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28 May 2004

Mr. Danny Leung  
Financial Services Branch,  
Financial Services and the Treasury Bureau,  
18/F., Admiralty Centre Tower 1,  
18 Harcourt Road, Hong Kong.

Dear Danny,

**Clearing and Settlement Systems Bill**

Thank you for your [letter of 25 May 2004](#). While we note your further explanation of the Administration's position, we would like to make the additional comments set out below.

**Clause 25(1)**

As we understand it, the main purpose of the proposed legislation is to ensure finality in respect of transactions that take place through a designated clearing system. This is largely achieved through providing that such transactions are not subject to insolvency law and cannot be attacked as preferences, transactions at an undervalue etc. The Society has made it clear that it accepts the policy reasons for this and our comments have therefore been limited to matters that do not impinge upon the finality principle.

Clause 25(1) of the bill is intended to preserve rights in relation to the transactions that underlie transfers through the clearing systems. It provides that "... this Part shall not operate to limit, restrict or otherwise affect ... any right, title, interest, privilege, obligation or liability of a person resulting from the underlying transaction in respect of a transfer order which has been entered into a designated system...".

Clause 25(1) at present commences with the words "Except to the extent that it expressly provides....", which qualifies the wording referred to in the paragraph above and gives the appearance that Part 3 does in some way provide for a limitation or restriction on underlying transactions. A careful reading of Part 3 reveals no express provision that in any way affects underlying transactions, which begs the question why these words are needed.

It seems that the Administration's position is that the opening wording is desirable to remove all doubt that finality is achieved. In our view there is no doubt anyway, because clause 25(2) says that "Nothing in subsection (1) shall be construed to require - (a) the unwinding of any netting effected by the system operator of a designated system...; (b) the revocation of any transfer order... which is entered into a designated system; or (c) the reversal of a payment or settlement made under the operating rules of a designated system. That appears to be quite clear.

From an insolvency practitioner's point of view, it is important that rights to challenge underlying transactions are clearly not affected by the legislation. The opening wording of clause 25(1) appears to qualify the otherwise clear statement that underlying transactions are not affected. This may open the way to argument that some other provision in Part 3 does affect the insolvency practitioner's ability to challenge underlying transactions (otherwise, it may be argued, why would the qualifying wording be there at all in the light of the clear saving language of clause 25(2)?).

It remains our view that the qualifying wording is unnecessary and could be problematic. However, we also accept that this is not a matter that would render the legislation unworkable and we are not suggesting that the qualifying wording is inconsistent with the finality principle, which the legislation seeks to enshrine. At the same time, it would be a pity if in the attempt to make finality abundantly clear, ammunition were given to a defendant who sought to avoid liability in respect of an underlying transaction.

Clauses 26(4) and 27(4)

We do not have any argument with the policy intention as explained in your letter. However, we note that the relevant provisions in the bill are not limited in any way but are open-ended and, in principle, do not distinguish the potentially different capacities in which a system operator or settlement institution could act. While it would be a preferable, in the interests of certainty, for the policy intention to be clearly reflected in the legislation, if the Administration is willing to give an unequivocal assurance that an exemption will be granted to a system operator or settlement institution only when they are acting in those respective capacities, this may suffice.

Yours sincerely,



PETER TISMAN  
TECHNICAL DIRECTOR  
(BUSINESS MEMBERS & SPECIALIST PRACTICES)

PMT/ay

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