

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

**Securities and Futures Bill  
Part III and Schedule 3**

**INTRODUCTION**

This paper outlines the major elements of Part III and Schedule 3 of the Securities and Futures Bill (“the Bill”), which deal with the regulation of the five main types of market operators and related institutions. These are the exchange companies, clearing houses, exchange controllers, investor compensation companies (ICCs) and providers of automated trading services (ATS).

2. These operators may assume certain public functions governing those who have access to their facilities and services, including market surveillance, intermediaries supervision, compensation arrangement for investors as well as listing activities and relevant conduct of listed corporations. The Securities and Futures Commission (“SFC”), being the regulator of the securities and futures market, has the responsibility to ensure proper discharge of such regulatory functions by market operators by coordinating closely with these operators and assuming a regulatory oversight. Under clause 5(1)(b) in Part II of the Bill, SFC is conferred with the function to supervise, monitor and regulate the activities carried on by these operators.

3. Stemming from the market structure reform announced by the Financial Secretary in the 1999 Budget Speech, the two exchanges and three clearing houses<sup>1</sup> were brought under common ownership by a single operator with the formal establishment of Hong Kong Exchanges and Clearing Limited (“HKEx”) on 6 March 2000. HKEx is a commercial entity and is now listed on its subsidiary stock exchange (i.e., Stock Exchange of Hong Kong (“SEHK”).

4. To provide a new regulatory framework for HKEx to operate, the Exchanges and Clearing Houses (Merger) Ordinance (Cap. 555) (“the Merger

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<sup>1</sup> The two exchanges and the three clearing houses are the Stock Exchange of Hong Kong Limited, the Hong Kong Futures Exchange Limited, the Hong Kong Securities Clearing Company Limited, the SEHK Options Clearing House Limited and the HKFE Clearing Corporation Limited.

Ordinance”) was enacted on 24 February 2000. The Merger Ordinance establishes safeguards to ensure an appropriate balance between the commercial interests of HKEx, and exchanges and clearing houses controlled by it, on the one hand and their public duties on the other. These safeguards have been incorporated in Division 4 of Part III, which reproduces the provisions of the Merger Ordinance. The need to balance the different roles of the exchanges and clearing houses has also influenced the drafting of Divisions 2 and 3 (exchanges and clearing houses).

## **POLICY OBJECTIVES AND MAJOR PROPOSALS**

5. This legislative reform seeks to rationalize the discrepancies among existing statutes governing the stock exchange, the futures exchange and the relevant clearing houses. Major changes proposed to the existing regulatory framework, enshrined in Part III of the Bill, are primarily to cater for the emergence of new operators in the securities and futures market, namely ICCs and ATS providers, including overseas exchanges that provide electronic facilities in Hong Kong.

6. The existing regulatory framework for stock and futures exchanges, and clearing houses, consists of a number of statutory provisions :

- (a) the Stock Exchanges Unification Ordinance (Cap. 361) and Part III of the Securities Ordinance (Cap. 333) which cover the Stock Exchange and stock markets;
- (b) Part III of the Commodities Trading Ordinance (Cap. 250), which covers the Futures Exchange and futures markets;
- (c) the Securities and Futures (Clearing Houses) Ordinance (Cap.420), which covers the clearing houses;
- (d) the Merger Ordinance, explained above; and
- (e) Part VI of the Securities and Futures Commission Ordinance (Cap.24) which contains special provisions relating to exchange companies and clearing houses.

7. The existing regulatory framework has generally been working effectively. We have largely retained the existing framework but have consolidated and conformed these provisions in the Bill. A comparison table on relevant statutory provisions in existing Ordinances and Part III is at the Annex. Key features of the proposed regulatory framework are set out below.

- (a) **Recognition** (clauses 19, 37, 59, and 79): The SFC may recognize a company as a controller of an exchange company or a clearing

house, an exchange company, a clearing house or an investor compensation company (referred to collectively as “recognized companies”); where it is satisfied that so doing is in the interest of the public, and for the proper regulation of markets.

- (b) **Statutory duty and immunity** (clauses 21, 22, 38, 39, 63, 64, and 81): The recognized companies have certain statutory duties corresponding to their nature of operation. These include public duties like in the case of exchanges, ensuring an orderly, informed and fair market, and in the case of clearing houses, ensuring that there are orderly, fair and expeditious clearing and settlement arrangements. In discharging their duties, or acting under the rules of the company, each company and any person acting on its behalf enjoys statutory immunity if they act in good faith.
- (c) **Rule-making powers** (clauses 23, 40, 66 and 82): The recognized companies may make rules for such matters as are necessary and desirable for performing their functions, as specified in the Bill. The rules are not effective unless first approved in writing by the SFC (clauses 24, 41, 67 and 83). The SFC may also require a recognized exchange company and a recognized clearing house to make rules (clauses 23(3) and 40(4)). The rules made by the recognized companies are not subsidiary legislation. The SFC may, after consulting with the Financial Secretary and the recognized exchange company concerned, separately make rules relating to listing matters, and the proper regulation of the markets and exchange participants (clause 36).
- (d) **Transfer of Regulatory Functions** (clauses 25, 68 and 80): The SFC may request the Chief Executive in Council to transfer certain of its functions to a recognized exchange company, a recognized exchange controller or a recognized ICC. For example, the SFC has transferred its regulatory functions regarding prospectuses of listed companies to SEHK under section 47 of the SFC Ordinance. This transfer mechanism provides an avenue to minimize regulatory overlap between the SFC and these recognized companies, and allows the SFC to entrust in the recognized companies certain regulatory functions which they are able and willing to perform.
- (e) **Safeguards** : The Bill preserves the safeguards governing the exchanges and clearing houses in the existing legislation and extends their application to the new recognized companies, namely controllers of an exchange company or clearing house, and ICCs.

Accordingly, 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 –

- (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 (clauses 25(6), 68(7), 80(7) and paragraph (d) above); and
- (iv) withdrawal of recognition (paragraph (a) above and clauses 28, 43, 72, and 85).

The exercise of the powers in (i) to (iv) above by the SFC is itself subject to a series of procedural safeguards. For instance, clauses 33, 44, 73, and 86 of the Bill allow a company affected to lodge an appeal to the Chief Executive in Council. Moreover, these powers are made non-delegable under clause 10. They are therefore not intended to be used lightly.

8. Authorization of ATS (clause 95): In Division 7 of Part III are provisions providing for the authorization of ATS. ATS refer to services provided by means of electronic facilities, whereby securities and futures related transactions can be negotiated, concluded, novated or cleared (the definition is in Schedule 6 of the Bill). The SFC may either license a person under Part V to provide ATS, or authorize a person under Part III to provide ATS. The nature of ATS, their relationship with the existing exchanges and the factors which determine whether they are authorized under Part III or licensed under Part V are explained further below.

## **MARKET DEVELOPMENT AND NEW ELEMENTS INTRODUCED IN THIS LEGISLATIVE REFORM**

### **Regulatory interface between the SFC and HKEx (clauses 59-78)**

9. As mentioned above, HKEx operates as a commercial entity. It is also vested with certain public functions. The design of HKEx's dual public-and-commercial role is deliberate. HKEx's operation will be governed by the existing regulatory framework for market operators, with additional safeguards to make sure that HKEx will strike an appropriate balance between its commercial objectives and public roles in performing its functions. In particular, section 9 of the Merger Ordinance, as presented in clause 65 of the Bill, requires HKEx to establish a Risk Management Committee (RMC) to formulate policies on risk management matters relating to its activities as well as the activities of its exchanges and clearing houses; and to submit such policies to the HKEx for consideration.

10. As regards the division of regulatory functions between the SFC and HKEx's subsidiaries, a review has been completed in accordance with the policy framework laid down for the merger exercise in July 1999. A new Memorandum of Understanding between HKEx and the SFC has recently been signed and the SFC has taken over from SEHK and Hong Kong Futures Exchange the supervision of exchange participants' financial condition and conduct. The Code of Conduct for Persons Registered with the SFC has been revised to incorporate provisions currently contained in the rules of the Exchanges and new conduct rules, which will apply to exchange participants, and the revised Code is now under public consultation.

### **Investor compensation companies**

11. The concept of establishing the ICC has its origin in the "Consultation Paper on New Investor Compensation Arrangements for Hong Kong" issued by the SFC in 1998. The proposals in the paper have received general support of both the Legislative Council Panel on Financial Affairs and the public. The exercise is a comprehensive review of the compensation arrangements in the securities and futures market. Part III of the Bill deals with the institutional framework for implementing the proposed new compensation arrangements. It also provides for the regulatory relationship between the SFC and the ICC, which is largely modeled on the existing framework designed for other market operators as outlined in paragraph 7 above. Other elements of the

new compensation arrangement, like payments to and out of the compensation funds, will be the subject of a separate paper on Part XII of the Bill.

12. Under existing law, the SFC administers the assets held in the Unified Exchange Compensation Fund and the Futures Exchange Compensation Fund set up under the existing Securities Ordinance (Cap. 333) and Commodities Trading Ordinance (Cap. 250) respectively, whilst the recognized exchange companies receive and determine claims and make apportionment where necessary. Although this arrangement provides certain checks and balances, it is cumbersome. There is also concern over potential conflicts of interest of the exchanges in relation to their role in the compensation process, both as contributors to the funds and the bodies to determine payment out of the funds. In this legislative reform exercise, an independent company, an ICC, will be recognized by the SFC (after consultation with the Financial Secretary) for dealing with investor compensation matters, where it is in the interest of the investing public or in the public interest that the company be so recognized. The Bill allows for the recognition of more than one ICC.

13. The SFC has already initiated discussions with HKEx on the new investor compensation proposals, given the need to reach suitable arrangements in time for the proposals to be implemented as soon as possible after the Bill is enacted. Further to these discussions, the SFC plans to publish a report on the proposed investor compensation arrangements for Hong Kong in the coming few months. The Bill provides for a flexible and broad framework for such discussions and should not restrict the development of these proposals and arrangements.

### **Automated Trading Services**

14. Advances in information technology enable the sale and purchase of securities and futures contracts via various electronic facilities. This effectively eliminates the need for stock exchanges or futures exchanges to be a physical place. These electronic facilities create a range of new regulatory issues and concerns that are not adequately addressed under current legislation, and pose challenges to the regulator as they become more sophisticated and increasingly popular among market participants. The Bill acknowledges their presence and seeks to address the new regulatory issues with flexibility.

15. It is well recognized that individual ATS can operate very differently, depending on accessibility, target investor group, product range, services provided, size of transactions, total trading volumes, etc. Accordingly, the Bill adopts a flexible and pragmatic approach. It empowers the SFC to

examine each application for the provision of ATS and, on the basis of the specifics of each application, to determine the regulations to be applied. Providers of ATS will either be licensed as an intermediary under Part V or authorized to operate exchange-like facilities under Part III of the Bill.

16. Through this proposed arrangement, the Bill seeks to provide an environment that will facilitate the growth of ATS operations in Hong Kong whilst at the same time ensuring adequate regulation to protect investors. It is noteworthy that the proposed approach is being adopted elsewhere, including the US and the UK, as outlined in paragraphs 26-34. To provide for guidance to ATS providers, the SFC has undertaken to promulgate guidelines which set out in greater detail as to how it is going to discharge its statutory functions in respect of ATS. We expect that the draft guidelines will be ready for market consultation in early 2001.

17. At present, a number of overseas exchanges provide ATS in Hong Kong for investing in overseas markets. This is a natural development of an increasingly globalised market. These exchanges are subject to regulation by the countries in which their operations are based. Clause 95(2) of the Bill empowers the SFC to authorize a stock exchange or futures exchange from outside Hong Kong to provide ATS in Hong Kong, and equips the SFC with a clear statutory basis to withdraw the recognition.

## **MARKET COMMENTS AND CHANGES MADE**

18. A number of detailed amendments to the Bill have been made in response to market comments on Part III of the White Bill. Those which are of a technical nature and addressed in the course of refining the Bill are not repeated here.

19. Concern was expressed that the listing of HKEx gave rise to potential conflicts of interest between the financial objectives of SEHK and its regulatory responsibilities (e.g. to achieve its financial objectives SEHK might relax its listing requirements). It is felt that the rule making powers of the SFC together with clauses 74 and 75 (which give the SFC powers to require HKEx to take steps to remedy any conflict) are adequate to deal with any potential conflict that might arise.

20. Under clause 19 of the Bill, only SEHK, HKEx and any other companies of which HKEx is the controller (effectively, any company in which HKEx controls 35% of the voting power) may, with recognition by the SFC, operate a stock market in Hong Kong. This seeks to honour a commitment made by the

Government in March 1999 in promoting the merger of the exchanges and clearing houses, i.e. to preserving the legal monopoly of SEHK to operate a stock market in Hong Kong, as set out in section 27 of the Stock Exchanges Unification Ordinance (Cap. 361). We believe that this will allow HKEx, as the merged entity, to benefit from economies of scale, concentration of resources, as well as consistency and coherence in business and risk management strategies in meeting the competitive challenge of globalisation. During the White Bill consultation, HKEx suggested that consideration should be given to giving HKFE exclusive rights to operate a futures market in Hong Kong, like SEHK. However, we have also received comments from the legislature and some market participants that the Bill should not carry provisions that may impede market development. We consider that, on balance, the status quo should be maintained having considered the interest of the entire securities and futures community as a whole and Hong Kong as an international financial centre and shall keep the subject under review in light of new market developments.

21. HKEx suggested that, at a more general level, in considering whether to authorise an overseas stock exchange or futures exchange to provide ATS, it is imperative that such exchanges must meet regulatory standards no less stringent than those imposed on markets operated by HKEx. This will ensure a high level of investor protection and a level playing field for exchanges and ATS. The criteria and regulatory standards should be set out explicitly in the principles and standards in relation to the granting of authorisation for providing ATS. Consideration should be given to including provisions similar to those set forth in clauses 90 – 93 (of the White Bill) for persons authorised to provide ATS (i.e. should the Commission have the power to issue restriction notices or suspension orders against these persons) in relation to authorising overseas stock and futures exchanges. We do not agree that it would be appropriate to include provisions purporting to give the Commission power to restrict or suspend the activities of overseas exchanges. The Commission can always withdraw authorization under clause 98 of the Bill.

22. HKEx also commented that SFC's power to make statutory rules for the recognised exchanges (clause 36) should be subject to a more vigorous consultation and appeal mechanism. In addition to consulting the recognised exchanges, the SFC will have to consult the Financial Secretary before making such rules.

23. Several respondents expressed concern that the definition of "automated trading services" was too broad. We agree and have amended the definition of "automated trading services" (Schedule 6). In doing so, we are



minded not to cast a narrow definition which may create regulatory gaps and fail to embrace new technology and trading methods.

24. Some other respondents asked in what circumstances the Commission will choose to use either the provisions in Part V of the Bill (as in the case of a broker/dealer) or Part III of the Bill (clause 95) for authorisation as an ATS. This will be clarified in the Guidelines which are to be issued by the SFC in early 2001. However, very broadly, corporations that are providing on-line services to their clients as part of a business of dealing in securities or dealing in futures contracts, are likely to be regulated under Part V. Persons who provide automated trading services as a stand alone business are likely to be authorized under Part III as an ATS.

25. We have taken the initiative to rearrange certain provisions in Part III to improve their logical sequence. For example, clause 20 of the White Bill was absorbed into clause 19(1)(a) of the Bill and sub-clauses 22(5) and (6) of the White Bill empowering the SFC to require production of records became clause 27 of the Bill. Equivalent provisions in Divisions 3, 4 and 5 were also re-numbered to become clauses 42, 71 and 84 in the Bill. Such re-numbering efforts do not alter the contents of the relevant provisions.

## **INTERNATIONAL COMPARISONS**

26. Technological advances are transforming global markets by making it possible for almost any type of right or interest to be traded in a cost-effective way using ATS. Globally, regulators are considering different mechanisms for regulating this new and expanding aspect of the financial services industry. The US has probably made the greatest progress, driven by the fact that a large proportion of the trade in securities and futures contracts is conducted through electronic networks in the US. However the authorities in the UK, Australia and Canada are all considering, or have adopted, proposals to regulate ATS.

### **United States - Securities and Exchange Commission (“SEC”)**

27. On December 8, 1998, the SEC adopted new rules and rule amendments to allow alternative trading systems to choose whether to register as national securities exchanges, or to register as broker-dealers and comply with additional requirements under new rules (“Regulation ATS”), depending on their activities and trading volume. The effective date for most of these new rules was April 21, 1999.

28. For alternative trading systems, trading 20 percent or more of the average daily trading volume in corporate debt securities over at least four of the preceding six months, fair access and systems capacity, security, and integrity requirements were imposed effective from April 1, 2000. These requirements are scaled and become more onerous as the market share increases.

29. The rules contemplate three levels of authorisation -
- (a) Broker-dealer;
  - (b) ATS; and
  - (c) Exchange (when no Regulation ATS requirements apply).

### **United States – Commodity Futures Trading Commission (“CFTC”)**

30. In June 2000 the CFTC also published rules concerning ATS. The CFTC has gone a different route from the SEC, contemplating three regulatory tiers providing electronic markets for trading: Recognised futures exchanges, derivatives transaction facilities and exempt multilateral transaction execution facilities. Broker-dealers will remain as a separate category.

### **United Kingdom**

31. The UK has recently consulted on its approach to regulation of ATS. It proposes to create more of a level playing field between trading systems entering as broker-dealers and those choosing to become an exchange. The UK will retain three levels of authorization for persons providing facilities which could be described as an ATS -

- (a) Authorised firm as a broker dealer;
- (b) Authorised firm as a service company (can deal only with profession); and
- (c) Recognised Investment Exchange or Clearing House

Each would have different requirements as to rule making powers, governance, financial resources, monitoring/enforcement and compensation.

### **Australia**

32. Australia has issued draft legislation which would create a single category of 'financial products market', which would include in a broad definition the whole range from an exchange to an ATS. A single set of

requirements would then apply to all these trading systems. The current classification –

- (a) Broker-dealer; and
- (b) Four Markets:
  - Stock Exchange
  - Approved Securities Organization
  - Stock market in unquoted prescribed interests
  - Exempt stock market

will move to only two levels-

- (a) Broker-dealer; and
- (b) Financial Product Market.

### ***Canada***

33. Canada recently consulted on the regulatory regime for ATS. They propose to add additional requirements to those trading systems that provide multilateral, non-discretionary market places (and are not a recognised exchange). Authorisation is proposed as-

- (a) Dealer; and
- (b) Exchange.

There are additional requirements for operating ATS for a dealer.

### **Federation of European Securities Commissions (“FESCO”)**

34. FESCO recently issued a report on the regulation of ATS in Europe. It proposes that ATS, which are licensed as broker-dealers, should be subject to some additional requirements to address the specific risks that ATS present (and which might not be covered by normal broker-dealer rules).

Securities and Futures Commission  
Financial Services Bureau  
28 December 2000

## ANNEX

### Comparison Table for Part III

This table includes provisions in the third column that indicate where, in current legislation, the subject matter of the relevant clause of the Bill is dealt with. The Bill is a consolidation Ordinance and, rather than following the current provisions which straddle different Ordinances (often with variations), similar provisions which appear in different Divisions of Part III (e.g. rule making powers) have been drafted in a consistent manner using consistent terminology. We have identified such clauses with the words “modelled on clause [ ]”. We use the term “Consolidation” to mean a clause that has been created from the two separate sections in the current legislation (identified in the Derivation column). The new clause may adopt parts only of each of the existing provisions and may follow neither provision closely. We use the term “Existing law” to mean that the drafting of the clause closely follows the section identified in the Derivation column. However, there may be minor textual amendments.

*Legend:*

- CTO = Commodities Trading Ordinance (Cap. 250)
- ECH(M)O = Exchanges and Clearing Houses (Merger) Ordinance (Cap.555)
- SEUO = Stock Exchanges Unification Ordinance (Cap. 361)
- SF(CH)O = Securities and Futures (Clearing Houses) Ordinance (Cap. 420)
- SFCO = Securities and Futures Commission Ordinance (Cap. 24)
- SO = Securities Ordinance (Cap. 333)

<b>PART III – EXCHANGES COMPANIES, CLEARING HOUSES, EXCHANGE CONTROLLERS, INVESTORS COMPENSATION COMPANIES AND AUTOMATED TRADING SERVICES</b>			
<b>Clause</b>	<b>Contents</b>	<b>Derivation</b>	<b>Notes</b>
18	<p style="text-align: center;"><b>Division 1 - Interpretation</b></p> Interpretation	SF(CH)O s.2; ECH(M)O s.2	<p><i>(Figures in brackets are sub-clause numbers)</i></p> Existing law
	<p style="text-align: center;"><b>Division 2 – Exchange Companies</b></p>		

19	Recognition of exchange company	SO s.20. SEUO ss.3 & 27; CTO s.13; ECH(M)O s.3	<p>(1) Consolidation of SO s.20 SEUO ss.3 &amp; 27 &amp; CTO s.13;</p> <p>(2) – (5) Modelled on clause 59 which follows ECH(M)O s.3;</p> <p>(6) New : Rationalisation with CF(CH)O s.3(1)</p> <p>(7) New : Safeguard that entitles an applicant for recognition to reasonable hearing</p> <p>(8) New : Avoids an overlap between “futures market” and ATS</p> <p>(9) New : Ensures the ambit of the SEHK monopoly is not extended to collective investment schemes</p>
20	Transactions that may be conducted on an exchange	CTO s.16	<p>(1) New : Rationalisation with CTO s.16</p> <p>(2) Has a similar effect to CTO ss.16, 115 &amp; Schedule 1 - with responsibility being passed from the Chief Executive to the SFC</p>
21	Duties of recognized exchange company	SEUO ss.15 & 29; CTO ss.13 & 100 ECH(M)O s.8	<p>(1) – (2) Follow ECH(M)O s.8 (1) &amp; (2) with duties slightly amended</p> <p>(3) – (4) New : To assist with ensuring proper regulation.</p> <p>(5) Consolidates SEUO s.15 &amp; CTO s.100</p> <p>(6) Consolidates SEUO s.29 &amp; CTO s.13(3) and new</p>
22	Immunity, etc.	SF(CH)O s.17; SFCO s.56; ECH(M)O s.8(3)	<p>(1) –(2) Follow ECH(M)O s.8 (3) &amp; (4)</p>
23	Rules of recognized exchange company	SEUO s.34; CTO s.13	<p>(1) – (4) (6) – (8) Consolidation</p> <p>(5) New. To address a specific difficulty identified in <u>R v. Robert Eli Low Magistracy Appeal No. 1180 of 1996,</u></p>

24	Approval of amendments to rules of recognized exchange company	SEUO s.35; CTO s.14	(1) – (6) Consolidation (7) New : Rationalisation with ECH(M)O s.10(6) (8) New : Clarification
25	Transfer and resumption of functions of Commission	SFCO s.47	Existing law
26	Appointment of chief executive of recognized exchange company requires approval of Commission	SEUO s.10A; CTO s.15	Consolidation
27	Production of records, etc. by recognized exchange company	CTO s.103	Existing law
28	Withdrawal of recognition of exchange company and direction to cease to provide facilities or services	SEUO s.36; CTO ss.18 & 19; SO s.26	(1)(a) (2) (4) Consolidation of SEUO s.36; CTO s.18 (1)(b) (7) Consolidation of CTO ss.18 & 19; SO s.26 (3) New : Safeguard that entitles an exchange to reasonable hearing before SFC's decision to withdraw its recognition etc. (5) New : Complementary to gazettal of recognition (6) New : Safeguard that allows SFC's withdrawal decision, etc to take effect only after the clearing of any possible appeals
29	Direction to cease to provide facilities or services in emergencies	SO s.27; CTO s.21	Consolidation
30	Contravention of notice constitutes offence	SO s. 27(4) & (6); CTO s.23	Consolidation
31	Prevention of entry into closed trading markets	SO s.27(5) & (6); CTO s.24	Consolidation
32	Publication of directions	SO s.28; CTO s.22	Consolidation
33	Appeals	SO s.29; SEUO s.37; CTO s.25	Consolidation
34	Restriction on use of titles relating to exchanges, markets etc.	SO s.21; CTO s.106	Consolidation

35	Contract limits and reportable open position	SO s.146(1); CTO ss.59, 60 & 65	(1), (3), (5) & (6) Consolidation of SO s.146(1)(p) & (3); CTO s.59 60 & 65 (2) New : Safeguard that requires the SFC to consult the Financial Secretary before exercising its rule making power under (1)(e) (4) New : To ensure a comprehensive scheme of regulation
36	Rule-making powers of the Commission	SO s.14	Existing law with some revision.
<b>Division 3 – Clearing Houses</b>			
37	Recognition of clearing houses	SF(CH)O s.3; ECH(M)O s.3	(1) & (4) Consolidation of SF(CH)O s.3; ECH(M)O s.3 (2) – (3) Modelled on clause 59 which follows ECH(M)O s.3; (5) New : Safeguard that entitles an applicant for recognition to reasonable hearing
38	Duties of recognized clearing house	ECH(M)O s.8 (1) & (2)	Modelled on clause 21.
39	Immunity etc.	SF(CH)O s.17	(1) – (3) Conform to the scheme of clause 22 (4) – (5) Existing law SF(CH)O s.17
40	Rules of recognized clearing houses	SF(CH)O s.4	(1) Modelled on clause 23(1) (2) – (5) Existing law SF(CH)O s.4
41	Approval of amendments to rules of recognized clearing house	SF(CH)O s.4	Modelled on clause 24.
42	Production of records, etc. by recognized clearing house	CTO s.103	Existing law.
43	Withdrawal of recognition of clearing house and direction to cease to provide facilities	New	Modelled on clause 28
44	Appeals	New	Modelled on clause 33.

45	Proceedings of recognized clearing house take precedence over law of insolvency	SF(CH)O s.5	Existing law.
46	Supplementary provisions as to default proceedings	SF(CH)O s.6	Existing law.
47	Duty to report on completion of default proceedings	SF(CH)O s.7	Existing law.
48	Net sum payable on completion of default proceedings	SF(CH)O s.8	Existing law.
49	Disclaimer of property, rescission of contracts, etc.	SF(CH)O s.9	Existing law.
50	Adjustment of prior transactions	SF(CH)O s.10	Existing law.
51	Right of relevant office-holder to recover certain amounts arising from certain transactions	SF(CH)O s.11	Existing law.
52	Application of market collateral not affected by certain other interests, etc.	SF(CH)O s.12	Existing law.
53	Enforcement of judgements over property subject to market charge, etc.	SF(CH)O s.13	Existing law.
54	Law of insolvency in other jurisdictions	SF(CH)O s.14	Existing law.
55	Clearing participant to be party to certain transactions as principal	SF(CH)O s.15	Existing law.
56	Securities deposited with recognized clearing house	SF(CH)O s.16	Existing law.
57	Preservation of rights, etc.	SF(CH)O s.18	Existing law.
58	Amendment of Schedule 3	SF(CH)O s.19	Existing law.
<b>Division 4 –Exchange Controllers</b>			



59	Recognition of exchange controller	ECH(M)O s.3	<p>Sub-clauses (1) – (3), (5), (6), (9)(c) – (11) and (13) – (18) follow the existing law. Appeal provision moved to clause 73</p> <p>(4) New : To clarify sub-clause (3)</p> <p>(7) &amp; (8) New : Closes a gap in (6)</p> <p>(9) New : Prevent the provisions of (1) being avoided</p> <p>(12) New : Safeguard that allows SFC’s notice served on an “unrecognized” exchange controller under 9(c) to take effect only after the clearing of any possible appeals</p> <p>(19) New : This enables an exchange controller to operate an exchange itself</p> <p>(20) New : Clarification</p>
60	Interest of recognized exchange controller in recognized exchange company or clearing house cannot be increased or decreased except with approval of Commission	ECH(M)O s.5	Existing law.
61	Person not to become minority controller of exchange controller, etc. without approval of Commission	ECH(M)O s.6	<p>Sub-clauses (1) – (5), (10) (11) (13) - (18) and (20) follow the existing law. Appeal provision moved to clause 73</p> <p>(6) &amp; (7) New : Closes a gap in (6)</p> <p>(8) &amp; (9) New : Prevent the provisions of (1) being avoided</p> <p>(12) New : Safeguard that allows SFC’s notice served under 9(b) on an unapproved minority controller, etc to take effect only after the clearing of any possible appeals</p> <p>(19) New : Clarification</p>
62	Exemption from section 59(1) and revocation of exemption	ECH(M)O s.7	Existing law.

63	Duties of recognized exchange controller	ECH(M)O s.8	Existing law with duties slightly amended. Exchanges and clearing houses duties stated separately in clauses 21 and 38.
64	Immunity, etc.	ECH(M)O s.8(3); SF(CH)O s.17	(1) Existing law (2) New : Rationalisation with SF(CH)O s.17(4)
65	Establishment and functions of Risk Management Committee	ECH(M)O s.9	Existing law
66	Rules of recognized exchange controllers	New	(1) Consistency with other Divisions of Part III (2) To enable an exchange controller to have participants and apply rules to them
67	Approval of amendments to the rules of recognized exchange controller	ECH(M)O s.10	Modelled on clause 24.
68	Transfer and resumption of functions of Commission	SFCO s.47	Modelled on clause 25.
69	Chairman of recognized exchange controller	ECH(M)O s.11	Existing law
70	Appointment of chief executive or chief operating officer of recognized exchange controller requires approval of Commission	ECH(M)O s.12	(1) & (2) Existing law (3) Appeal provision moved to clause 73
71	Production of records, etc. by recognized exchange controller	New	Modelled on clause 27.
72	Withdrawal of recognition of exchange controller	ECH(M)O s.4	Existing law. (5) New : Complements the gazettal of recognition
73	Appeals	ECH(M)O ss.3(10), 4(6), 6(11), 12(3) & 14(2)	(1) Several appeal provisions in the ECH(M)O are consolidated here (2) New : To ensure finality
74	Provisions applicable where recognized exchange controller, etc. seeks to be listed company	ECH(M)O s.13	Existing law.
75	Commission may give directions to recognized exchange controller where it is satisfied that conflict of interest exists, etc.	ECH(M)O s.14	Existing law (appeal provision moved to clause 73)

76	Fees to be approved by Commission	ECH(M)O s.15	Existing law
77	Financial Secretary may appoint not more than 8 persons to board of directors of recognized exchange controller	ECH(M)O s.20	Existing law
78	Amendment of Schedule 3	ECH(M)O s.16	Existing law
<b>Division 5 – Investor Compensation Companies</b>			
79	Recognition of investor compensation company	New; ECH(M)O s.3	Modelled on clause 37.
80	Transfer and resumption of functions of Commission	New	Modelled on clause 25.
81	Immunity	New; SF(CH)O s.17	Modelled on clause 22.
82	Rules of recognized investor compensation company	New	Modelled on clause 23(1)
83	Approval of amendments to rules of recognized investor compensation companies	New	Modelled on clause 24.
84	Production of records, etc. by recognized investor compensation company	New	Modelled on clause 27.
85	Withdrawal of recognition of investor compensation company	New	Modelled on clause 28.
86	Appeals	New	Modelled on clause 33.
87	Subrogation of recognized investor compensation company to rights, etc., of claimant on payment from compensation fund	New; SO s.118	(1) Modelled on SO s.118 (2) New : To ensure proper procedures are followed
88	Financial statements of a recognized investor compensation company	New	Modelled on clause 152.
89	Employees of and delegations by a recognized investor compensation company	New	To enable the SFC and other companies to assist the ICC with its duties
90	Further activities of recognized investor compensation company	New	To limit the ICC to performing only complementary services

	<b>Division 6 – General – Exchange Companies, Clearing Houses, exchange controllers and investor compensation companies</b>		
91	Supply of information	SFCO s.48	(1) (2) & (3) follow SFCO s.48 expanded to cover investor compensation companies (4) New : Safeguard that ensures the proper handling of the information supplied.
92	Additional powers of Commission – restriction notices	SFCO s.50	(1) – (2), (5) – (10) & (12) – (13) follow the existing law expanded to cover investor compensation companies (3) New : Safeguard that provides for the right of appeal against a restriction notice (4) New : To ensure that the SFC can take action promptly (11) New : Complementary to (10)
93	Additional powers of Commission – suspension orders	SFCO s.51	Existing law (9) New : Consistency with SFCO s.50(7) clause 92(8)
94	Application of Companies Ordinance	SEUO s.4	Existing law in relation to SEHK has been extended to apply to all companies regulated under Divisions 2, 3 , 4 &5 of Part III
	<b>Division 7 – Automated Trading Services</b>		
95	Authorization for providing automated trading services	New	Please see paragraphs 8 and 14 – 17 of the paper for an explanation of the rationale of Division 7
96	Application for authorization	New	
97	Conditions for authorization	New	
98	Withdrawal of authorization	New	
99	Rule-making powers	New	

100	Breach of condition of authorization	New	
<b>Schedule 3 – Exchange Companies, Clearing Houses, Exchange Controllers</b>			
Part 1	Definitions	New	Cross reference
Part 2	Specification of persons who are associated persons	ECH(M)O Part 1 Schedule 1	Existing law.
Part 3	Specification of persons who are not associated persons	ECH(M)O Part 2 Schedule 1	Existing law.
Part 4	Specification of persons who are not indirect controllers	ECH(M)O Part 3 Schedule 1	Existing law.
Part 5	Requirements for default rules of recognized clearing houses	SF(CH)O Schedule 2	Existing law.
Part 6	Provisions applicable where there is contravention of notice under section 59(9)(c), 61(9)(b) or 72(1) of this ordinance	ECH(M)O Schedule 2	Existing law.
Part 7	Specification of persons who are not minority controllers for the purposes of this ordinance	ECH(M)O Part 1 Schedule 3	Existing law.
Part 8	Exemption from section 59(1) of this ordinance	ECH(M)O Part 2 Schedule 3	Existing law.
<b>Schedule 9 Part III - Transitional arrangements</b>		New	