

For information  
on 31 July 2002

**Legislative Council  
Panel on Financial Affairs**

**A tiered regulatory framework  
for the securities and futures industry in Hong Kong**

**Purpose**

This paper outlines the operation of the three-tier regulatory framework for the securities and futures industry in Hong Kong and the underlying policy.

**Tiered regulatory framework**

2. As enshrined in the Securities and Futures Commission Ordinance, the Exchanges and Clearing Houses (Merger) Ordinance and other related legislation<sup>1</sup>, there are three tiers in the regulatory framework for the securities and futures industry.

***First Tier***

3. The Government has broad policy oversight in financial market development and regulation in keeping with our role as a premier financial centre. It is a well-tested policy that the operation of the market should rest with a market operator close to the market and its regulation with an independent regulator staffed with personnel equipped with the requisite expertise and market experience. Through its leading role in introducing legislation into the Legislative Council and processing of public funding items, the Government keeps a policy overview of ensuring the soundness of our regulatory systems. Checks and balances are provided in ensuring a proper distribution of powers and responsibilities.

***Second Tier***

4. The statutory powers of regulation are vested with the SFC in order to ensure its independence. As per the recommendation of the Securities

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<sup>1</sup> Recently re-enacted in the Securities and Futures Ordinance in March 2002.

Review Committee<sup>2</sup>, the SFC was established as a statutory body outside the civil service. SFC is responsible for regulating the market operators, such as the exchanges and clearing houses, and the intermediaries, to ensure an efficient, fair, orderly and transparent market for all market participants. For the SFC to perform its regulatory functions effectively, the existing securities and futures legislation vests in the SFC a panoply of necessary regulatory powers, including powers to recognise exchanges and clearing houses, approve exchange rules, investigate market misconduct, etc.

5. The SFC is principally the regulator of the securities and futures market and has to act independently in performing its regulatory functions. To avoid undermining the independence of the day-to-day exercise of its regulatory powers, the Secretary for Financial Services and the Treasury does not sit in the Commission's governing board or its advisory committee. The Commission keeps the policy bureau updated of its broad policy direction through regular liaison meetings and dialogue.

### *Third Tier*

6. The Hong Kong Exchanges and Clearing Limited (HKEx) and its subsidiaries are the front-line market operator which performs certain public functions, such as managing the clearing infrastructure, risk management and market surveillance, to ensure a robust, fair and orderly market. HKEx is governed by its Board of Directors and seeks advice from the Risk Management Committee, the Listing Committees and other consultative panels in performing its functions. If necessary, the SFC may require market operators to take remedial action in relation to their constitution, governance, rules, conduct and operation of business.

7. The tiered framework has served the securities and futures industry well since the establishment of the SFC in 1989. The Administration has no intention to change it. We are, however, keeping the implementation of the system under review with the SFC and HKEx to see how we may do better in implementing the tiered framework.

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<sup>2</sup>. On 16 November 1987, following the October stock market crash, the then Governor established the Securities Review Committee (the "SRC") to review, among other things, the constitution, powers, management and operation of the government offices responsible for regulating respectively the securities and futures markets at the time; and to recommend changes that were desirable to ensure the integrity of the markets and to protect investors. The SRC published its Report in May 1988 and recommended, among other things, the establishment of a new market regulator outside the civil service to replace the then Securities Commission, the Commodities Trading Commission and the Office of the Commissioner for Securities and Commodities Trading.

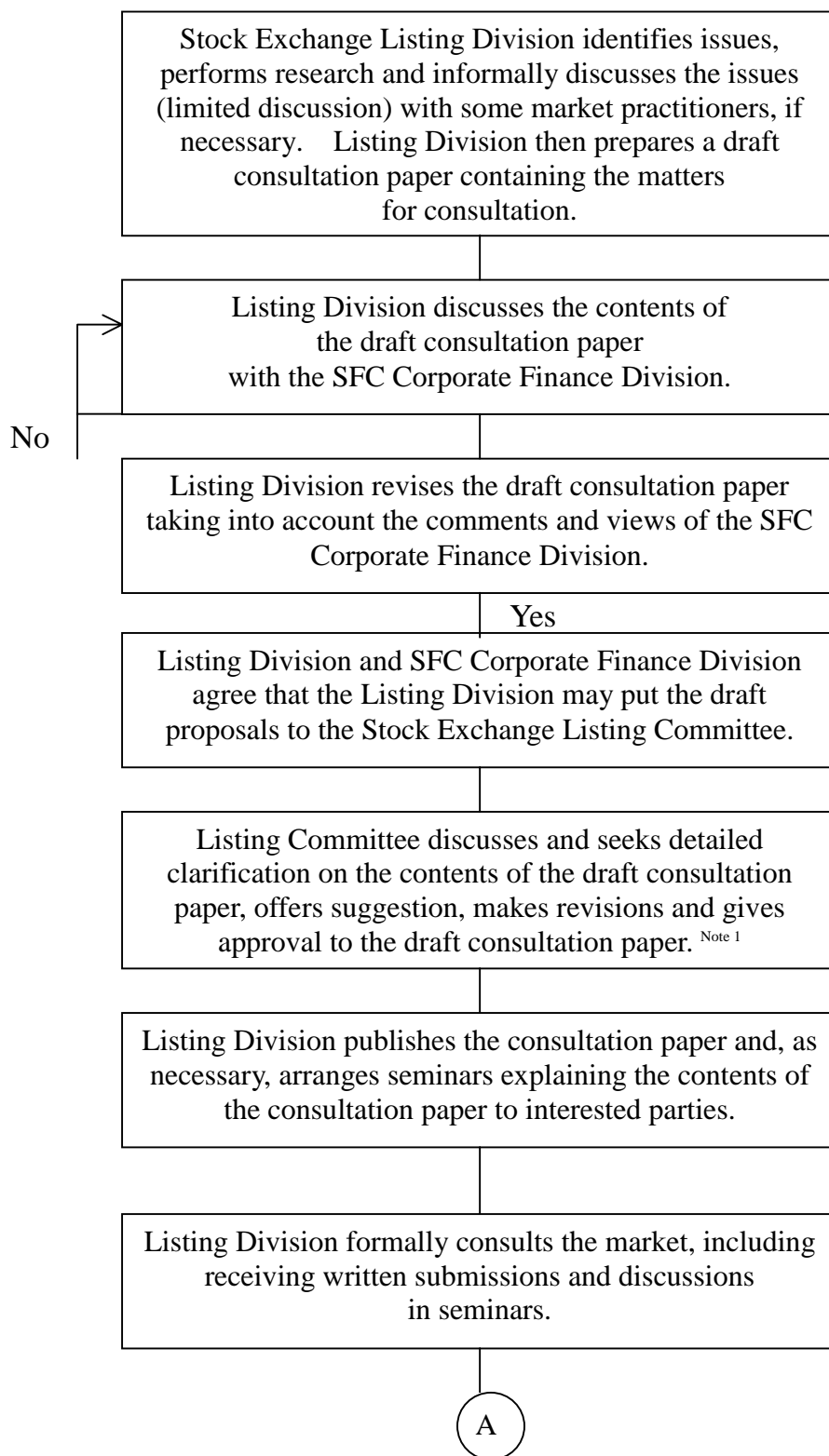
8. In the case of the making of rules by HKEx, a chart showing HKEx's process of issuing consultation papers and approving proposed Listing Rule changes is at Annex.

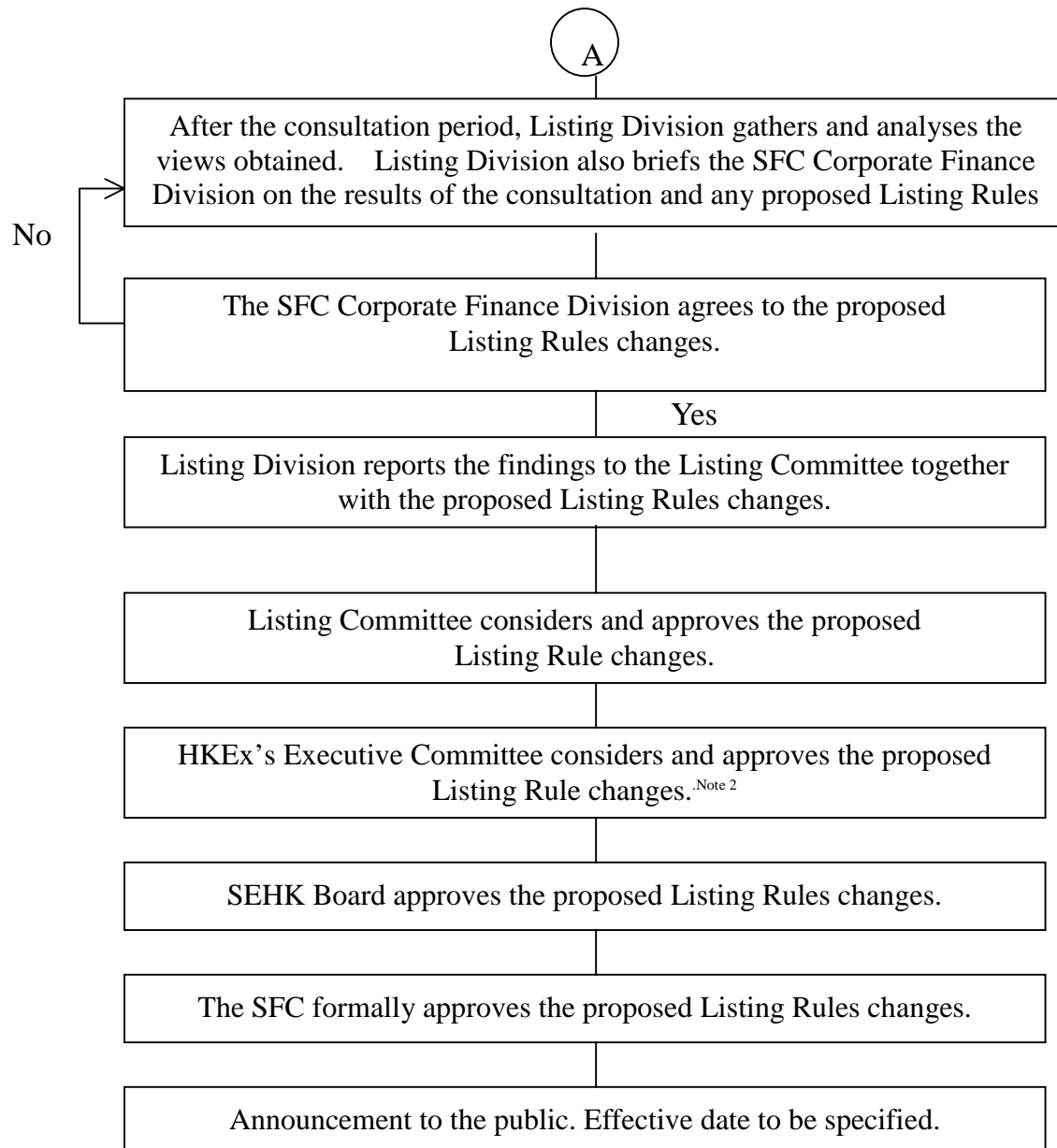
### **Proposed Changes to HKEx Rules on Continuing Listing and Cancellation of Listing Matters**

9. In respect of HKEx's July 2002 delisting proposals, the Government supports the establishment of an effective mechanism for listing and delisting that closely reflects market consensus and protects investors' interests. Overall, this will help enhance corporate governance and improve market quality. The processing of the consultation paper on this matter follows the usual procedures as outlined in the chart at Annex. The proposal will require amendments to HKEx rules for implementation. As provided in the Exchanges and Clearing Houses (Merger) Ordinance, all HKEx rules will not take effect unless they are approved by the SFC, and the SFC will have to consider their purpose and likely impact on the market before granting approval to HKEx. In line with the spirit of the three-tier structure, the Government did not participate in the deliberation of the proposals in HKEx consultation papers.

Financial Services Branch  
Financial Services and the Treasury Bureau  
31 July 2002

### Flowchart for Issuing Consultation Papers and Approving Proposed Listing Rules Changes





Note 1: Listing Committee comprises members from exchange participants, listed company representatives or market practitioners. Listing Rule 2A.01 states that, inter alia, SEHK Board has arranged for all of its powers and functions in respect of all listing matters to be discharged by the Listing Committee.

Note 2: Since the merger of the exchanges and the clearing houses, the HKEx Board has authorized that any Listing Rules changes have to be approved by HKEx's Executive Committee prior to their approval by SEHK Board.