



SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

Consultation on Proposed Enhancements to the Investor Compensation Regime and Related Legislative Amendments

April 2018



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Foreword

The Securities and Futures Commission (**SFC**) invites market participants and interested parties to comment on the proposals discussed in this consultation paper and any related matters that might have a significant impact on the proposals.

Comments should be submitted in writing by 27 June 2018, and by any one of the following means:

On-line submission: <http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/>

Email: icfconsult@sfc.hk

Post : Supervision of Markets Division
Securities and Futures Commission
35/F, Cheung Kong Center
2 Queen's Road Central
Hong Kong

Fax: (852) 2521 7917

Any person who wishes to submit comments on behalf of an organisation should provide details of the organisation whose views are represented.

Please note that the names of commentators and the content of their submissions may be published on the SFC's website and in other documents to be published by the SFC. In this regard, please read the Personal Information Collection Statement attached to this consultation paper.

If you do not wish your name or submission to be published, please state this clearly when making your submission. In this connection, the SFC will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

All submissions received before the expiry of the consultation period will be taken into account before the proposals are finalised, and a consultation conclusions paper will be published in due course.

**Securities and Futures Commission
Hong Kong**

April 2018



Personal Information Collection Statement

This Personal Information Collection Statement (**PICS**) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data¹ will be used following collection, what you are agreeing to with respect to the SFC's use of your Personal Data and your rights under the Personal Data (Privacy) Ordinance, Cap. 486 (**PDPO**).

Purpose of collection

2. The Personal Data provided in your submission to the SFC in response to this consultation paper may be used by the SFC for one or more of the following purposes:
 - (a) to administer the relevant provisions² and codes and guidelines published pursuant to the powers vested in the SFC;
 - (b) in performing the SFC's statutory functions under the relevant provisions;
 - (c) for research and statistical purposes;
 - (d) for other purposes permitted by law.

Transfer of personal data

3. Personal Data may be disclosed by the SFC to members of the public in Hong Kong and elsewhere, as part of the public consultation on this consultation paper. The names of persons who submit comments on this consultation paper together with the whole or part of their submission may be disclosed to members of the public. This will be done by publishing this information on the SFC website and in documents to be published by the SFC during the consultation period or at its conclusion.

Access to data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on this consultation paper. The SFC has the right to charge a reasonable fee for processing any data access request.

Retention

5. Personal Data provided to the SFC in response to this consultation paper will be retained for such period as may be necessary for the proper discharge of the SFC's functions.

¹ Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance (Cap. 486).

² The term "relevant provisions" is defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) and refers to the provisions of that Ordinance together with certain provisions in the Companies (Winding up and Miscellaneous Provisions) Ordinance (Cap. 32), the Companies Ordinance (Cap. 622) and the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615).



Enquiries

6. Any inquiries regarding the Personal Data provided in your submission on this consultation paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

The Data Privacy Officer
Securities and Futures Commission
35/F Cheung Kong Center
2 Queen's Road Central
Hong Kong

A copy of the Privacy Policy Statement adopted by the SFC is available upon request.



Introduction and executive summary

1. The current investor compensation regime (**ICF regime**) in Hong Kong was established in April 2003 when the Securities and Futures Ordinance (**SFO**) came into effect. Its key features include:
 - (a) Compensation Fund: An investor compensation fund (**ICF**) has been established under the regime from which compensation payments are made. It is funded by: (i) monies from the pre-SFO compensation funds; (ii) investment income; and (iii) transaction levies (**ICF levies**) charged to investors when purchasing or selling securities or futures on the Stock Exchange of Hong Kong (**SEHK**) or on the Hong Kong Futures Exchange (**HKFE**).
 - (b) Compensation coverage: The regime only covers losses in respect of securities or futures contracts that are listed or traded on the SEHK or the HKFE, as well as any related assets (eg, related purchase monies or sale proceeds). Moreover, only losses attributable to the default of a dealing or financing intermediary³, or a person related to such an intermediary (eg, its employee), are covered under the regime.
 - (c) Compensation limit: The regime sets a limit on the amount of compensation that can be paid to an investor in the event of a default. The current limit is \$150,000⁴ per investor per default. Separate limits apply for securities-related losses and for futures-related losses, and these operate independently⁵.
 - (d) Levy suspension and reinstatement mechanism: The regime provides a mechanism for suspending and reinstating the ICF levies when the net asset value of the ICF reaches certain trigger levels. The mechanism was introduced in 2005, and aims to ensure that the ICF is maintained at a sufficiently prudent level to cover potential obligations, but without resulting in investors having to contribute beyond what is necessary. The current levy suspension and levy reinstatement levels are \$1.4 billion and \$1 billion respectively. These levels are expected to vary with changes in the compensation limit.
2. The ICF regime is reviewed regularly and enhanced as necessary. The last enhancement exercise was conducted in 2005, when the levy suspension and reinstatement mechanism was introduced. Since then, we have regularly conducted surveys of a limited number of brokers⁶ to obtain more specific and up-to-date

³ A dealing or financing intermediary refers to: (i) an intermediary licensed or registered for dealing in securities or for dealing in futures contracts (ie, Type 1 or Type 2 regulated activity); (ii) an intermediary licensed for securities margining financing (ie, Type 8 regulated activity); or (iii) an authorised financial institution which provides securities margin financing.

⁴ Unless stated otherwise, values given in this paper are in Hong Kong dollars.

⁵ For example, if an intermediary with both a securities and futures business defaults, its clients can claim up to \$150,000 in respect of any securities-related losses and a further \$150,000 in respect of any futures-related losses. However, the \$150,000 limit for securities-related losses cannot be used to offset any futures-related losses that exceed \$150,000, and vice versa.

⁶ The SFC conducts broker surveys every two to three years to get a better idea of the value of assets held with intermediaries. Our surveys cover a dozen to several dozen intermediaries and focus on large non-bank related intermediaries (ie, intermediaries that are not banks, nor related to banks, and whose default is likely to have the greatest impact on the ICF due to the large number of clients they serve or the large amount of client assets held).



information about client asset portfolios held with intermediaries. Data from these surveys are used to assess the continued suitability of various aspects of the ICF regime including the compensation limit and the trigger levels for suspending and reinstating ICF levies.

3. Over the past 10 years, our markets have undergone substantial change.
 - (a) Market growth: Our markets have grown significantly, not only in terms of market capitalisation and average daily turnover⁷, but also in terms of the number of listed companies⁸ and exchange participants⁹.
 - (b) Stock Connect: The implementation of Stock Connect¹⁰ has expanded the reach of our markets and investors. The Hong Kong stock market is now accessible to Mainland investors via Mainland intermediaries. Similarly, Hong Kong investors are able to access the Mainland stock market via intermediaries in Hong Kong.
 - (c) Global financial crisis: In the wake of the global financial crisis of 2008, more emphasis has been placed on detecting and managing risks, particularly systemic risks, and this has been the focus of several legislative reforms and global standards.
4. In the light of these changes, and taking into account data from the two most recent broker surveys (conducted in 2014 and 2017), the SFC proposes the following enhancements to the ICF regime:
 - (a) raising the compensation limit from \$150,000 to \$500,000, and, consequential to this, raising the trigger levels for suspending and reinstating the ICF levies from \$1.4 billion and \$1 billion, to \$3 billion and \$2 billion respectively;
 - (b) adjusting the coverage of the ICF regime so that it covers the northbound leg of Stock Connect, but not the southbound leg; and
 - (c) empowering the SFC (in exceptional circumstances) to make interim compensation payments out of the ICF where urgent pay-outs are necessary to manage potential systemic risk.
5. The above proposals, and rationale for them, are discussed in more detail in paragraphs 9 to 21 below.
6. The proposed enhancements will require amendments to various subsidiary legislation, namely:

⁷ Between the end of 2009 and the end of 2017, market capitalisation almost doubled from \$17,570 billion to \$33,999 billion, while our average daily turnover rose by about 42% from \$62 billion to \$88 billion.

⁸ Between end 2009 and end 2017, the number of companies listed on the SEHK rose by 61% from 1,319 to 2,118.

⁹ Between end 2009 and end 2017, the number of exchange participants rose by 32% from 495 to 654.

¹⁰ The Stock Connect programme is a mutual market access programme between Hong Kong and the Mainland, which allows investors in each market to participate in the other via local intermediaries. It comprises Hong Kong-Shanghai Stock Connect launched in November 2014 and Hong Kong-Shenzhen Stock Connect launched in December 2016.



- (a) the Securities and Futures (Investor Compensation—Claims) Rules, Cap 571T (**ICF Claims Rules**);
 - (b) the Securities and Futures (Investor Compensation—Levy) Rules, Cap 571AB (**ICF Levy Rules**);
 - (c) the Securities and Futures (Investor Compensation—Compensation Limits) Rules, Cap 571AC (**ICF Limits Rules**); and
 - (d) the Securities and Futures (Transfer of Functions—Investor Compensation Company) Order, Cap 571AD (**ICF Transfer Order**).
7. **Annex 1** sets out an indicative draft of the amendments to the ICF Claims Rules, while **Annex 2** sets out a description of the amendments needed to the ICF Levy Rules, the ICF Limits Rules and the ICF Transfer Order.¹¹
8. Interested parties are invited to comment on the proposed enhancements and related legislative amendments, and have two months from the issue of this paper to do so, ie, by 27 June 2018.

Proposed enhancements to the Investor Compensation Regime

Raising the compensation limit

9. For the following reasons, we propose raising the compensation limit from \$150,000 to \$500,000.
- (a) Growth in client assets: With the growth and development of our securities and futures markets (as noted in paragraph 3 above), the value of client assets held with intermediaries has also increased substantially. Data from the 2014 and 2017 broker surveys indicate that the total value of client assets held with the securities intermediaries covered in both surveys has increased by more than 50%, from \$598 billion to \$918 billion, over the last three years. For some intermediaries, the increase was close to or over 100%.
 - (b) Coverage ratio: The SFC generally aims for the compensation limit to achieve a coverage ratio of about 80% — in other words, the limit should aim for the losses of around 80% of investors to be within the level of the compensation limit, and hence compensated in full, if their intermediary were to default.¹² However, data from the 2014 and 2017 surveys suggest an average coverage ratio of about 75% for 2014 but only around 64% for 2017. This is on the basis that the compensation limit remains \$150,000. The 2017 survey data also

¹¹ Amendments to the ICF Claims Rules are made by the SFC while amendments to the ICF Levy Rules, the ICF Limits Rules and the ICF Transfer Order are made by the Chief Executive in Council. Pursuant to section 398 of the SFO, in general, a draft of any amendments by the SFC must be exposed for consultation. Accordingly, this paper attaches an indicative draft of the amendments to the ICF Claims Rules.

¹² It is worth noting that the 80% is only a target which may not always be possible to achieve – eg, in the case of a fraud against a targeted group of high net worth investors (all of whose assets with the defaulting intermediary exceed the compensation limit), the actual coverage ratio may be far lower than 80%, and perhaps even 0% (ie, no one will be fully compensated).



indicates that if the compensation limit were raised to \$500,000, the average coverage ratio would rise to around 83%.¹³

- (c) International comparison: We have compared our current \$150,000 compensation limit with limits adopted under other comparable investor compensation schemes (see table below). We are mindful that comparing the limit alone may not give a full picture since each scheme may differ in terms of the precise scope of persons and assets covered and the circumstances in which compensation is paid. Even so, the existing limit of \$150,000 appears to be on the low side. Raising it to \$500,000 would bring us within the mid-range and on a par with the UK and the Hong Kong Monetary Authority's (**HKMA's**) Deposit Protection Scheme (**DPS**), albeit still below the limits in the US and Canada which are at the other end of the spectrum.

Jurisdiction	Protected assets	Compensation limit (per investor)	Hong Kong dollar equivalent ¹⁴
EU	May vary from member state to member state	€20,000 (being the minimum set at the EU level)	\$191,000
Singapore	Cash, securities and futures held with members of an approved exchange	SGD50,000	\$295,000
HKMA's DPS	Certain deposits held at banks	\$500,000	\$500,000
UK	Client assets held at authorised financial services firms (ie, financial services firms regulated by the UK Financial Conduct Authority or Prudential Regulatory Authority)	GBP50,000 (investment business)	\$547,000
US	Cash, securities and certain derivatives held with members of the US Securities Investor Protection Corporation (which include all registered brokers or dealers)	US\$500,000	\$3.9 million
Canada	Cash, securities, futures and other client assets held by an investment dealer that is a member of the Investment Industry Regulatory Organization of	CAD1 million	\$6.1 million

¹³ The figures 75%, 64% and 83% represent weighted averages. The figures are calculated by first establishing the coverage ratio in respect of each intermediary covered in both surveys, and then taking a weighted average of these. The weighting assigned to an intermediary is based on the number of clients it has.

¹⁴ Conversion is based on the exchange rates on Bloomberg on 25 April 2018.



	Canada		
Australia	Cash, securities and futures held with certain exchange participants	Limit is generally on a per default basis	-
Mainland China	All client assets held with licensed brokers	No limit per investor	-

Raising the trigger levels for levy suspension and reinstatement

10. Consequential to raising the compensation limit to \$500,000, it will be necessary to raise the trigger levels for suspending and reinstating the ICF levies. In considering what the new levels should be, we have taken into account the following:
- (a) **Objective:** As mentioned in paragraph 1(d) above, the levy suspension and reinstatement mechanism was introduced to help ensure that the ICF is maintained at a sufficiently prudent level to cover potential obligations, but without resulting in investors having to contribute beyond what is necessary. The trigger levels should reflect this objective.
 - (b) **Pay-outs in past default cases:** There have only been a handful of relatively large-scale intermediary defaults since the establishment of the ICF in 2003.¹⁵ The total compensation pay-out ranged from about \$2.5 million to \$5.6 million in three cases, and was about \$25 million and \$51 million in the other two cases.
 - (c) **Approach to estimating potential obligations:** The size of past pay-outs is relatively small compared to the current trigger levels of \$1 billion and \$1.4 billion. However, given the increased focus on potential systemic risk (as mentioned in paragraph 3(c) above), it is not enough to consider only the size of past pay-outs. The ICF must also be able to withstand the immediate impact of more significant defaults, including defaults which may pose systemic risk. That said, we are also mindful that the monies in the ICF can be supplemented by borrowing. We therefore do not consider it necessary to build the ICF to levels necessary to fund a default of the largest of intermediaries, which are likely to be banks with a very large client base. Such an approach would be extreme and also counter to the objective described above. We propose instead to adopt a more reasonable and pragmatic approach which focuses on the two largest non-bank/non-bank related intermediaries. Basically, we estimate the potential pay-out if any of them were to default, and then take an average of these estimates over a period of five years or so — averaging would have the added benefit of avoiding skewed results that may otherwise arise as a result of unique events or circumstances.
 - (d) **Trigger levels should be sustainable for some time:** As the levy suspension and reinstatement levels are set out in legislation, and frequent changes can translate into higher costs and burdens for the market, we should aim for

¹⁵ There have been five such cases since 2003. Over 400 investors suffered losses in each of the Tiffit Securities (Hong Kong) Limited default of 2006 and the Goodcape Securities Limited default of 2015. In the other three cases, the Wing Yip Company Limited default of 2006, the Man Lung Hong Securities Limited default of 2007 and the Great Honest Investment Company Limited default of 2007, around 20 to 70 investors were affected.



changes to be sustainable for a reasonable period (say, around seven to 10 years). Accordingly, when considering what the new levels should be, we should take into account potential future growth in client assets.

11. Applying the above, we propose raising the levy suspension level from the current \$1.4 billion to \$3 billion, and the levy reinstatement level from the current \$1 billion to \$2 billion.
12. As of end-February 2018, the size of the ICF was about \$2.36 billion. This is between the proposed new levy suspension and levy reinstatement levels. The question thus arises:
 - (a) whether the ICF levies should be reinstated (on the basis that the current ICF size is below the proposed new levy suspension level of \$3 billion); or
 - (b) whether the current suspension, which has been in place since December 2005, should remain in force (on the basis that the size of the ICF is in any event still above the proposed new levy reinstatement level of \$2 billion).
13. We believe the latter would be more in line with the spirit of the levy suspension and reinstatement mechanism, and therefore propose that the current levy suspension remain in place – ie, despite the change in the trigger levels, the ICF levies should remain suspended until the ICF falls below \$2 billion.
14. Apart from the above, we have also reviewed the funding of the ICF more generally. In particular, we have considered whether there should be any change to the current arrangement whereby ICF levies are charged on a transaction basis and paid by buyers and sellers of securities or futures.¹⁶ We note that this arrangement is different from other jurisdictions where compensation funds are generally funded by market participants, but then the scope and coverage of each scheme is also different. Moreover, the current arrangement in respect of the ICF has worked well in that it: (i) imposes a minimal cost on investors (at 0.002% of the transaction value which, unless suspended, is payable by each party to the transaction); (ii) provides an effective and fairly quick means for building up a reserve to provide protection for retail investors; and (iii) is relatively straightforward and inexpensive to administer. We therefore do not consider it necessary to introduce any change at this time.

Q1.	Do you agree that the compensation limit should be increased to \$500,000? If not, please explain why.
Q2.	Do you agree that the levy suspension and reinstatement levels should be raised to \$3 billion and \$2 billion respectively? If not, please explain why.
Q3.	Do you have any other comments regarding the proposals discussed in paragraphs 9 to 14 above?

¹⁶ The imposition of transaction levies to fund the ICF was introduced in April 2003 when the ICF was established. The rationale for adopting this approach was discussed in the SFC's 2001 Consultation Paper on Proposed New Investor Compensation Arrangements (accessible at www.sfc.hk) – see in particular paragraphs 73 onwards of that paper.



Adjusting coverage to cater for Stock Connect

15. The ICF regime is intended to protect investors against default by intermediaries in Hong Kong. However, the regime currently only covers losses relating to securities or futures traded on the SEHK or HKFE. It does not cover losses relating to securities traded on the Shanghai Stock Exchange or the Shenzhen Stock Exchange under Stock Connect (**Northbound trading**) even though orders for such trades must be routed through Hong Kong intermediaries. This presents an incongruity because it means investors can only be partially compensated for losses arising from a default by the same intermediary, ie, they will only be able to claim compensation for losses in respect of their Hong Kong-listed securities. This does not seem appropriate or rational. We therefore propose expanding the scope of the ICF regime to cover losses relating to Northbound trading.
16. We appreciate that Hong Kong investors can also trade securities listed on other overseas markets (such as the US and UK), and that such trading is not covered by the ICF regime either. However, we do not propose to expand the scope of the ICF regime to cover such trading. There is a key difference between such trading and Northbound trading under Stock Connect. Trading on overseas markets is typically through intermediaries that are regulated in the overseas market. In contrast, Hong Kong investors wishing to conduct Northbound trading do so only via Hong Kong-regulated intermediaries, ie, Mainland regulated intermediaries are not involved. Given this unique feature and the critical role played by Hong Kong intermediaries under Stock Connect, we believe it is appropriate to extend the ICF regime to cover Northbound trading under Stock Connect, but not trading on other overseas markets. It also follows that Northbound trading will be subject to ICF levies (if and when triggered), but that trading in other overseas market will not.
17. On the other hand, we do not believe the ICF regime should cover Mainland investors trading SEHK securities under Stock Connect (**Southbound trading**). This is because Southbound trading must be conducted via Mainland regulated intermediaries, ie, Hong Kong regulated intermediaries are not involved. Given that the regime seeks to protect investors against default by Hong Kong regulated intermediaries, it is only reasonable and logical that Southbound trading should not be covered. It also follows that Mainland investors trading SEHK securities under Stock Connect should not be liable to pay ICF levies (if and when triggered).

Q4.	Do you agree that the ICF regime should be expanded to cover losses relating to Northbound trading? If not, please explain why?
Q5.	Do you have any other comments regarding the proposals to adjust coverage to cater for Stock Connect?

Providing flexibility for the SFC to make interim payments

18. Currently, compensation can only be paid after ascertaining all the relevant details of a claim, including the amounts due to and from the investor. This invariably requires time as relevant information may not always be readily available or reliable. However, depending on the size of a particular default and the market conditions at the time of default, a delay in making compensation payments may pose a threat to the stability of



the wider market. For example, a default of one of the largest intermediaries may trigger a run which could threaten market stability.

19. We therefore propose to enable the SFC to make interim payments in exceptional circumstances only where:
- (a) there is uncertainty as to any amount payable to a claimant by the defaulting intermediary (or vice versa), and hence to the amount of compensation payable, and time is needed to resolve such uncertainty;
 - (b) circumstances exist, in Hong Kong or elsewhere, which pose or may pose a systemic risk in the securities or futures industry or to the financial stability of Hong Kong; and
 - (c) as a result of those circumstances, it is in the interest of the investing public or in the public interest not to delay payment of compensation until the uncertainty is resolved.
20. It is worth highlighting that we do not intend that the power to make interim payments be exercised in all, or even most, cases. Rather, the power is intended to be exercised with caution and restraint, and only in exceptional circumstances where delay in payment may raise or increase systemic concerns, and where there is sufficient information and records available to make interim payments to investors.
21. Additionally, we propose that where any compensation payment is made (whether or not as an interim payment), and it is later discovered that the amount paid exceeds the total that should have been paid to the claimant (eg, due to an error, mistake of fact or misrepresentation by the claimant), the SFC should be able to recover the excess paid. Moreover, if there is a delay in the return of any excess, a late repayment fee (not exceeding 5% of the amount of the excess that remains to be repaid) should be imposed. We note that similar provisions are included in the Deposit Protection Scheme Ordinance (Cap 581).

Q6.	Do you agree that the SFC should be able to make interim compensation payments in the exceptional circumstances described in paragraph 19 above? If not, please explain why.
Q7.	Do you have any other comments regarding the proposals to provide flexibility for the SFC to make interim payments?

Proposed legislative amendments

22. As mentioned at the outset, the proposed enhancements discussed in this paper will require amendments to the following subsidiary legislation:
- (a) the ICF Claims Rules;
 - (b) the ICF Levy Rules;



- (c) the ICF Limits Rules; and
- (d) the ICF Transfer Order.

23. An indicative draft of the amendments to the ICF Claims Rules is attached at Annex 1. As for the proposed amendments to the ICF Levy Rules, the ICF Limits Rules and the ICF Transfer Order, a brief description of these is set out at Annex 2.¹⁷

Concluding remarks and the way forward

24. We believe the proposed enhancements will benefit investors and the wider market. In particular:
- (a) The higher compensation limit will offer better protection to investors, while the higher trigger levels for suspending and reinstating ICF levies will ensure that the ICF is maintained at a prudent level without resulting in the accumulation of excessive amounts at the market's expense. Together, these will assure investors of a reasonable level of compensation in all circumstances, and provide the SFC with the tools to manage potential systemic risks.
 - (b) The proposed expansion of the scope of the ICF regime to cater for Stock Connect will provide better protection for Hong Kong investors.
 - (c) The proposal to allow interim payments in exceptional circumstances will enable the SFC to handle situations presenting potential systemic risk more effectively and promptly. This can be critical to restoring investor and market confidence in times of crisis.
25. This consultation will last two months. Subject to the feedback received, and the completion of relevant legislative drafting work, we hope to be able to finalise the proposals by mid-2018, and to introduce relevant legislative amendments into the Legislative Council for negative vetting in accordance with the established procedures before end-2018.

¹⁷ See footnote 11 above.



Annex 1 – Indicative draft amendments to the ICF Claims Rules

SECURITIES AND FUTURES (INVESTOR COMPENSATION—CLAIMS) RULES
(Cap. 571, section 244(2))

[1 April 2003]
L.N. 12 of 2003

PART 1 PRELIMINARY

1. (Omitted as spent)

2. Interpretation

In these Rules, unless the context otherwise requires—

“*appointed day*” (指定日期) means the date appointed under section 13;

“*associated person*” (相聯者), in relation to a specified person, means—

- (a) a person employed or otherwise engaged by the specified person;
- (b) a person who may receive or hold client assets of the specified person under section 164 of the Ordinance; or
- (c) an employee of the person referred to in paragraph (b);

“*claimant*” (申索人) means a qualifying client who makes a claim under section 4;

“*default*” (違責), in relation to a specified person or an associated person of the specified person, means—

- (a) the insolvency, bankruptcy or winding up of the specified person or associated person of the specified person; or
- (b) any breach of trust, defalcation, fraud or misfeasance committed by the specified person or associated person of the specified person, which occurs on or after the appointed day;

“*prescribed market*” (訂明市場), means a stock market operated by the Shanghai Stock Exchange or the Shenzhen Stock Exchange;

“*prescribed securities*” (訂明證券) means any securities which—

- (a) are listed or traded or to be listed or traded on a prescribed market; and
- (b) are determined by the Stock Exchange Company to be “China Connect Securities” in accordance with the rules of the Stock Exchange Company;

“*qualifying client*” (合資格客戶), in relation to a specified person, means a person for whom the specified person provides a service but does not include—



- (a) a licensed corporation;
- (b) an authorized financial institution;
- (c) a recognized exchange company, a recognized exchange controller, or a recognized clearing house;
- (d) a person authorized to provide automated trading services under section 95(2) of the Ordinance;
- (e) an insurer authorized under section 8 of the Insurance Companies Ordinance (Cap. 41);
- (f) a manager or operator of a collective investment scheme authorized under section 104(1) of the Ordinance;
- (g) a manager or operator of an arrangement referred to in paragraph (iii) of the definition of “collective investment scheme” in section 1 of Part 1 of Schedule 1 to the Ordinance;
- (h) a person who is authorized, licensed or exempt by a competent authority in a jurisdiction outside Hong Kong for any activity that in the opinion of the Commission is the same as or similar to any of the activities carried on by a person referred to in paragraphs (a) to (g);
- (i) an associated person of the specified person—
 - (i) which is a corporation; or
 - (ii) who has committed any breach of trust, defalcation, fraud or misfeasance or assisted in the commission of a default by the specified person or any other associated person of the specified person;
- (j) the Government or a government of any place outside Hong Kong; and
- (k) a person in his capacity as a trustee or custodian of a person, scheme or arrangement referred to in paragraphs (a) to (j);

“*related assets*” (有連繫資產) means money and other property—

- (a) which are entrusted to or received by a specified person or an associated person of the specified person;
- (b) to which a claimant is entitled or in which he has a beneficial interest; and
- (c) which relates to the—
 - (i) purchase;
 - (ii) sale;
 - (iii) holding;
 - (iv) pledge;
 - (v) adjustment;
 - (vi) exercise; or
 - (vii) expiry,of specified securities or futures contracts;

“*securities margin financing*” (證券保證金融資) has the same meaning as in Part 2 of Schedule 5 to the Ordinance except that paragraph (v) of the definition of that expression does not apply;



“*specified person*” (指明人士) means—

- (a) an intermediary licensed or registered for dealing in securities or dealing in futures contracts;
- (b) an intermediary licensed for securities margin financing; or
- (c) an authorized financial institution which provides securities margin financing;

“*specified securities or futures contracts*” (指明證券或期貨合約) means any securities or futures contracts listed or traded or to be listed or traded on a recognized stock market or recognized futures market, or any prescribed securities—

- (a) which are entrusted to or received by a specified person or an associated person of the specified person; and
- (b) to which a claimant is entitled or in which he has a beneficial interest;

“*Tribunal*” (審裁處) means the Securities and Futures Appeals Tribunal established by section 216 of the Ordinance.

PART 2

CLAIMS FOR COMPENSATION

3. Notice inviting claims

- (1) Where the Commission has reason to believe that a specified person or any associated person of the specified person has committed a default, it may publish a notice inviting a qualifying client of the specified person named in the notice who believes he has sustained loss as a result of such default to claim for compensation. Such a notice shall be published in one or more English language newspapers and one or more Chinese language newspapers which are published daily and circulating generally in Hong Kong.
- (2) A notice published under subsection (1) shall specify a date, not being earlier than 3 months after publication of the notice, on or before which a claim for compensation may be made under section 4.

4. Making a claim for compensation

- (1) Subject to subsection (1A), where a qualifying client of a specified person sustains a loss— (7 of 2004 s. 55)
 - (a) as a result of a default committed on or after the appointed day by—
 - (i) the specified person; or
 - (ii) an associated person of the specified person;
 - (b) in relation to—
 - (i) specified securities or futures contracts; or
 - (ii) related assets,the qualifying client may claim compensation from the compensation fund in respect of such loss.



- (1A) A qualifying client of a specified person shall not claim compensation from the compensation fund in respect of any loss in respect of which he has been paid an amount of compensation from the Deposit Protection Scheme Fund established by section 14 of the Deposit Protection Scheme Ordinance (Cap. 581). (7 of 2004 s. 55)
- (2) A claim under subsection (1) may include a claim for the costs reasonably incurred in and incidental to the making and proving of the claim.
- (3) A claim under subsection (1) shall be lodged with the Commission—
 - (a) if a notice under section 3(1) has been published, on or before the date specified in the notice; or
 - (b) if no such notice has been published, within 6 months after the day the claimant first became aware of the default giving rise to the claim.
- (4) A claim which is not lodged within the time limit provided in subsection (3) is barred, unless the Commission determines otherwise.

5. Submission of claims

- (1) Subject to subsection (2), a claim under section 4(1) shall be—
 - (a) lodged in the form specified by the Commission under section 402(1) of the Ordinance for the purposes of this section;
 - (b) completed and signed in accordance with such directions and instructions as are included in the form; and
 - (c) accompanied by such documents as are specified in the form.
- (2) The Commission may accept a claim lodged otherwise than in accordance with subsection (1).

PART 3
PROCESSING OF CLAIMS

6. Commission may require records

- (1) The Commission may, by notice in writing served upon a person, require the person to produce to the Commission originals or copies of such records as the Commission may reasonably require—
 - (a) in connection with a claim for compensation made under section 4(1); or
 - (b) for the purpose of assisting—
 - (i) the Commission in the exercise of its rights of subrogation under section 243 of the Ordinance; or
 - (ii) a recognized investor compensation company in the exercise of its rights of subrogation under section 87 of the Ordinance.
- (2) A notice under subsection (1) shall specify the records required and the date by which the person served with the notice is to furnish them to the Commission.

7. Determination by Commission

- (1) The Commission shall, in relation to a claim for compensation, determine—



- (a) whether there has been a default by the specified person concerned or any associated person of the specified person;
 - (b) the date of the default (if any); and
 - (c) whether the claimant is entitled to compensation from the compensation fund.
- (2) If the Commission determines that—
 - (a) there has been a default by a specified person or any associated person of the specified person; and
 - (b) the claimant is entitled to compensation from the compensation fund, the Commission shall determine a provisional amount of compensation in accordance with subsection (3).
- (3) The provisional amount of compensation referred to in subsection (2) shall be determined by the Commission having regard to—
 - (a) the market value, as at the date of the default, of the specified securities or futures contracts and of any related assets that the Commission is satisfied the claimant has lost as a result of the default less—
 - (i) any amount that the Commission is satisfied was due from the claimant to the specified person; and
 - (ii) any specified securities, or futures contracts or related assets that have been returned to the claimant after the date of the default; and
 - (b) any costs that the Commission is satisfied were reasonably incurred by the claimant incidental to the making and proving of his claim for compensation under section 4.

8. Notice of determination

- (1) Subject to subsection (2), where the Commission makes a determination under section 7, it shall issue a notice of determination to the claimant as soon as practicable thereafter.
- (2) The Commission shall not issue a notice of determination specifying a provisional amount of compensation that is less than the compensation claimed unless it has given the claimant a reasonable opportunity of being heard and, where the Commission decides to issue such a notice, it shall give its reasons in the notice of determination.
- (3) Where the Commission determines that compensation should be paid to a claimant, it shall specify the following in the notice of determination—
 - (a) the name of the person found to be in default;
 - (b) the date of the default;
 - (c) the provisional amount of compensation as determined under section 7;
 - (d) any relevant specified securities or futures contracts or related assets; and
 - (e) the amount of compensation payable under these Rules, inclusive of any interim payment of compensation paid to the claimant under section 8A.

8A. Interim payment by Commission

- (1) The Commission may make an interim payment of compensation to a claimant in an amount that the Commission considers appropriate, if the Commission has a reasonable cause to believe that—



- (a) there is uncertainty as to the entire amount of compensation payable to the claimant in accordance with these Rules;
 - (b) circumstances exist, in Hong Kong or elsewhere, which pose, or may pose, systemic risk in the securities or futures industry, or to the financial stability of Hong Kong; and
 - (c) as a result of those circumstances, it is in the interest of the investing public or in the public interest not to delay payment of compensation to one or more claimants (including the claimant) until the uncertainty is resolved.
- (2) Where the Commission makes an interim payment of compensation to a claimant pursuant to subsection (1), it must notify the claimant that the payment is an interim payment.
 - (3) Subsection (1) does not prevent the Commission from making interim payments of different amounts to different claimants or different classes of claimants.

9. Payment of compensation

- (1) Subject to subsection (2) and section 11, the following amounts shall be paid out of the compensation fund—
 - (a) any compensation payable to a claimant as specified in the notice of determination under section 8(3)(e), inclusive of any interim payment of compensation paid to the claimant under section 8A;
 - (b) any compensation payable following a decision of the Tribunal or the Court of Appeal, under Part XI of the Ordinance; and
 - (c) any costs awarded in favour of a claimant by the Tribunal, or the Court of Appeal, following a decision referred to in paragraph (b).
- (2) The total amount of compensation payable to a claimant under subsection (1)(a) and (b) shall not exceed the maximum amount of compensation prescribed by rules made under section 244(1) of the Ordinance.
- (3) In determining the total amount of compensation to be paid to a claimant under subsection (1)(a) and (b), and in applying the limits on the maximum amount of compensation prescribed by rules made under section 244(1) of the Ordinance, the Commission may aggregate separate claims for compensation by a claimant, or a number of claimants, or parts of those claims, if it is satisfied that the separate claims, or parts of those claims, represent the losses sustained by one person arising out of the same default.
- (4) The Commission may pay compensation by instalments if it determines that it is necessary or appropriate to do so.

9A. Recovery of payment by Commission

- (1) If the amount of compensation paid, whether or not as an interim payment under section 8A, to a claimant from the compensation fund is later found to be greater than the amount of compensation payable to the claimant in accordance with these Rules, the claimant must repay the excess to the Commission in a manner, and within a period, specified by the Commission.
- (2) If a claimant contravenes subsection (1)—



- (a) the Commission may impose on the claimant a late repayment fee of a sum not exceeding 5% of the amount of the excess that remains to be repaid by the claimant; and
- (b) the claimant must pay to the Commission the late repayment fee in a manner, and within a period, specified by the Commission.
- (3) Any such excess or late repayment fee repayable or payable by a claimant under this section is recoverable by the Commission as a civil debt due to the Commission.
- (4) The Commission may, in relation to the excess or late repayment fee—
 - (a) determine, if it considers uneconomical to do so, not to recover the excess or late repayment fee from the claimant; or
 - (b) take such steps as it considers appropriate to recover the excess or late repayment fee from the claimant.
- (5) The Commission must, on collecting any such excess or late repayment fee from a claimant, pay it into the compensation fund.

PART 4
MISCELLANEOUS

10. Financial arrangements

The Commission may arrange for such insurance, surety, guarantee or other financial arrangements as it considers appropriate to facilitate the administration of the compensation fund.

11. Provision where the money available to the compensation fund is insufficient to meet claims

- (1) If, at any time, the Commission determines that the amount of money available to the compensation fund is insufficient to pay the total amount of compensation then payable to the claimants, or likely to become so payable—
 - (a) under these Rules; and
 - (b) in the circumstances referred to in section 9(1)(b), the amount available to the compensation fund is to be apportioned among the claimants in such manner as the Commission may determine.
- (2) In the event that any amounts referred to in section 9(1) remain unpaid because the Commission has determined that an apportionment shall be made under subsection (1), the amounts are to be paid when there is sufficient money available to the compensation fund.

12. Discharge of claims

Upon payment of the full amount determined to be payable to a claimant under these Rules, the rights of the claimant against the compensation fund in relation to the claim and the default are absolutely discharged.

13. Appointed day



The Commission may by notice published in the Gazette appoint a date as the appointed day for the purposes of these Rules.



Annex 2 – Summary of other proposed legislative amendments

Proposed amendments to the ICF Levy Rules

1. Rule 3(1) prescribes the scope of transactions in respect of which ICF levies are payable. This will need to be amended to include securities traded under the Northbound leg of Stock Connect, and exclude those traded under the Southbound leg.
2. Given that the phrase “sale and purchase” is used in various places in the ICF Levy Rules, it may be necessary to include amendments to clarify that ICF levies may not always be payable by both the buyer and seller to a transaction. (For example, if one or both parties to the transaction are transacting under the Southbound leg of Stock Connect, such party or parties will not be liable to pay ICF levies.)
3. Rules 24 to 26 set out the trigger levels for suspending and reinstating ICF levies. These will have to be amended to reflect the proposed new levels.
4. Part 5 sets out the mechanism for suspending and reinstating ICF levies. For the avoidance of doubt, it will be necessary to introduce provisions to make clear that, notwithstanding the introduction of the new trigger levels, the current levy suspension will remain in force until the net asset value of the ICF falls below the new levy reinstatement level (ie, \$2 billion) and a termination of exemption notice under section 26 of the ICF Levy Rules is issued in respect of such fall.

Proposed amendments to the ICF Limits Rules

5. Rule 3(1) prescribes the scope of losses in respect of which the compensation limit applies. This will need to be amended to include losses in respect of securities traded under the Northbound leg of Stock Connect, and exclude those traded under the Southbound leg.
6. Rules 3(1) and 3(2) set out the compensation limits. These will have to be amended to reflect the proposed new limits.

Proposed amendments to the ICF Transfer Order

7. The proposal to empower the SFC to make interim compensation payments in exceptional circumstances will require the introduction of new provisions under the ICF Claims Rules. Currently, all of the SFC’s functions in respect of the handling and processing of compensation claims have been transferred to the Investor Compensation Company Limited under the ICF Transfer Order. In keeping with this, the Order should be amended so that powers under the aforesaid new provisions are similarly transferred.