additional time in the listing application process because the SFC only stays in the background, giving comments on major issues only and doing it swiftly.

Under the SFO which came into force on 1 April 2003, listing applicants and listed companies are required to file their

listing application and disclosure materials with the SFC as well as HKEx.

The SFC has reviewed 27 new listing applications in March and April and commented on 10 of them. In four cases, there were fundamental problems giving rise to serious regulatory concerns. The average response time for the 10 cases was seven working days. The shortest time was one day.

*"Applications with good disclosure should encounter fewer hurdles than before."*

*--- SFC Executive Director Ashley Alder*

It is clear that the dual filing arrangement has not caused and will not cause any additional compliance burden or time to the overall

listing process on issuers who have prepared adequate draft prospectuses.

Under the regime, the SFC gives comments only on substantive issues. It seeks to ensure that the overall disclosure in a prospectus enables investors to understand the business of a company and to make informed investment decisions.

## Investor Compensation Company

An *Information Booklet* has been published by the Investor Compensation Company Limited (ICC) to inform investors about its role and functions. It lists out 15 frequently asked questions on the Investor Compensation Fund including how to file a claim.



The ICC, established by the SFC, administers and manages the Fund. The ICC is responsible for receipt, determination and payment of valid claims against the Fund in respect of defaults of covered intermediaries occurring on or after 1 April 2003.

*The ICC booklet is available free of charge at the SFC office and can be downloaded from the ICC website at <http://www.hkicc.org.hk>.*

## Updates on new licensing regime

### 346 have obtained new SFO licences

More than two months have passed since the implementation of the SFO on 1 April. More licensees have applied to convert their old licences to new ones under the new licensing regime.

In May, 583 licensees submitted their migration applications to the SFC, more than three times the previous month's total. This number included 26 corporations and 557 individuals. Four corporations and 166 individuals applied in April.

Up to the end of May, 346 licensees have successfully obtained their new SFC licences.

The SFC also received 267 new licence applications in May. Out of the 258 applications submitted by individuals, 26% also applied for provisional licences (which can be granted in about one week) so that they can conduct regulated activities before their normal representative licences are granted (which normally takes a few more weeks).

The public can get more specific information about their licensed brokers or other registered intermediaries on a public register of licensed persons and registered institutions on the SFC website.

INVESTOR FOCUS

# How dealings with intermediaries have changed?

## Find out changes brought by the SFO

A licensed or registered intermediary is subject to ongoing operational requirements, which may have a direct or indirect impact on you as a client. These requirements have been modernised under the new SFO and its subsidiary legislation to improve investor protection and to make compliance easier. Here, we explain some of the major changes which may affect your dealing with your intermediary.

**Contract notes:** Previously your intermediary had to issue you a contract note by the next trading day after execution of a transaction, i.e. T+1. The time limit is now changed to the second trading day, i.e. T+2.

**Daily statements:** In the past, only firms conducting share margin financing or leveraged foreign exchange business were required, upon certain specified events, to issue daily statements of account by T+1. Now there is a requirement to provide daily statements for any firm entering into margin transactions (e.g. futures and options) except in the course of conducting asset management. The time limit is extended to T+2.

**Monthly statements:** Previously, your intermediary had to issue you with a regular account statement at least once a month, unless there had been no transactions and there was no cash or stock in your account. The time allowed for issuing a monthly statement was seven days for firms conducting share margin financing or leveraged foreign exchange business; but not specified for other firms. Under the new law, the time allowed is 10 days for asset managers and seven days for other firms.

**Receipts:** Only securities dealers were required to provide receipts for stock certificates received for their clients. The time allowed for issuing a receipt was not specified. Now the requirement to provide receipts is applicable to any firm including any associated entities (e.g. nominee companies) receiving client assets. A receipt should be issued in two days.

**Segregation of client money:** Previously, your intermediary had to put your money into a segregated trust account within four days from the date of receipt. The time limit is now reduced to one day. Cheque payment is considered as received when the cheque has been cleared.

**Client standing authority:** An intermediary can get a written standing authority from its client to deal with client securities or securities collateral in one or more specified ways (e.g. to re-pledge a margin client's securities to borrow money from a bank, or to apply a client's securities following a securities borrowing and lending agreement). In the past, the authority had to be renewed in writing every year.

Under the new law, unless an investor qualifies as a professional investor, a standing authority still has to be renewed every year. A firm can be deemed to have renewed a standing authority provided:

- it reminds the client in writing that the standing authority is due to expire at least 14 days in advance,
- the client does not object, and
- the firm issues a written confirmation within one week after the date of expiry.

The requirements for renewal of standing authority in relation to client money, not specified previously, are similar to those for client securities.

For more details, please visit the SFC-operated Electronic Investor Resources Centre (eIRC) at [www.hkeirc.org](http://www.hkeirc.org).

## INVESTOR TIPS

We have published more education materials to enhance investors' skills and knowledge about their rights.

### Portfolio planning

You would have already seen our literature on the fundamentals of investment and various products such as stocks, bonds, futures and equity-linked instruments. Now, you may wish to increase your knowledge of the investment world so that you can effectively plan your own portfolio to suit your unique requirements.

We have published an investor leaflet, *Portfolio Planning - Managing Your Investments to Suit You*, and four feature articles: *Fundamental*



*Analysis, Technical Analysis, Risk Management and Investing in Emerging Industries.*

### Hedge funds

*Dealing in Hedge Funds* talks about the minimum subscription thresholds for different types of hedge funds, common fees and charges involved, fund valuation requirements, and possible liquidity constraints on redemption etc.

*Monitoring Your Hedge Funds* explains the importance for investors of monitoring their investments in hedge funds, how to interpret the information disclosed in hedge fund reports etc.

The investor publications are available at the SFC office. The e-versions are available on the "Features" section of the Electronic Investor Resources Centre at [www.hkeirc.org](http://www.hkeirc.org).

## Shareholders Group

The SFC Shareholders Group held two meetings in the last two months. In April, members were consulted on the consultation paper regarding the regulation of sponsors conducted jointly by the SFC and HKEx. Members generally agreed that tightening the regulation of sponsors would help improve the quality of the market. They also emphasised the need for a transparent process for better compliance. The consultation paper was subsequently published on 30 May.

During the 13th meeting in May, the Group discussed straight-through processing for investor participant account (STPIP). The SFC formed a task force comprising industry participants and HKEx to consider the enhancement of the IP accounts system towards the end of 2002.

The task force aims to design a new STPIP model to perform full clearing and settlement functions in order to better safeguard investors' securities and money, and improve trade settlement efficiency. Brokers would be able to have their risks minimised and compete with banks on the basis of quality of service. Members were generally supportive of the initiative and also suggested some modifications.

## Annual Report published (continued from page 1)

Staff costs dropped by 4% to \$302.4 million as the SFC froze staff pay. Variable pay was not awarded for a second year. Vacancies were not filled except for urgent operational needs and for dual filing functions.

Owing to these measures, the deficit for 2002-03 was \$58.4 million, which was only about half of the original budgeted deficit. By

the end of March this year, the reserves level stood at \$565.6 million, equivalent to 16 months of estimated expenditure (including depreciation) of \$433.3 million for 2003-04.

The Annual Report can be downloaded from the SFC website. Printed copies are available at the SFC office for \$100 each.