

**For discussion
on 24 November 2014**

Legislative Council Panel on Economic Development

**Subsidiary Legislation Proposals
under the Competition Ordinance**

Purpose

This paper briefs Members on the Administration's proposal to introduce three pieces of subsidiary legislation into the Legislative Council ("LegCo") as part of the preparatory work before the full implementation of the Competition Ordinance ("Ordinance")(Cap. 619).

Preparatory work for the full commencement of the Ordinance

2. The Ordinance, enacted on 14 June 2012, provides a legal framework to tackle anti-competitive conduct in all sectors. The Ordinance provides for general prohibitions in three major areas described as the first conduct rule, the second conduct rule and the merger rule.

3. The Ordinance was designed to be implemented in phases. The Administration, the Judiciary and the Competition Commission have been working on the preparatory work necessary for the full commencement of the Ordinance. On the part of the Administration, we will introduce the subsidiary legislation as detailed below.

Regulation to apply the key provisions of the Ordinance to six statutory bodies

4. Section 3(1) of the Ordinance provides that certain provisions in the Ordinance ("key provisions") do not apply to a statutory body. Those key provisions are Part 2 (relating to the first and second conduct rules), Part 4 (relating to the enforcement powers of the Competition Commission), Part 6 (relating to the enforcement before the Competition Tribunal), and Schedule 7 (relating to the merger rule) of the Ordinance. The Chief Executive ("CE") in Council may, under section 5(1)(a) of the Ordinance, make regulation to apply the key provisions to any statutory body, if he is satisfied that the criteria set out in section 5(2) of the Ordinance are met.

5. During the deliberation of the then Competition Bill in 2012, we briefed LegCo that the Administration intended to apply the key provisions of the Ordinance to six statutory bodies on the ground that they meet the criteria of section 5(2) of the Ordinance. The six statutory bodies are -

- (i) Ocean Park Corporation (established under the Ocean Park Corporation Ordinance (Cap. 388));
- (ii) Federation of Hong Kong Industries (established under the Federation of Hong Kong Industries Ordinance (Cap. 321));
- (iii) The general committee of the Federation of Hong Kong Industries (established under the Federation of Hong Kong Industries Ordinance (Cap. 321));
- (iv) Matilda and War Memorial Hospital (incorporated under the Matilda and War Memorial Hospital Ordinance (Cap. 1035));
- (v) Kadoorie Farm and Botanic Garden Corporation (established under the Kadoorie Farm and Botanic Garden Corporation Ordinance (Cap. 1156)); and
- (vi) The Helena May (incorporated under The Helena May Incorporation Ordinance (Cap. 1021))

6. The Administration reminded the six statutory bodies in early August 2014 of the plan to apply the key provisions of the Ordinance to them, and invited them to provide supplementary information if they wish to. After reviewing the feedback from the six bodies, the Administration considers that the conditions for applying the key provisions of the Ordinance to these bodies continue to be valid.

Regulation to disapply the key provisions of the Ordinance to bodies which are not statutory bodies

7. Section 5(1)(b) of the Ordinance provides that the CE in Council may by regulation disapply the key provisions of the Ordinance to any person or any person to the extent that the person is engaged in an activity specified in the regulation. This section applies to bodies which are not statutory bodies, and provides a mechanism to disapply the key provisions of the Ordinance to these bodies where there is a justifiable cause to do so.

8. In this connection, the Administration proposes to disapply the key provisions of the Ordinance to the recognized exchange companies

(“RECs”)^{Note (1)}, recognized clearing houses (“RCHs”)^{Note (2)} and recognized exchange controller (“RXC”)^{Note (3)} regulated under the Securities and Futures Ordinance (“SFO”)(Cap. 571) on public interest grounds. These bodies are -

(i) RECs

- The Stock Exchange of Hong Kong Limited (“SEHK”); and
- Hong Kong Futures Exchange Limited (“HKFE”)

(ii) RCHs

- Hong Kong Securities Clearing Company Limited (“HKSCC”);
- HKFE Clearing Corporation Limited (“HKCC”);
- The SEHK Options Clearing House Limited (“SEOCH”); and
- OTC Clearing Hong Kong Limited (“OTCC”)

(iii) RXC

- Hong Kong Exchanges and Clearing Limited (“HKEx”)

9. The RECs, RCHs and RXC are engaged in economic activities and are undertakings in the context of the Ordinance. They however are systemically important financial market infrastructures which need to operate under a high degree of legal certainty for financial stability and systemic risk management reasons. The specific roles of these bodies in developing a safe and efficient financial infrastructure in Hong Kong are reflected in the duties and functions imposed on them under the SFO. Among other things, it is required that: (i) the RECs shall ensure, so far as reasonably practicable, an

Note (1) An REC is a company that is recognized by the Securities and Future Commission (“SFC”) as an exchange company under the SFO (e.g. a company recognized by the SFC to operate a stock market or a futures market in Hong Kong). There are currently only two RECs, i.e. (i) the SEHK, which operates Hong Kong’s only stock market, and (ii) the HKFE, which operates Hong Kong’s only futures market.

Note (2) An RCH is a company that is recognized by the SFC as a clearing house under the SFO (e.g. a clearing house for the clearing and settlement of transactions in securities, futures contracts or over-the-counter (“OTC”) derivatives). There are currently four RCHs, i.e. (i) the HKSCC, which provides clearing and settlement services for transactions in securities (other than stock options); (ii) HKCC, which provides clearing and settlement services for transactions in futures contracts; (iii) the SEOCH, which provides clearing and settlement services for transactions in stock options; and (iv) the OTCC, which provides clearing and settlement services for OTC derivatives transactions.

Note (3) An RXC is a company that is recognized by SFC as a controller of an REC or RCH under the SFO. As RECs and RCHs are important market infrastructures for the securities, futures and derivatives market, and systemically important to the financial stability of Hong Kong’s financial markets, it is necessary to ensure that their controller is also subject to regulation under the SFO. Currently, the HKEx is the only RXC. It is the holding company of all existing RECs and RCHs (holding 75% of OTCC, and 100% of each of SEHK, HKFE, HKSCC, HKCC and SEOCH).

orderly, informed and fair market in securities or futures contracts that are traded on the stock or futures market they operate or through the facilities of the RECs concerned; (ii) the RCHs shall ensure, so far as reasonably practicable that there are orderly, fair and expeditious clearing and settlement arrangements for any transactions in securities, futures or derivatives contracts cleared or settled through their facilities; (iii) both RECs and RCHs shall ensure that their business and operation risks are managed prudently; and (iv) the RXC shall ensure that the RECs and RCHs comply with their statutory obligations and legal requirements. All RECs, RCHs and RXC are required by the SFO to act in the interest of the public, and they shall, in discharging their duties, ensure that the interest of the public prevails where it conflicts with their interests as set out in sections 21(2), 38(2) and 63(2) of the SFO.

10. Under the SFO, there is a specially calibrated regime for regulating the securities, futures and derivative markets. The regulatory objectives of the Securities and Futures Commission (“SFC”) under the SFO are, among other things, to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry with special attention to the stability of the financial system and the protection of the interest of members of the public. The SFO provides the SFC with sufficient powers to ensure that the RECs, RCHs and RXC do not engage in anti-competitive activities. Rules of these bodies have to be approved by the SFC before they can be implemented. In addition, the SFC has various functions under the SFO to regulate the conduct and activities of the RECs, RCHs and RXC. For example, the SFC can direct the RECs, RCHs and RXC to cease to provide certain services or to operate certain facilities, in addition to withdrawing their recognition status. Specifically on competition, section 6(2) of the SFO states that in pursuing its regulatory objectives and performing its functions, the SFC shall have regard to, among other factors, the principle that competition among persons carrying on activities regulated by the SFC under any of the relevant provisions should not be impeded unnecessarily. Also, as required by section 4 of the SFO, in pursuing its regulatory objectives, the SFC shall provide protection for members of the investing public. Section 76 of the SFO further provides that an REC, RCH or RXC may not impose any fees unless those fees are specified in its rules and has the approval of the SFC. In approving such fees, the SFC is required to have regard to, among other things, first, the level of competition in Hong Kong for the matter for which the fee is to be imposed, and second, the level of fee imposed by another REC, RCH or RXC, or any similar body outside Hong Kong, for the same or a similar matter to which the fee relates.

11. The SFO takes a preventive approach in its regulation of the RECs, RCHs and RXC as it requires SFC approval for all their rules and fees before they can be implemented and imposed. Competition is an element in a balance of factors to be considered to ensure a safe and efficient financial

infrastructure in Hong Kong. The RECs, RCHs and RXC play a key role in maintaining Hong Kong's position as an international financial centre. The Administration is satisfied that RECs, RCHs and RXC should continue to be regulated under the SFO framework. The SFC is establishing a regular dialogue with the Competition Commission to discuss competition matters relating to the RECs, RCHs and RXC.

Regulation to be made on turnover of undertakings

12. Turnover of an undertaking is the measurement of eligibility for the exclusions of “agreements of lesser significance” and “conduct of lesser significance” under sections 5 and 6 of Schedule 1 to the Ordinance, namely, the first conduct rule does not apply to an agreement between undertakings if their combined turnover for the relevant turnover period does not exceed \$200 million; and the second conduct rule does not apply to conduct of an undertaking the turnover of which does not exceed \$40 million for the relevant turnover period. Turnover is also the basis for determining the cap on pecuniary penalties under section 93 of the Ordinance. The maximum amount of pecuniary penalty imposed in relation to conduct that constitutes a single contravention may not exceed in total 10% of the turnover obtained in Hong Kong by the undertaking concerned for each year in which the contravention occurred, for up to three years.

13. Section 163 of the Ordinance provides that the Secretary for Commerce and Economic Development may make a regulation to provide for the determination of the turnover of an undertaking.

14. The Administration has drawn reference from the Hong Kong Accounting Standards and overseas competition laws, and intends to make a regulation to clarify that -

- (a) for the purpose of exclusions under sections 5 and 6 of Schedule 1 to the Ordinance, such turnover would refer to the amounts derived by the undertaking from the undertaking's ordinary activities whether in Hong Kong or outside Hong Kong, after deduction of sales rebates and taxes directly related to turnover; and
- (b) for the purpose of determining the cap of pecuniary penalty, the turnover of an undertaking will be confined to that obtained in Hong Kong. In practice, the turnover obtained in Hong Kong will include sales of an undertaking to customers in Hong Kong as well as its export sales made from Hong Kong.

15. The regulation will also clarify that in case an undertaking consists of two or more undertakings that each prepares accounts, the turnover of the undertaking concerned should be calculated by adding together the respective turnover of each, but that the turnover arising from intra-group transactions would be excluded. For new undertakings which may not have active economic activities to generate turnover throughout the preceding financial year or calendar year, only the actual turnover in the preceding year will be counted for the purpose of the Ordinance, despite the fact that such a turnover period will be less than 12 months.

Timetable

16. The Administration plans to introduce the above-mentioned three pieces of subsidiary legislation into LegCo in early 2015.

**Commerce and Economic Development Bureau
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