

**Bills Committee
on Securities and Futures Bill and Banking (Amendment) Bill 2000**

**Sanctions against a recognized exchange
and closure of it in emergencies**

Introduction

In considering Part III of the Securities and Futures Bill (SF Bill) at the Bills Committee meeting on 12 January 2001, Members requested the Administration to provide information for comparing Hong Kong with leading overseas jurisdictions in respect of the following matters –

- (a) the type of regulatory measures which may be imposed on a recognized exchange for failure to discharge its statutory duties; and
- (b) whether there are legal provisions to close a recognized exchange in emergencies.

Sanctions against a recognized exchange

Hong Kong

2. Part III of the SF Bill covers the following types of measures which may be taken to ensure that a recognized exchange company discharges its statutory duties properly –

- (a) the Securities and Futures Commission (SFC) may withdraw recognition given to an exchange company; or give direction to it to cease to provide specified facilities or services (both under clause 28 of the SF Bill);
- (b) the SFC may issue a restriction notice (clause 92) or a suspension order (clause 93) to the exchange company, compliance with either of which is enforceable through a court order; and

- (c) an exchange company may be taken to court for statutory sanctions against non-compliance with specified provisions. For example, clause 27 of the SF Bill provides that a recognized exchange company which fails to comply with the SFC's request for production of records commits an offence and is liable on conviction to a fine.

3. The above provisions in the SF Bill seek to re-enact existing regulatory measures enshrined in various sections of the Securities and Futures Commission Ordinance (Cap. 24), the Commodities Trading Ordinance (CTO, Cap. 250), the Securities Ordinance (SO, Cap. 333) and the Stock Exchanges Unification Ordinance (Cap. 361).

The US

4. In the US, comparable provisions in the Securities Exchange Act 1934 (SEA) are as follows –

- (a) suspension or withdrawal of recognition given to an exchange, censure or imposition of limitations on the activities of the exchange (section 19.h.1 of the SEA); and
- (b) statutory sanctions when an exchange is taken to court for non-compliance with an applicable provision of the SEA and the rules and regulations thereunder (section 32.a of the SEA).

The UK

5. In the UK, comparable provisions in the Financial Services and Markets Act 2000 (FSMA) are as follows –

- (a) withdrawal of recognition given to an exchange (section 297 of the FSMA); and
- (b) issuance of a direction to the exchange (section 296 of the FSMA), compliance of which can be enforced through a court order.

Australia

6. Comparable provisions in the Australian Corporations Law (ACL) and the Securities Industry Act 1980 (SIA) are as follows –

- (a) withdrawal of recognition given to an exchange (the Acts Interpretation Act);
- (b) issuance of a direction to an exchange (section 769B of the ACL), compliance with which can be enforced through a court order; and
- (c) statutory sanctions against non-compliance by an exchange with specified provisions. For example, section 10 of the SIA penalizes an exchange for failure to comply with the regulator's request for production of books and records, etc.

Closure of a recognized exchange in emergencies

Hong Kong

7. Clause 29 in Part III of the SF Bill empowers the SFC, after consultation with a recognized exchange company, to direct the company to cease to provide or operate specified facilities or services for a period not exceeding five business days, extendable to further periods not exceeding 10 business days in total, if the orderly transaction of business on the stock or futures markets is being, or is likely to be, impeded by an emergency, a natural disaster, an economic or financial crisis or other circumstances.

8. The SFC's power under the SF Bill to direct an exchange to cease to provide facilities or services in emergencies is basically adapted from existing section 27 of the SO and section 21 of the CTO. It is a reserve power which has not been used to date. Naturally, the SFC would be most careful and prudent if it were ever to exercise such a power, having regard to the impact on the operation of the securities and futures market. We have put in place checks and balances to prevent abuse of this power, including the following –

- (a) the SFC is required to consult the recognized exchange company concerned (clause 29);
- (b) the SFC may only give the direction if the orderly transaction of business on the stock or futures markets is being, or is likely to be, impeded by an emergency, a natural disaster, an economic or financial crisis or other circumstances (clause 29);

- (c) the SFC may direct cessation of business for a maximum period of 15 business days (clause 29); and
- (d) the SFC's decision to direct an exchange under clause 29 is subject to appeal to the Chief Executive in Council (clause 33).

The US

9. Section 12.k.1.B. of the SEA empowers the Securities and Exchange Commission (SEC), with the consent of the President, summarily to suspend all trading on any national securities exchange for a period not exceeding 90 days, if, in the opinion of the SEC, the public interest and the protection of investors so require. This sub-paragraph is not explicitly limited to use in an emergency. In addition, section 12.k.2 provides that in an emergency the SEC may take such action by order as it determines is necessary in the public interest or for the protection of investors to maintain or restore fair and orderly securities markets or prompt, accurate and safe clearing and settlement. Such order may remain in effect for up to 10 business days. An emergency is defined as meaning "a major market disturbance" which involves "sudden and excessive fluctuations of securities prices generally" that "threaten fair and orderly markets", or a "substantial disruption...of the national system for clearance or settlement of securities" (s.12.k.6).

The UK

10. The FSMA does not empower the Financial Services Authority to direct a recognized exchange company to cease to provide or operate its facilities or services.

Australia

11. The Australian Securities and Investments Commission (ASIC) is not specifically empowered to direct a recognized exchange company to cease to provide or operate any facilities or services. However, the ASIC is generally empowered to do whatever is necessary for or in connection with its functions which are described as monitoring and promoting market integrity and consumer protection in relation to the Australian financial systems (section 12A(6) of the ASIC Act). This general power may be interpreted as extending to closing an exchange.

Conclusion

12. We consider that the proposed regulatory measures under the SF Bill which may be taken against a recognized exchange company's failure to discharge its statutory duties are comparable to those available in other major international financial centres.

13. The position is less clear-cut in respect of whether there are explicit legal provisions to close an exchange or suspend its trading in emergencies. The situation in Hong Kong is more akin to that in the US.

Financial Services Bureau
Securities and Futures Commission
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