

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

**Rule Making Powers of a Recognized Exchange Company
and the Checks and Balances**

Introduction

At the Bills Committee meeting on 23 February 2001, Members asked for more information on the rule making powers of the Stock Exchange of Hong Kong (SEHK) and the checks and balances for such powers.

2. This paper summarizes the various rule making powers of SEHK which will be recognized by the Securities and Futures Commission (SFC) as a recognized exchange company under the Securities and Futures Bill (the SF Bill) when it is enacted and brought into force. It also covers related checks and balances for such powers. In particular, the SFC must approve the rules of a recognized exchange company and has additional powers to require particular rules to be made or amended. The SFC can also make rules for SEHK. The overall regulatory regime for exchange companies is provided for under Part III of the SF Bill.

Rule making powers

3. Clause 23 of the SF Bill specifies the matters for which non-statutory rules may be made by a recognized exchange company. There are also provisions relating to compliance with or enforcement of these rules. Under clause 21, a recognized exchange company must (a) operate its facilities in accordance with its rules; and (b) formulate and implement appropriate procedures for ensuring that its participants comply with its rules. A recognized exchange company must notify the SFC if it becomes aware that any of its participants is unable to comply with its rules.

Checks and balances

4. The major checks and balances concerning a recognized exchange company in the exercise of its powers (including rule making powers) and performance of its statutory duties are summarized below –

- (a) the rules must be approved by the SFC before they can take effect (clauses 24(1));
- (b) the rules submitted to the SFC for approval must contain explanations of their purpose and likely effect, including their effect on the investing public, in sufficient detail to enable the SFC to decide whether to approve them or refuse to approve them (clause 24(2));
- (c) the SFC may by notice in writing request a recognized exchange company to make rules or amend rules made by the company as specified in the SFC's notice (clause 23(3));
- (d) the SFC may make or amend the rules instead of the exchange company if it is satisfied that the latter has not act according to the SFC's request at (c) (clause 23(4));
- (e) following consultation with the Financial Secretary and the recognized exchange company, the SFC may make various kinds of non-statutory rules concerning the operation of a recognized exchange company and other matters which may be prescribed by rules made by the exchange company (clause 36);
- (f) where it is appropriate to do so in the interest of the investing public or in the public interest, or for the protection of investors or for the proper regulation of recognized companies, the SFC may take any of the following courses of action subject to a series of procedural safeguards –
 - (i) issuance of restriction notices (clause 92) to require a recognized company to change its memorandum or articles of association or rules and regulations or to take certain action. A restriction notice can also be served prohibiting any such company from doing such things relating to the conduct and operation of its business as specified in the restriction notice;

- (ii) issuance of suspension orders (clause 93) relating to the functions of –
 - ♦ the board of directors or governing body;
 - ♦ a director or member of the governing body;
 - ♦ a committee or sub-committee;
 - ♦ the Chief Executive Officer;
- (iii) application to the Chief Executive in Council for resumption of regulatory functions that have been transferred to the exchange company (clauses 25(6)); and
- (iv) withdrawal of recognition (clause 28).

Securities and Futures Commission
Financial Services Bureau
12 May 2001