

REGULATION OF THE SECURITIES MARKET IN THE UNITED STATES

The United States (US) Congress makes laws on the regulation of the financial services industry. The securities market is regulated by the Securities and Exchange Commission (SEC), which is the primary overseer and regulator of the US securities market. The SEC's mission is to protect investors and maintain the integrity of the securities market.

HISTORICAL BACKGROUND

2. Before the Great Crash of 1929, there was little support for federal regulation of the securities market. Tempted by the promises of “rags to riches” transformations and easy credit, most investors gave little thought to the danger inherent in uncontrolled market operation. It is estimated that of the US\$50 billion (HK\$390 billion) in new securities offered during the 1920s, half became worthless.

3. Following the Great Crash, public confidence in the market plummeted. There was a consensus that for the economy to recover, the public's faith in the capital market needed to be restored. The Congress held hearings to identify the problems and search for solutions. Based on the findings in these hearings, the Congress passed the Securities Act 1933 and the Securities Exchange Act of 1934. As stated in section 2 of the Securities Exchange Act, transactions in securities “are affected with a national interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters relating thereto”. The laws were designed to restore investor confidence in the capital market by providing more structure and government oversight. The Congress also established the SEC in 1934 to enforce the securities laws, to promote stability in the market and to protect investors. The two Acts continue to provide the basis for the regulation of the securities market to this day.

SECURITIES ACT OF 1933

4. The 1933 Act has two basic objectives –
 - (a) ensuring that investors receive financial and other significant information concerning securities being offered for public sale; and
 - (b) prohibiting deceit, misrepresentations and other frauds in the sale of securities.

5. A primary means of achieving these goals is the disclosure of important financial information through the registration of securities. In general, the Act prohibits any public distribution of securities that has not been registered with the SEC. Registration with the SEC requires –
 - (a) a description of the company's properties and business;
 - (b) a description of the security to be offered for sale;
 - (c) information about the management of the company; and
 - (d) financial statements certified by independent accountants.

SECURITIES EXCHANGE ACT 1934

6. This Act provides for, inter alia, the creation of the SEC. It gives the SEC broad authority over all aspects of the securities industry, including the power to register, regulate and oversee brokerage firms, transfer agents and clearing agencies, as well as the self-regulatory organisations (SROs) which include the stock exchanges and the National Association of Securities Dealers, Incorporated (NASD), Municipal Securities Rulemaking Board (MSRB), and clearing agencies (SROs that help facilitate trade settlement).

MAIN PARTIES INVOLVED IN THE REGULATION OF THE SECURITIES MARKET

A. The SEC – market regulator and overseer of SROs

7. The SEC is comprised of five presidentially-appointed Commissioners, four Divisions and 18 Offices. It is based in Washington, DC and has 11 regional and district offices throughout the country.

8. The five Commissioners are appointed by the President with the advice and consent of the Senate. Their terms last five years and are staggered with one Commissioner's term ending on 5 June each year. To ensure that the Commission remains non-partisan, no more than three Commissioners may belong to the same political party. The President designates one of the Commissioners as Chairman, who is the Commission's top executive.

9. The Commissioners meet to discuss and resolve a variety of issues brought to their attention by staff of the Commission. At these meetings the Commissioners –

- (a) interpret federal securities laws;
- (b) amend existing rules;
- (c) propose new rules to address changing market conditions; and
- (d) enforce rules and laws. (There is a statutory framework, including the Securities Act of 1933, that provides for the SEC's oversight of the securities market. As the statutory regulator, the SEC engages in rule-making to maintain fair and orderly market and to protect investors by altering regulations or creating new ones.)

The meetings are open to the public and the media unless the discussion pertains to confidential subjects, such as whether to begin an enforcement investigation.

10. The Division of Corporation Finance oversees corporate disclosure of important information to the investing public. It reviews documents that publicly-held companies are required to file with the Commission, including registration statements of newly-offered securities, annual, quarterly or interim filings, proxy materials sent to shareholders before an annual meeting, annual reports to shareholders, documents relating to tender offers and filings relating to mergers and acquisitions. Connected transactions, mergers and acquisitions, and corporate actions in general are matters for the law of the state in which the issuer is incorporated. The relevant proxy solicitations (i.e. circulars setting out matters on which shareholders are requested to vote) are however subject to SEC regulation.

11. The Division of Market Regulation establishes and maintains standards for a fair, orderly and efficient market by regulating the major securities market participants: broker-dealer firms, SROs, transfer agents (parties that maintain records of stock and bond owners) and securities information processors. Its major activities include –

- (a) carrying out the Commission's financial integrity programme for stockbrokers;
- (b) reviewing and approving proposed new rules and proposed changes to existing rules filed by SROs;
- (c) establishing rules and issuing interpretations on matters affecting the operation of the securities market; and
- (d) monitoring market activities.

12. The Division of Investment Management oversees and regulates the US\$15 trillion (HK\$117 trillion) investment management industry and administers the securities laws affecting investment companies and investment advisers. It also exercises oversight of registered or exempt utility holding companies under the Public Utilities Holding Company Act of 1935.

13. The Division of Enforcement investigates possible violations of securities laws, and recommends Commission action where appropriate. Under the securities laws, the Commission can bring enforcement actions either in the federal courts or internally before an

administrative law judge. It also negotiates settlements on behalf of the Commission. While the SEC has civil enforcement authority only, the Division works closely with various criminal law enforcement agencies to develop and bring criminal charges when the misconduct warrants more severe action.

B. SROs – Self-regulators overseen by SEC

14. An SRO is a member organisation that creates and enforces rules for its members based on the federal securities laws. SROs are registered and overseen by the SEC and are the front line regulator of broker-dealers. The exchanges and the NASD are SROs. SROs must create rules that allow for disciplining members for improper conduct and for establishing measures to ensure market integrity and investor protection. SROs' proposed rules or changes to existing rules are published for public comment before final SEC review and approval. The SEC may also amend the rules of SROs as it deems necessary or appropriate. A rule so adopted should include a statement of the reason for or purpose in so amending the rule.

New York Stock Exchange

15. The New York Stock Exchange (NYSE) is the largest exchange, and is responsible for the supervision of member firms to enforce compliance with financial and operation requirements, periodic checks on broker's sales practices and continuous monitoring of specialist operations. Every transaction made at the NYSE is under continuous surveillance during the trading day.

16. The NYSE has its origin in a founding agreement in 1792. It registered as a national securities exchange with the SEC in 1934. In 1971, it was incorporated as a not-for-profit corporation. In 1972, its board members voted to replace the Board of Governors with a 25 member Board of Directors, comprising a Chairman and CEO, 12 representatives of the public and 12 representatives from the securities industry. Its mission is to add value to the capital-raising and asset-management processes by providing the highest-quality and most cost-effective self-regulated marketplace for the trading of financial instruments, promote confidence and understanding in the processes, and serve as a forum for discussion of relevant national and international policy issues.

National Association of Securities Dealers, Incorporated

17. The National Association of Securities Dealers, Incorporated (NASD) is a non-profit organisation of which virtually all securities firms doing business with the public are members. Its membership includes 5 300 brokerage firms, with over 92 000 branch offices and more than 664 000 registered securities representatives. It provides education to industry professionals and investors. It operates the largest securities dispute resolution forum with arbitration and mediation programmes in the world, and also monitors all tradings on the Nasdaq Stock Market and other selected markets worldwide. Until recently, NASD was known as the owner of Nasdaq. In 2000, it decided to sell Nasdaq in order to concentrate solely on its core mission – ensuring market integrity and investor confidence.

C. The Executive Branch and the Legislature

18. The executive branch is not involved in the day-to-day regulation of the securities market, nor the establishment of rules governing the operation of the securities market and SROs (including the exchanges). The regulatory function is performed by the SEC which is an independent statutory body set up by statute.

19. Neither the executive branch nor the legislature has any power of direction over the SEC. The checks and balances under constitutional and administrative law doctrines are ensured through the power to appoint the Commissioners and to require the SEC to make reports and give evidence to the legislature. The SEC will consult the Secretary of the Treasury if the proposed changes to rules filed with the SEC by registered securities associations primarily concern conduct relating to transactions in government securities. There is no statutory requirement for the SEC to consult the Secretary of the Treasury on other changes to the rules proposed by the SROs.

LISTING AND DELISTING

20. Before securities may be admitted to trading on an exchange, they must be authorised for listing by the exchange and, in addition, must be registered under the Securities Exchange Act of 1934. An issuer is

required to file an application with the exchange and file with the SEC a duplicate original of a registration statement conforming to the rules of the SEC. Having received the application and sufficient supporting documents, the exchange will authorise the company's securities for listing and certify such authorisation to the SEC. Registration becomes effective automatically 30 days after receipt by the SEC of the exchange's certification, but may become effective within a shorter period, by order of the SEC, upon request made by the company to the SEC. Once the registration process is completed, the company's securities can be traded. The original listing date can be set for a day any time after the effectiveness of registration.

21. The exchanges set their own standards for listing and continuing to trade, such as rules governing corporate governance standards, board meetings, audit and other committees, concentration of voting power, voting rights, etc. The SEC does not set listing standards. The initial listing requirements mandate that a company meets specified minimum thresholds for the number of publicly traded shares, total market value, stock price and the number of shareholders. Some exchanges such as the NYSE have broad discretion regarding the listing of a company. An exchange may deny listing or apply additional listing criteria even if the company meets all the stipulated listing standards. After a company starts trading, it must continue to meet the various standards set by the exchanges. These continuing standards are usually less stringent than the initial listing requirements.

22. When a company fails to meet any of the continued listing criteria, the exchange may suspend its securities from dealings or remove the securities from the list at any time. In the case of delisting, the exchange will suspend trading in the security and submit an application to the SEC to strike the security from listing and registration.

23. Although the SEC does not set listing standards, it is involved in the process of changing the rules, including listing rules, set by the exchanges in the following ways –

- (a) all proposed new rules or changes to existing rules of the registered exchanges have to be reviewed and approved by the SEC;
- (b) the SEC may amend the rules of registered exchanges as it

deems necessary or appropriate; and

- (c) the SEC may ask the registered exchanges to review their rules, including those relating to listing standards. For instance, in the aftermath of the “meltdown” of significant companies due to failures of diligence, ethics and controls, the former SEC Chairman, Mr. Harvey Pitt, asked the NYSE on 13 February 2002 to review its corporate governance listing standards. Pursuant to that request, the NYSE appointed a Corporate Accountability and Listing Standards Committee to review the NYSE’s listing standards, along with recent proposals for reform, with the goal of enhancing the accountability, integrity and transparency of the companies listed on the exchange. Following the review, the NYSE has filed the Corporate Governance Proposals for new corporate governance listing standards with the SEC for review and approval.

24. Listing, or delisting, is an arrangement between the exchanges and the applicants/listed companies. The setting and enforcement of listing rules are primarily the responsibilities of exchanges which also serve as “self-regulators” in operating the market and administering the listing regime. As stated above, the SEC does have some control over the setting of listing rules as the rules proposed by the exchanges are subject to its review, amendment and approval. Backed by statutory enforcement powers, the SEC can investigate any potential securities violation “as it deems necessary” and can impose a wide range of sanctions. The law also provides that wilful and knowing violations of securities law are criminal offences subject to prosecution, and that investors who have suffered losses in the purchase or sale of securities in reliance on false or misleading statements and reports may initiate class action suits to seek damages.

REGULATION OF INVESTMENT MARKETS IN THE UNITED KINGDOM

In the United Kingdom (UK), the HM Treasury is responsible for the overall institutional structure of regulation in the field of financial stability, and the legislation which governs it.

2. The Financial Services and Markets Act (FSMA), which came into force on 1 December 2001, sets out the statutory framework for the regulation of the financial markets, and provides for the establishment of the Financial Services Authority (FSA) as the single statutory regulator directly responsible for the regulation of deposit-taking, insurance and investment businesses. It is an independent non-governmental body (a company limited by guarantee and financed by levies on the industry) accountable to the Treasury and, through it, to the Parliament. Although the members of its board are all appointed by the Chancellor of the Exchequer, the FSA is not subject to the executive authority of the Treasury. There are however a variety of circumstances where the FSA will need to alert the Treasury about possible problems, such as serious problems which could cause wider economic disruption, diplomatic or foreign relations problems, or a problem that might suggest the need for a change in law, etc. The government's power of oversight lies in the requirement for the FSA to produce an annual report on its work to the Treasury, which has to be laid before the Parliament, and the Treasury's power to commission investigations into activities that may give rise to public concern, and independent reviews of the FSA's resource management.

BACKGROUND FOR SETTING UP THE FSA

3. Prior to the coming into effect of the FSMA, the responsibility for the regulation of the financial matters was shared by several organisations, namely the Bank of England, the Securities and Investments Board (which became the FSA), Self-Regulating Organisations (SROs)¹, the Department of Trade and Industry Insurance

¹ Self-regulatory organisations include the Investment Management Regulatory Organisation, Personal Investment Authority, and Securities and Futures Authority.

Directorate, the Building Societies Commission, the Friendly Societies Commission and the Registry of Friendly Societies. Their powers had derived from different pieces of legislation, and each had approached its regulatory tasks in its own distinctive way.

4. The FSA is in corporate and legal terms the Securities and Investments Board renamed. The purpose of creating a single regulator was to produce a more coherent and cost-effective approach to regulation, and to remove the scope for duplication, gaps and inconsistency that had affected the old system. The FSA acquired its responsibility for supervising banks, listed money market institutions and related clearing houses from the Bank of England, and the regulatory and registration functions from the SROs (including the listing function of the London Stock Exchange (LSE)). The FSA's assuming all of the listing regulatory functions formerly performed by the LSE has removed the potential for conflict of roles on the part of LSE, particularly in light of pressures to relax listing standards, and has recognised that statutory regulators can better weigh public interest arguments than a profit-seeking exchange.

FSA'S STATUTORY OBJECTIVES

5. The FSMA requires the FSA to pursue four objectives –
- (a) to maintain confidence in the UK financial system;
 - (b) to promote public understanding of the financial system;
 - (c) to secure an appropriate degree of protection for consumers while recognising their own responsibilities; and
 - (d) to reduce the scope for financial crime.

Regulatory Approach

6. To achieve the goal of maintaining efficient, orderly and clean financial markets, and help retail consumers achieve a fair deal, the FSA has embarked on a risk based approach to regulation, which recognises both the proper responsibilities of consumers and of a firm's

own management, and the impossibility and undesirability of removing all risks and failure from the financial system. It switches resources from reactive post-event actions towards front-end intervention, and creates incentives for firms to manage their own risks better thereby reducing the burden of regulation.

Responsibilities of the FSA

7. A summary of the responsibilities of the FSA is at Appendix.

8. As far as the investment markets are concerned, the FSA is responsible for –

- (a) supervising exchanges, clearing and settlement houses and other market users and practitioners –

The FSA recognises and supervises eight Recognised Investment Exchanges (RIEs). These are organised markets on which member firms can trade investments such as equities and derivatives. Examples are the LSE and the London Metal Exchange. The FSA is also responsible for recognising and supervising Recognised Clearing Houses which organise the settlement of transactions on RIEs. It also has the responsibility for applications from, and supervision of, recognised overseas investment exchanges (such as the Sydney Futures Exchange and Nasdaq) and recognised overseas clearing houses regarding cross-border trading.

- (b) conducting market surveillance and transaction monitoring –

The FSA analyses transactions collected from authorised firms, RIEs and settlement systems to look for unusual trading activities. It has issued the Code of Market Conduct which sets out the standards required of all market participants and monitors compliance with powers to impose financial penalties.

LISTING OF SECURITIES

9. Unlike the United States where the stock exchange is responsible for assessing the eligibility of an issuer to be listed whilst the regulator is responsible for information disclosed to the market by the issuer, all responsibilities for primary market regulation in the UK lie with the UK Listing Authority (UKLA), a division of the FSA which is the competent authority responsible for admission of securities to the official list. There is a distinction between “admission to listing” and “admission to trading”. The former process is to ensure that minimum standards for the protection of investors are met and to provide for mutual recognition of the listing status across the European Union. The latter process is for a stock exchange to decide whether trading of a security should be permitted on its trading board.

10. The UKLA establishes and updates listing rules which govern the listing of securities with the regulatory objectives to –

- (a) provide an appropriate level of protection for investors in securities;
- (b) facilitate access to capital markets for a broad range of enterprises; and
- (c) seek to maintain the integrity and competitiveness of UK markets for listed securities.

Under the FSMA, the FSA has a duty to publicly consult on any proposed changes to the rules or the issuing of guidance, and to conduct and publish cost benefit analysis.

11. More specifically regarding the listing and delisting of securities, the UKLA’s responsibilities include –

- (a) Admitting securities to the official list for listing. The UKLA considers applications for listing by examining and approving prospectuses, listing particulars and equivalent offering documents to ensure that the issuer has met all the relevant conditions as set out in the listing rules before it is admitted to the official list. The power to make non-disciplinary decisions (e.g. listing approval) rests with the

relevant FSA executives, with appeal to the Listing Authority Review Committee (LARC). The UKLA seeks to ensure that listed companies comply with their on-going obligations under the listing rules (including the provision of a regular flow of relevant information into the market), and has the power to impose a financial penalty on a listed company or its directors for breaches of the listing rules. The FSMA requires the FSA to publish a policy statement setting out the factors to be taken into account in its decisions to impose financial penalties.

- (b) Regulation of sponsors and advisers. Sponsors and advisers cannot provide services to issuers unless they are approved by the FSA, as “fit and proper”.
- (c) Imposing and enforcing ongoing obligations on issuers to promote full, accurate and timely disclosure to the market of all relevant information through the continuing obligations set out in the listing rules. As with the vetting of prospectuses for listing, the UKLA does not investigate or verify the accuracy or completeness of the information given, but it reserves the right to require additional information.
- (d) Suspending and cancelling listing to protect investors from trading without access to full and complete information. The UKLA will suspend securities from the official list if there is not enough information available to ensure an orderly market. It will cancel a company’s securities if there are special circumstances which prevent normal dealings in them. The power to make disciplinary decisions rests with a Regulatory Decisions Committee (RDC).

Firms which are aggrieved by the regulatory decisions of the LARC or RDC may appeal to the Financial Services and Markets Tribunal. Review is on the full merits of the case. Parties may introduce new evidence and the Tribunal can affirm, reverse, or otherwise alter any determinations of the LARC or RDC.

12. Officially listed securities are traded on the RIEs including the LSE's main market, virt-x and CoredealMTS. These exchanges choose whether or not they wish to admit an officially listed security to trading on their market, but have no role in the admission of securities to the official list.

LONDON STOCK EXCHANGE

13. The LSE is one of the world's leading equity exchanges and the most international of all stock exchanges, with about 470 companies from over 60 countries admitted to trading on its various trading boards. It is a publicly listed company and, in the context of the FSMA, one of the RIEs recognised and supervised by the FSA.

Historical Background

14. Prior to the setting up of the FSA, the LSE was a private limited company, and was the Competent Authority for Listing in the UK. In July 1999, the LSE announced its intention to move from its mutual ownership to a new basis of transferable share ownership, ending the traditional link between usage and ownership of the Exchange. The purpose was to move the Exchange towards a more commercial basis of operation that would allow greater speed and flexibility in its decision-making process, which had become essential because of the increasing competition and demand for more efficient delivery of services and more innovative products. After announcing its intention to demutualise, the Exchange had discussed with the Treasury about its statutory role as the Competent Authority for Listing. In the light of the new ownership structure that the Exchange intended to create, and its intended move to a more commercial basis of operation, the Treasury agreed with the LSE to transfer the role of Listing Authority to the FSA. In 2000, the LSE transferred its role as the UK Listing Authority to the FSA and became a public limited company. It was listed in July 2001. Notwithstanding the transfer of the listing functions, the Exchange has continued to set its own requirements for companies quoted on its trading boards, including the right to decide whether or not to admit a listed security to trading and to make and enforce its own rules.

RELATIONSHIP BETWEEN THE FSA AND LSE IN THE REGULATION OF LISTING/TRADING

15. The FSMA provides the framework for the regulation of the securities market. It is a criminal offence to carry on a regulated activity without authorisation or exemption. Most of the statutory powers are held by the FSA, to which the LSE is answerable as an RIE. To become and remain an RIE, an exchange must satisfy the FSA that it meets the various prerequisites set out in the FSMA, including effective arrangements for monitoring and enforcing compliance with its rules.

(a) Admission to trading

Admission to trading on the main market is a two-stage process. A company which wants to have its securities admitted to trading on the LSE has to apply to the FSA for the admission of its securities to the Official List by the UKLA of the FSA. Having obtained admission to the Official List, the company would need to seek admission to trading on the Exchange.

(b) Continuing Obligations

After admission to trading, the companies must comply with continuing obligations which include timely publication of price sensitive information in accordance with the UKLA's listing rules, and disclosure of information as set out in the Admission and Disclosure Standards (Standards) devised and enforced by the Exchange which are applicable to companies admitted to trading on the main market. The purpose of requiring companies to comply with continuing obligations is to give their investors proper information for determining the current value of the securities.

(c) Enforcement

The Exchange monitors compliance with the Standards. It can censure a company for breaching the Standards by suspending trading in the company's securities and, in extreme cases, cancel the right of a company's securities to be traded.

16. The FSA has issued in July 2002 a discussion paper entitled “Review of the Listing Regime” for public comments. It was noted in the paper that “there remains a degree of uncertainty in the corporate sector about the role of the competent authority”. It appears that many market participants were unclear, following the transfer of the UK Listing Authority from the LSE to the FSA, about the boundaries between those functions carried out by the LSE and those performed by the FSA as the competent authority for listing. The FSA has expressed its intention to explain clearly the role and responsibility of the competent authority in the context of the changing UK and European Union regulatory environment.

A SUMMARY OF THE RESPONSIBILITIES OF UK'S FINANCIAL SERVICES AUTHORITY

(a) Authorisation

The FSA authorises or approves all firms or individuals before they can carry on a regulated activity unless the firm is exempt from regulation under the FSMA. It aims to allow only those firms and individuals satisfying the “threshold conditions” (which include honesty, competence and financial soundness) to engage in regulated activities.

(b) Supervision

It supervises deposit-takers and insurance firms, major financial groups, pension review, investment markets and exchanges, listing matters, and regulates investment firms.

(c) Enforcement

The FSMA provides the FSA with statutory investigation and enforcement powers. The FSA investigates and where appropriate, disciplines and/or prosecutes firms/individuals for breaches of the FSA's rules and FSMA requirements. Enforcement actions may take the form of withdrawal of a firm's authorisation, financial penalties, seeking injunctions, prosecution actions and requiring the firms to compensate consumers, etc.

(d) Reducing Financial Crime

The FSA focuses on money laundering, fraud and dishonesty, and criminal market misconduct such as insider dealing. Under the FSMA, the FSA can make rules on firms' systems and controls relating to money laundering; supervise firms' compliance with those requirements; and prosecute firms for systems and controls failures in this area.

(e) International Activity

The FSA maintains bilateral contacts with other regulators in Europe and around the globe, as well as supporting groups where regulators can share information with one another.

(f) Service to Consumers

It promotes public understanding of the financial system and secures an appropriate degree of protection for consumers by providing information and generic advice to consumers, operating a consumer help line and providing schools with resources on personal finance education.

REGULATION OF THE SECURITIES AND INVESTMENTS MARKETS IN AUSTRALIA

The supervision of securities exchanges in Australia is the responsibility of the following three parties –

- (a) the Minister for Financial Services and Regulation who has functions and powers to maintain market integrity and investor protection in a general sense;
- (b) the Australian Securities and Investments Commission (ASIC) as the statutory regulator which broadly oversees market supervision; and
- (c) the exchanges which are the front line regulators of the markets.

This is generally known as a co-regulatory model, a combination of statutory and self-regulation, aimed at contributing to investor confidence and market integrity.

2. Chapter 7 of the Corporations Act provides the legal foundation for securities industry regulation, dealing with markets, exchanges and associations, clearing houses, industry participants and their conduct, investor protection funds and misconduct.

FINANCIAL SERVICES REFORM ACT 2001

3. The Financial Services Reform Act 2001 (FSR Act) was passed by the Parliament in August 2001. It maintains the above basic framework for regulatory oversight of the securities exchanges, but has made significant changes to licensing requirements and ongoing obligations of markets. It has created a single licensing regime for financial sale, advice and dealings in relation to financial products and more uniform regulation. More specifically, it has ended the former distinction between securities and futures exchanges by introducing a single licensing regime for “financial markets” and harmonises the legislation relating to securities and futures contracts, thereby achieving a more flexible regulatory regime.

MINISTER FOR FINANCIAL SERVICES AND REGULATION

4. Under the Corporations Act, the Minister for Financial Services and Regulation is vested with powers relevant to market approval and supervision. The Act sets out a number of criteria that must be satisfied before the Minister can approve a body as a securities exchange. These criteria are aimed at maintaining standards of market integrity and consumer protection. Specifically, it requires the body to have listing rules which set out the conditions under which securities may be traded, and for the protection of the interests of the public. The Minister has specific powers to require a securities exchange to provide the ASIC with a report on its compliance with ongoing obligations, to direct an exchange to take action to meet those obligations, to exercise a disallowance function with respect to operating rule amendments and revoke the approval of a securities exchange.

AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION

5. The ASIC received its current name in July 1998. It is an independent Commonwealth government body established by the Australian Securities and Investments Commission Act 1989. It began on 1 January 1991 as the Australian Securities Commission to administer the then Corporations Law, replacing the National Companies and Securities Commission and the Corporate Affairs Offices of the States and Territories.

6. The ASIC operates under the direction of three full-time Commissioners appointed by the Governor-General on the nomination of the Treasurer. It reports to the Commonwealth Parliament and to the Treasurer and the Parliamentary Secretary to the Treasurer. Its role is to enforce company and financial services laws to protect consumers, investors and creditors. It regulates and informs the public about Australian companies, financial markets, financial services organisations and professionals who deal in and advise on investments, superannuation, insurance, deposit taking and credit. The Corporations Act confers a range of specific functions and powers on the ASIC in respect of its oversight role of market supervision. These include powers to review compliance reports by exchanges, suspend trading of securities, consider changes to market operators' rules, apply to Court to order compliance

with the business or listing rules of an exchange or to require an exchange to pursue an enforcement action under its listing rules, and supervisory and enforcement functions and powers including the powers of investigation, inspection of books and information gathering. The ASIC is also responsible for the licensing of brokers. Consideration is being given to the ASIC having a power to impose fines.

AUSTRALIAN STOCK EXCHANGE LIMITED

7. Australia currently has three operational stock exchanges, namely the Australian Stock Exchange Limited (ASX), the Stock Exchange of Newcastle Limited and the Bendigo Stock Exchange Limited, and a specialist futures exchange, the Sydney Futures Exchange Limited. For all intents and purposes, the ASX is Australia's only significant stock exchange. It operates Australia's primary national stock exchange for equities, derivatives and fixed interest securities.

8. Prior to 1998, the ASX was a mutual enterprise. A company limited by guarantee, it was owned collectively or mutually by its members and run on behalf of its members under its own constitution and operating rules. Its members were the brokers who used the facilities of the exchange to deal with securities.

9. The initiative to demutualise the ASX came from within the exchange itself. The major considerations that drove demutualisation were the prospect of competition for ASX business and services, divergence of members' interests from one another and the exchange itself, and a proposition that in the longer term, it is undesirable for control of an entity to reside with one group of its customers. In return for ceding mutual membership and any control of the ASX that mutual membership may bestow, each relevant member would be allocated shares in the ASX.

10. ASX members endorsed the demutualisation proposal in October 1996. The legislation authorising and facilitating demutualisation came into force in December 1997. The exchange subsequently demutualised and listed its shares on the exchange in October 1998.

11. The ASIC supervises the ASX's listing and undertakes the day-to-day supervision of its compliance with the listing rules to ensure that the ASX is subject to the same independent scrutiny as all other listed entities.

12. The ASX supervises the market of the exchange on a day-to-day basis with the objective of ensuring the market is fair and orderly. It does this through a series of contractual arrangements with market participants whereby they agree to comply with rules for admission to and continued participation in trading activity. It monitors the compliance of listed entities with the ASX Listing Rules and the compliance of participating organisations and affiliates with the ASX Business Rules. It works closely with the ASIC to ensure that the highest levels of market integrity are maintained.

13. The ASX's supervisory activities include –

(a) Markets

It conducts surveillance of market activities and preliminary investigation of unusual trading. Where necessary, it will refer cases to the ASIC for follow-up actions.

(b) Listed Entities

It sets standards for listed entities through the ASX Listing Rules and supervises compliance.

(c) Market Participants

It sets standards for market participants through the ASX Business Rules and supervises compliance. It also investigates breaches and instigates cases for disciplinary action if foul play is proven.

(d) Systems

It establishes standards for testing and authorisation of designated trading, and gauges compliance with trading rules and procedures.

Listing and Delisting

14. The ASX Listing Rules govern the admission of entities to the official list, quotation of securities, suspension of securities from quotation and removal of entities from the official list. They also govern disclosure and some aspects of a listed entity's conduct. They specify certain listing standards such as the minimum standards of an entity's quality, size, operation and disclosure, sufficiency of investor interest, and integrity, accountability and responsibility of the entities and their officers, etc.

15. The Listing Rules are not just binding contractually. They are enforceable against listed entities and their associates under the Corporations Act. The Listing Rules create obligations that are additional, and complementary, to common law obligations and statutory obligations. Under the Corporations Act, Listing Rule amendments must be lodged with the ASIC. They are subject to disallowance by the Minister for Financial Services and Regulation. Companies that are in dispute with the ASX may appeal to the ASX Listing Appeal Committee which is made up of external industry practitioners.

16. The ASX has an absolute discretion concerning the admission of an entity to the official list (and its removal) and quotation of its securities (and their suspension). The ASX also has discretion whether to require compliance with the Listing Rules in a particular case. In exercising its discretion, the ASX takes into account the principles on which the Listing Rules are based.

17. The ASX may suspend an entity's securities from quotation if –

- (a) the entity does not comply with the Listing Rules;
- (b) it is necessary to do so to prevent a disorderly or uninformed market;
- (c) the ASX's rules, including the Listing Rules, Business Rules and articles of association, require the suspension; and
- (d) it is appropriate to do so for some other reason.

The ASX may also remove an entity from the official list if the entity does not comply with the Listing Rules, has no quoted securities or it is appropriate to do so for some other reason.

VIEWS ON THE EXISTING REGULATORY FRAMEWORK

18. In February 2002, the Senate Economics References Committee released a report entitled “Inquiry into the Framework for the Market Supervision of Australia’s Stock Exchanges”. The remainder of this note is a paraphrase of the Executive Summary of that report. The Committee found that the market was well served by having as its front line supervisor an operator that is familiar with the day-to-day operations of the market and is able to respond quickly to developments in the market itself. The existing framework is considered to have the following advantages –

- (a) familiarity with and proximity to the market – being both the operator and front line supervisor places the ASX in a strong position to recognise any irregularities in trading and respond to them quickly and flexibly;
- (b) the ASX has the ability to adapt elements of its supervisory arrangements to meet the needs of the market and its users and cater for developments in business practices, through changes to its operating rules; and
- (c) the framework bestows a commercial incentive on the ASX to ensure that it discharges supervisory responsibilities effectively – it has a vested interest in maintaining reputation and attracting investments.

The Committee also noted some significant disadvantages arising from the ASX’s demutualisation and listing. They include –

- (a) conflicts between commercial and supervisory responsibilities – there are questions about whether a “for profit” exchange will devote sufficient resources to ensuring effective supervision, whether it will be tempted to commercialise services such as the provision of information that might otherwise have been considered a public good, or

to reduce listing standards to attract listing;

- (b) an inherent conflict of interests resulting from self-listing; and
- (c) conflicts of interests resulting from the ASX's expansion of its commercial activities, which result in it being required to supervise the activities of direct competitors.

ASX SUPERVISORY REVIEW PTY LIMITED

19. To address such concerns, the ASX had already established a subsidiary company called ASX Supervisory Review Pty Limited (ASXSR) which reports to the ASIC and the government, to provide a further level of assurance that it is directing appropriate resources to supervisory functions and maintaining standards. The ASXSR, set up to develop policies and practices for the ASX's regulatory function, is not, in terms of its structure and funding, independent of the ASX but is more like the ASX's internal review mechanism with an external reporting role. It is not a market regulator.

20. The ASXSR Board is comprised of a majority of independent directors who has not had any material connection with the ASX for the last two years and chosen from a panel nominated by the ASX, although the ASIC retains a power to veto any proposed members and also to veto their removal prior to the expiry of their terms.

21. The ASXSR's role and functions are as follows –

- (a) review the policies and procedures of areas in the ASX Group which have supervisory functions, including the level of funding and resources for supervisory functions;
- (b) provide reports and express opinions to the ASX Board on whether appropriate standards are being met and whether the level of funding for supervisory activities is adequate;
- (c) provide assurance that the ASX Group adequately complies with its ongoing responsibilities as a market and clearing house operator, and is conducting its supervisory activities

ethically and responsibly; and

- (d) oversee supervision of listed entities with special identified conflicts that select ASXSR supervision (listed entities that have opted to seek the extra level of protection offered by ASXSR scrutiny is known as the Review Group).

22. The ASX has maintained that there is a commercial disincentive associated with failing to maintain the highest standards of integrity, which offsets any temptation that might have existed to take commercial advantage of its position. It has been pointed out that the ASXSR, the Trade Practices Law, the monitoring activities of the Australian Competition and Consumer Commission, and the ASIC can all provide safeguards against problems associated with real or perceived conflicts of interests.

23. The Committee concluded that, despite the above, there is still concern that demutualisation and listing of the ASX would give rise to conflicts of interests that might compromise its supervisory activities. There is a consensus that, in view of the globalisation of the financial markets, imposition of too many layers of regulation with a view to removing all possible conflicts of interests will make the conditions of trading unnecessarily costly, thereby making the market unattractive for both local and international investors. Parties involved in the regulation of the Australian financial markets are well aware of the need to strike a delicate balance between concern over the possible conflicts of interests of the ASX which has both commercial and supervisory responsibilities, and the need to maintain flexibility and professionalism of the regulatory regime. Notwithstanding the above observations, the Committee is of the view no major change to the existing market supervision framework should be contemplated in the near future.

REGULATION OF THE SECURITIES MARKET IN CANADA

The regulation of the Canadian securities industry is carried out by the provinces and territories, each of which has its own securities regulator. The 13 provincial and territorial regulators collaborate through the Canadian Securities Administrators (CSA), which is an informal body with no powers of enforcement. The goal of the CSA is to harmonise and streamline securities regulation in Canada through enhanced inter-provincial cooperation. By collaborating on rules, regulations and other programmes, the CSA helps avoid duplication of work and streamlines the regulatory process for companies seeking to raise investment capital and others working in the investment industry.

2. The provincial securities regulators delegate some authority to self-regulatory organisations (SROs) such as the exchanges, which have a long history of regulating and supervising market intermediation in Canada. The well-recognised SROs are the Toronto Stock Exchange (TSX), the Montreal Exchange (in Quebec), Market Regulation Services Incorporated (RS), which is jointly owned by TSX and the Investment Dealers Association of Canada (IDA), and the IDA itself outside Quebec. The IDA membership includes investment dealers that are actively engaged in securities trading in Canada. The IDA monitors the activities of investment dealers across the country in terms of their capital adequacy and business conduct.

3. We have chosen to look at the regulatory regime in Ontario in view of the fact that the majority of Canada's equity trading is done at the TSX in Toronto.

ONTARIO SECURITIES COMMISSION

4. The Ontario Securities Commission (OSC) administers the Ontario Securities Act and Commodity Futures Act. Its mandate is to protect investors from unfair, improper and fraudulent practices, foster fair and efficient capital markets and maintain public and investor confidence in the integrity of these markets. It has the statutory authority to make rules with binding legislative effect, subject to a

process involving both public comment and review of the proposed rule by the Minister of Finance. This power enables OSC to respond flexibly and quickly to market developments.

Oversight of SROs

5. The Securities Act permits the OSC to recognise market participants including SROs, exchanges, clearing agencies and quotation and trading reporting systems. An SRO as defined in the Act is a “person or company that represents registrants and is organised for the purpose of regulating the operation and the standards of practice and business conduct of its members and their representatives with a view to promoting the protection of investors and the public interest.” Currently, only stock exchanges must be recognised in order to carry on business in Ontario. The Draft Report issued by the Five Year Review Committee in May 2002 recommended that the Act be amended to require that all SROs must be recognised to carry on the functions as defined in the Act.

6. Recognised SROs have the ability to establish codes of behaviour and practice, and impose sanctions for breaches of these rules, both through contractual agreements with their members and through their by-laws. Unlike the SROs in the US, SROs in Ontario are not required to enforce Ontario securities law.

7. When an organisation is recognised by the OSC, it continues to regulate the operations and standards of practice and business conduct of its members, but is subject to the OSC’s oversight. The OSC has the authority to review any of the organisation’s directions, decisions, orders or rulings.

8. The Securities Act also confers on the OSC powers to review and approve by-laws, hear appeal against decisions of an SRO, and ask an SRO to retain an auditor to conduct compliance reviews, etc.

TSX GROUP

9. In 1999 Canada’s established exchanges underwent a major realignment in order to operate along lines of market specialisation and to better compete with exchanges abroad and new electronic entrants

penetrating the Canadian market. The Toronto Stock Exchange became the sole senior equity exchange (similar to Hong Kong's Main Board); the Montreal Exchange assumed responsibility for all derivatives such as stock index options, bond futures and stock options; and the Canadian Venture Exchange (CDNX), created through merger of the Vancouver and Alberta (and later Winnipeg) exchanges, took over sole responsibility for junior equity (for emerging companies). In May 2001, the Toronto Stock Exchange signed an agreement to acquire full ownership of the CDNX, thus bringing all of Canada's equity trading under one organisation for the first time. In April 2002, the CDNX was renamed TSX Venture Exchange, and is now part of the TSX Group, which also includes the Toronto Stock Exchange and TSX Markets.

10. Apart from realignment, the exchanges in Canada have also demutualised from member-owned cooperative institutions into leaner for-profit firms in response to intensifying international competition brought about by consolidation of exchanges. The TSX was demutualised in 2000, and became a listed public company in mid-November 2002. It is believed that with the change of ownership from "a cozy club of brokerage firms" to a wide circle of institutionalised and individual shareholders, the Group would be completely free to focus on the sole objective to build a stronger Canadian capital market.

11. A pressing issue surrounding the self-regulatory regime in Ontario is the potential conflict of interests between the regulatory/public interest role of an SRO and its commercial objective. The TSX is subject to possible conflicts because it is owned by member shareholders and is also the market regulator. Against this background, when the TSX demutualised in 2000, it established a separate subsidiary, RS, which is specifically mandated to oversee member regulation. Under its terms of recognition, the RS must be operated on a cost-recovery basis and shall be independent and structurally separated from the for-profit operations of the TSX. The RS is organised in this way so as to ensure that member regulation is not a for-profit activity and that trading operations do not subsidise regulation. In addition, the RS has a separate committee which reports to the TSX board and over half of its directors cannot be associated with any participating organisation. The RS has a segregated budget which is subject to the approval of the TSX board. In granting the TSX recognition on these terms, the OSC was of the view that this organisational structure addressed the potential for conflict between member advocacy and market regulation at the TSX.

Listing on TSX

12. The TSX Listings Committee considers and approves all applications for listing on the TSX. The Listings Committee is comprised of members of the Exchange's Issuer Services. In addition, the Listings Committee may consult the TSX's Listings Advisory Committee, which is comprised of representative figures of the securities industry. Listing requirements such as public distribution, management, sponsorship and financial conditions, etc. are laid down by the TSX. The TSX may at any time temporarily halt trading in any listed securities or suspend trading or delist a company's securities if it is satisfied that the company has failed to comply with the provisions of the Listing Agreement, or such action is necessary in the public interest.

RECENT DEVELOPMENTS

13. The Draft Report released in May 2002 by the Five Year Review Committee appointed by the Ontario Minister of Finance called for the creation of a single securities regulator with responsibilities for the capital markets across Canada. Because securities regulation in Canada is a matter of provincial jurisdiction – there are 13 different sets of securities laws administered by 13 provincial and territorial regulatory authorities, there is believed to be opposition to this proposal in other provinces, with no likelihood of its early adoption.

REGULATION OF THE SECURITIES MARKET IN JAPAN

The securities market in Japan is governed by the Securities and Exchange Law which was first enforced in 1947. The Financial System Reform, dubbed the “Japanese Big Bang”, that began in November 1996, brought about a number of changes to the regulation of the financial markets. The aim of the Reform was to rebuild the Japanese financial markets into a free, fair and global market comparable to the New York and London markets. In December 1998, the Financial System Reform Law came into force. It is a package of revisions to a number of laws including the Securities and Exchange Law. These revisions included switching from a licensing system to a registration system for securities companies to promote entry of banks, securities companies and insurance companies into one another’s business, liberalising cross-border capital transactions and foreign exchange business, fully liberalising brokerage commissions, improving disclosure system, setting up fair trading rules and protecting customers in times of failure of financial institutions.

FINANCIAL SERVICES AGENCY

2. The Financial Services Agency (FSA) is responsible for ensuring the stability of the financial system in Japan, protection of depositors, planning and policy making concerning the financial system, inspection and supervision of the private sector financial institutions and surveillance of securities transactions. It was first set up in 1998 as an administrative organ of the Prime Minister’s Office responsible for the inspection and supervision of private sector financial institutions and surveillance of securities transactions. In conjunction with the reorganisation of central government ministries, the FSA was established as an external organ of the Cabinet Office in January 2001, and took over the responsibility of disposition of failed financial institutions from the former Financial Reconstruction Commission.

3. The FSA's duties in respect of the securities sector include –
- (a) planning and policy making – establishing rules for financial institutions through legislation, amendment and abolition of financial-related statutes and regulations such as the Securities and Exchange Law;
 - (b) inspection of private sector financial institutions' compliance and risk management – conducting on-site inspections in accordance with inspection manuals which summarise the fundamental principles of inspection and specific points of focus in inspection;
 - (c) supervision of financial institutions – ensuring sound and proper business operations of financial institutions by conducting on-site inspection and off-site monitoring, obtaining reports on risk-related data from financial institutions, and requesting institutions to take remedial measures should their capital adequacy ratio fall below the threshold;
 - (d) establishment of rules for trading in securities market and financial futures exchanges; and
 - (e) surveillance of compliance of rules governing the securities market.

SECURITIES AND EXCHANGE SURVEILLANCE COMMISSION

4. The Securities and Exchange Surveillance Commission (SESC) was set up under the Ministry of Finance in 1992, following a series of financial scandals involving major securities houses, to monitor compliance in the securities and financial futures markets. The Commission was detached from the Ministry and put under the FSA in 1998. It consists of a Chairperson and two Commissioners appointed by the Prime Minister with the consent of the Diet.

5. The SESC conducts inspections of securities companies for compliance with transaction rules, daily market surveillance, and investigation of criminal offences including insider trading, market manipulation and falsified financial statements. It also conducts joint on-site inspections with the Inspection Bureau of the FSA. It may recommend to the FSA to take disciplinary administrative actions against non-compliant securities brokers, or refer cases involving securities crimes to the prosecutors. On the policy side, the SESC may make proposals to the Prime Minister, the Minister of Finance and the FSA to ensure fairness of securities transactions.

6. The SESC is also authorised to review the activities of self-regulatory organisations (SROs), including the Japan Securities Dealers Association (JSDA) and stock exchanges. The role of the SROs is stipulated in the Securities and Exchange Law. The SROs establish standards of acceptable conduct for members' compliance, inspect securities companies and monitor securities trading on a daily basis. In effect, the SESC and SROs share the responsibilities of monitoring compliance by securities firms and conducting market surveillance.

DEMUTUALISATION

7. The Securities and Exchange Law and the Financial Futures Trading Law were amended in December 2000 to allow the stock exchanges to be organised in the form of joint-stock companies or continue to operate in the form of membership organisations. The disciplinary measures and the authorising system of self-established rules that apply to membership stock exchanges, will also apply to exchanges operating in the form of a joint-stock company. The purpose of allowing exchanges to develop into joint-stock companies was to speed up the exchanges' decision-making process to better respond to the changing needs of market users, allow exchanges to raise funds for systems investment, and improve international standing of the Japanese securities markets.

8. To safeguard public interests, the exchanges have to meet the following requirements –

- (a) capital must not be less than an amount specified in the relevant law;
- (b) no entity might hold more than 5% of a stock exchange's outstanding shares;
- (c) the scope of business is limited to opening of markets and business incidental to it;
- (d) the articles of association must stipulate that members have to comply with the laws and rules set by the exchanges, and that sanctions will be imposed on members for breaches of the laws and rules; and
- (e) the authority may order amendments of the self-established rules such as the articles of association and measures necessary for supervisory reasons in respect of business management and conditions of assets.

(a) and (b) are only applicable to exchanges that are joint-stock companies.

TOKYO STOCK EXCHANGE

9. The Tokyo Stock Exchange (TSE) is Japan's leading stock exchange. It is a stock corporation that provides a market for the trading of securities under the authorisation of the Prime Minister. The TSE had operated as a not-for-profit membership organisation, and was demutualised in November 2001 to become a joint-stock company, i.e. Tokyo Stock Exchange, Incorporated.

10. The TSE is responsible for the listing of securities, monitoring listed companies, monitoring trading and supervising trading participants. The Securities and Exchange Law stipulates that the stock exchanges themselves shall establish rules for the listing of securities. Accordingly, the TSE has established, among others, "Listing Regulations", "Criteria for Stock Listing" and "Regulations for Notice or the Like by Issuer of Listed Security".

Listing

11. A company applying for initial listing has to meet quantitative criteria such as number of shareholders, market capitalisation, net profit before tax and financial statements and audit reports, etc. If these criteria are met, the TSE would conduct a rigorous check against certain non-quantitative criteria such as business continuity and profitability, soundness of corporate management, adequacy of corporate disclosure, public interest and the protection of investors, etc. Listing will be approved if the TSE determines that the stock is appropriate for listing, and the applicant will enter into a “Listing Agreement” with the Exchange. Stocks are traded on either the first or the second sections of the Exchange. Newly listed domestic stocks are generally assigned to the second section (which has lower thresholds in terms of the number of shares and shareholders, trading volume, market capitalisation and net profit, etc.) except under special circumstances. The TSE examines stocks at the end of each business year to determine whether they should be transferred to the other section.

Listing of Foreign Companies

12. A foreign corporation has to file a Securities Registration Statement with the Prime Minister when it makes a public offer or sale of securities at the time of listing or after listing on the Exchange, and will have to continue to disclose specified information in their Annual Securities Reports and other reports. These statements and reports are prepared in accordance with the “Ministerial Ordinance” with respect to the disclosure of corporate information. Foreign corporations must also engage the services of the following institutions –

- (a) Securities firm

It must be selected from the trading participants authorised by the TSE.

- (b) Attorney-in-fact in Japan

The attorney-in-fact of a company is an officer of a foreign applicant residing in the Tokyo area who is responsible for liaising with the TSE before and after listing.

(c) Shareholder Services Agent

It is usually a Japanese trust bank for handling matters regarding shareholders in Japan.

(d) Dividend Payment Services Bank

It is usually a trust bank or major bank with branch offices nationwide to serve as a Dividend Payment Services Bank.

(e) Custodian in Home Country

A Central Securities Depository in the home country usually provides custodian service for share certificates. However, when there is no such depository, a competent commercial bank may provide the service.

13. An applicant company can adopt the accounting standard of its home country only if the FSA does not object to it on public interest and investor protection grounds.

REGULATION OF THE SECURITIES MARKET IN SINGAPORE

Pursuant to the Monetary Authority of Singapore Act of 1970 (MASA), the Monetary Authority of Singapore (MAS) was established on 1 January 1971 and is empowered to approve financial institutions and control their operations if their business would affect monetary stability and credit and exchange conditions in Singapore, the development of Singapore as a financial centre or the financial situation of Singapore. The Securities and Futures Supervision Department of the MAS has supervisory responsibility for the capital market and administers the Securities and Futures Act (SFA) of 2001. It regulates the origination and trading of securities and their derivatives products, supervises capital market intermediaries, regulates prospectuses and collective investment schemes, and oversees takeover issues. It has regulatory oversight of securities and futures exchanges and clearing houses. It also enforces the civil penalty regime for market misconduct.

2. The Singapore Exchange Limited (SGX) is a publicly listed company that operates the securities and futures markets. It was formed by the demutualisation and merger of the Stock Exchange of Singapore and the Singapore International Monetary Exchange Limited under the Exchanges (Demutualisation and Merger) Act of 1999, in December 1999, and was listed in November 2000. The demutualisation and merger were based on the recommendation of the Committee on Governance of the Exchanges made in 1999, to improve ownership and governance structure of the exchanges to cope with increasing competition and globalised investment environment.

3. The SFA consolidates legislation relating to the capital market and provides the legislative framework for a disclosure-based regulatory regime.

4. As the statutory regulator of the securities and futures markets, the MAS has the following powers –

- (a) approving and making regulations relating to the establishment and operation of the securities market or futures market;

- (b) endorsing, amending or supplementing the listing rules and business rules of the securities exchange and futures exchange;
- (c) giving directions to the securities exchange or the futures exchange if it is considered necessary or expedient for ensuring a fair and orderly securities market or futures market, the integrity of and proper management of systemic risks in the securities market or futures market, or in the public interest or for the protection of investors; and
- (d) removing officers of the securities exchange or the futures exchange.

5. A general provision in the SFA authorises the MAS to apply to the High Court for an order to require a person to comply with the listing rules. The MAS may apply to the court for a restraining order on any person who appears to have committed an offence. The MAS may, with the consent of the Public Prosecutor, begin civil proceedings in court for imposition of civil penalties. Criminal prosecutions require the consent of the Attorney-General.

6. The SFA also provides for the establishment of the Securities Industry Council which is an advisory body that advises the Minister for Finance on all matters relating to the securities industry. The Securities Industry Council consists of representatives of business, the Government and the MAS appointed by the Minister. The MAS may consult the Council on the proper and effective implementation of the SFA.

7. The SGX carries on, inter alia, the business of providing, regulating and maintaining facilities for conducting the business of a stock exchange in Singapore pursuant to the Securities Industry Act. The Singapore Exchange Securities Trading Limited (SGX-ST) is a wholly-owned subsidiary of the SGX. It is a stock exchange which has been approved as provided in section 16(2) of the Securities Industry Act and is the front line regulator for corporations listed on it. It is not vested with any statutory powers but is responsible for front line regulatory functions such as listing approval and market surveillance. It regulates listing matters by issuing the Listing Manual which sets out the requirements that apply to issuers, the manner in which securities are to

be offered, and the continuing obligations of issuers. It has also published a Best Practice Guide to provide guidance on the principles and best practices in corporate governance and dealings by listed issuers and their directors and employees in the securities of the listed issuers, and has adopted the Code of Corporate Governance issued by the Corporate Governance Committee. The underlying principles of the listing rules which are subject to MAS approval are to ensure that issuers shall have minimum standards of quality, operation, management experience and expertise. Issuers are required to disclose all the information necessary for investors to make assessment and shall act in the interests of shareholders as a whole.

THE LISTING PROCESS

8. The SGX-ST is directly responsible for approving listing applications in accordance with the rules sets out in the Listing Manual. The SGX-ST considers an issuer's application and may issue approval in-principle for listing with or without conditions. The issuer can then lodge and register the final copy of the prospectus or offering memorandum with the MAS and the SGX-ST, and launches offer. On satisfaction of the conditions expressed in the in-principle approval, the issuer is admitted to the Official List at the discretion of the SGX-ST. Trading of the listed securities commences on a date determined by the SGX-ST. The MAS has the power to issue "stop orders" to halt an offering and require the return of moneys if there are problems.

9. The SGX-ST may at any time suspend trading of the listed securities of an issuer and may remove an issuer from the Official List.

CONFLICT OF INTERESTS

10. The Exchanges (Demutualisation and Merger) Act of 1999 confers on the MAS the authority to require the SGX to enter into arrangements for dealing with possible conflicts of interests that may arise from the listing and quotation of the SGX on a stock exchange, and for the purpose of ensuring the integrity of trading of the securities of the transferee holding company. In this regard, the SGX, SGX-ST and MAS signed a Deed of Undertaking which sets out listing arrangements

and procedures for handling conflicts of interests. The MAS is authorised to make all decisions and take action in relation to the SGX that would be taken by the SGX-ST in the case of other corporations listed on the SGX-ST. SGX and SGX-ST have to abide by and comply with the decisions taken by the MAS. The SGX's compliance with the listing rules of the SGX-ST as a corporation listed on the SGX-ST is supervised by the MAS. The MAS has all the powers and functions that the SGX-ST has in relation to a corporation listed on the SGX-ST, including the power to remove the SGX from the stock exchange Official List and the power to suspend or stop the quotation of securities of the SGX on the stock exchange, in order for the MAS to discharge its supervisory role in relation to the listing of the SGX on the SGX-ST. The procedures to deal with conflicts of interests are set out in the Appendix to the Deed of Undertaking, which requires the Board of the SGX to appoint a committee (the "Conflicts Committee") to consider possible conflicts of interests or conflicts of interests that may arise from the listing or quotation of SGX shares on the SGX-ST. The Conflicts Committee shall notify the MAS of any proposals for resolving a conflict of interests in a manner which assures the proper performance of the SGX's regulatory functions. The following matters shall be referred directly to the MAS instead of the Conflicts Committee –

- (a) complaints received concerning insider trading in SGX shares; or
- (b) market surveillance reports indicating that insider trading in SGX shares could have taken place or investigations into possible insider trading in SGX shares; or
- (c) the receipt by the SGX-ST of a listing application from an applicant that the SGX regards as a competitor of the SGX.

REGULATION OF THE SECURITIES MARKET IN THE MAINLAND

CHINA SECURITIES REGULATORY COMMISSION

The China Securities Regulatory Commission (CSRC) is the central statutory regulatory body of the securities and futures markets on the Mainland. In April 1998, the CSRC became a ministry rank unit under the State Council and the authorised department governing the securities and futures markets of Mainland China. It directly supervises the two exchanges in Shanghai and Shenzhen, organisations engaged in securities trading formerly supervised by the People's Bank of China, and all local securities regulatory departments.

2. The main functions of the CSRC are –
- (a) to establish a centralised supervisory system for securities and futures markets and assume direct leadership over securities and futures market supervisory bodies;
 - (b) to strengthen the supervision over securities and futures business, stock and futures exchange markets, listed companies, fund management companies investing in securities, securities and futures investment consulting firms, and other intermediaries involved in the securities and futures business; raise the standard of information disclosure;
 - (c) to increase the abilities to prevent and handle financial crisis;
 - (d) to organise the drafting of laws and regulations; study and formulate principles, policies and rules; formulate development plans and annual plans for the securities market;
 - (e) to direct, coordinate, supervise and examine matters related to securities in various regions and relevant departments; direct, plan and coordinate test operations of the futures market; and

- (f) to exercise centralised supervision of the securities industry.
3. Specifically, the CSRC is responsible for –
- (a) studying and formulating policies and development plans regarding securities and futures markets; drafting relevant laws and regulations on securities and futures markets; and working out relevant rules on securities and futures markets;
 - (b) supervising securities and futures markets and exercising vertical power of authority over regional and provincial supervisory institutions of the securities market;
 - (c) overseeing the issuance, trading, custody and settlement of equity shares, convertible bonds and securities investment funds; approving the listing of corporate bonds; supervising the trading activities of listed government and corporate bonds;
 - (d) supervising the listing, trading and settlement of domestic futures contracts; monitoring domestic institutions engaged in overseas futures businesses in accordance with relevant regulations;
 - (e) supervising the behaviour of listed companies and their shareholders who are liable for relevant information disclosure in securities market;
 - (f) supervising securities and futures exchanges and their senior management in accordance with relevant regulations, and securities associations in the capacity of the competent authorities;
 - (g) supervising securities and futures companies, securities investment fund managers, securities registration and settlement companies, futures settlement institutions, and securities and futures investment consulting institutions; approving in conjunction with the People’s Bank of China, the qualification of fund custody institutions and supervising their fund custody business; formulating and implementing

rules on the qualification of senior management for the above-mentioned institutions; and granting qualification of the people engaged in securities and futures-related business;

- (h) supervising direct or indirect issuance and listing of shares overseas by domestic enterprises; supervising the establishment of securities institutions overseas by domestic institutions; and supervising the establishment of domestic securities institutions by overseas organisations;
- (i) supervising information disclosure (the PRC Securities Law and State Council regulations contain continuous disclosure requirements) and proliferation related to securities and futures; being responsible for the statistics and information resources management for securities and futures markets;
- (j) granting, in conjunction with relevant authorities, the qualification of law firms, accounting firms, asset appraisal firms, and professionals in these firms, engaged in securities and futures intermediary business, and supervising their relevant business activities;
- (k) investigating and penalising activities violating securities and futures laws and regulations (the CSRC has express powers to impose administrative penalties/fines, “responsibility and correction orders”, and warnings); and
- (l) managing the foreign relationships and international cooperation affairs in the capacity of the competent authorities.

SHANGHAI AND SHENZHEN STOCK EXCHANGES

4. The Shanghai Stock Exchange and Shenzhen Stock Exchange were set up in December 1990, each being a non-profit institution and legal person. They are to provide a fair, transparent and efficient trading environment for market participants and ensure normal operation of the securities market under the supervision of the CSRC.

5. The Shanghai Stock Exchange has a wholly-owned subsidiary, i.e. Shanghai Securities Central Registration and Settlement Company, which is responsible for central registration, custody, management and settlement. Similarly, the Shenzhen Stock Exchange has a wholly-owned subsidiary, i.e. Shenzhen Securities Settlement Company, which is responsible for the registration, custody and settlement of shares listed on the exchange.

STOCK ISSUANCE

6. Stock issuance is subject to approval by the CSRC. Article 11 of the PRC Securities Law stipulates that “public offer of shares shall, in compliance with the conditions provided for in the Company Law, be reported to the securities regulatory authority under the State Council for verification”.

7. The examination and approval of stock issuance applications are the responsibilities of the Public Offering and Listing Review Committee, set up by the CSRC in 1993 pursuant to Article 14 of the PRC Securities Law which states that “in the securities regulatory authority under the State Council an issuance examination commission shall be established to examine according to law applications for issuance of shares. The issuance examination commission shall be composed of professionals from the security regulatory authority under the State Council and other relevant specialists engaged from outside the said authority, who shall vote on applications for issuance of shares and state their opinions after examination.” Prospectuses, listing applications, periodic reports and public announcements are filed with the CSRC. Their contents are governed by the Securities Law, the Company Law, applicable State Council regulations, and various CSRC rules and forms.

8. The listing regime is therefore controlled directly by the CSRC, while the stock exchanges provide a trading environment and ensure smooth operation of the market.

REGULATION OF THE SECURITIES MARKET IN HONG KONG

The Securities and Futures Commission (SFC) is the statutory regulator of the securities and futures markets in Hong Kong. It was set up in 1989 under the Securities and Futures Commission Ordinance (Cap. 24), after the October market crash in 1987 and on the recommendation of the Securities Review Committee chaired by Mr. Ian Hay Davison. The SFC has the following regulatory objectives –

- (a) maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
- (b) promote understanding by the public of the operation and the functioning of the securities and futures industry;
- (c) provide protection for members of the public investing in or holding financial products;
- (d) minimise crime and misconduct in the securities and futures industry;
- (e) reduce systemic risks in the securities and futures industry; and
- (f) assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.

2. The SFC supervises and monitors the activities of the Hong Kong Exchanges and Clearing Limited (HKEx) and its subsidiaries in the operation of the securities market and futures market. The regulatory objectives, functions, responsibilities and powers of the SFC are enshrined in the Securities and Futures Ordinance (SFO) (Cap. 571) passed by the Legislative Council on 16 March 2002 to come into effect on 1 April 2003. The Ordinance consolidates and modernises ten pieces of securities and futures legislation enacted over the last quarter of a century and aims to maintain fair, transparent and orderly markets,

promote public confidence in the securities and futures markets, provide an appropriate level of investor protection, minimise market misconduct and facilitate market innovation and competition. Its main features include a streamlined licensing system under which one single licence covers all regulated activities that a licensee can conduct; additional disciplinary sanctions on licensees; parallel civil and criminal regimes to combat market misconduct and the establishment of a Market Misconduct Tribunal; private civil action for individuals who have suffered pecuniary loss caused by market misconduct or false or misleading information; a strengthened disclosure of interest regime; a new investor compensation scheme covering a broader range of market intermediaries; a flexible licensing regime to cater for companies providing automatic trading services; extended supervisory, investigation and intervention powers along with enhanced checks and balances on the SFC, including the establishment of an independent Securities and Futures Appeals Tribunal.

3. The SFC has four operational divisions. The Corporate Finance Division oversees the stock exchange listing-related functions and responsibilities, administers securities legislation relating to listed companies, the Takeovers and Mergers Code and the Share Repurchases Code. The Intermediaries and Investment Products Division devises and administers licensing requirements for securities and futures, and leveraged foreign exchange trading intermediaries, supervises and monitors intermediaries' conduct and financial resources, and regulates the public marketing of investment products. The Enforcement Division conducts market surveillance to identify market misconduct for further investigation, undertakes inquiry into alleged breaches of relevant laws and codes, and institutes disciplinary procedures for misconduct by licensed intermediaries. The Supervision of Markets Division supervises and monitors activities of the exchanges and clearing houses, encourages development of the securities and futures markets, promotes and develops self-regulation by market bodies, and oversees and manages the investor compensation funds.

4. The securities and futures markets are operated by the Stock Exchange of Hong Kong Limited (SEHK) and the Hong Kong Futures Exchange Limited (HKFE), both wholly owned subsidiary of the HKEx which became the holding company of the SEHK, HKFE, the Hong Kong Securities Clearing Company Limited (HKSCC), the SEHK Options Clearing House Limited (SEOCH) and the HKFE Clearing Corporation Limited (HKCC) on 6 March 2000 following demutualisation and merger.

The HKEx was listed on the SEHK on 27 June 2000 by way of introduction.

5. The HKEx is a recognised exchange controller under the Exchanges and Clearing Houses (Merger) Ordinance (Cap. 555). It owns and operates the only stock exchange (SEHK) and futures exchange (HKFE) in Hong Kong and their related clearing houses. The SEHK has the right under the Stock Exchanges Unification Ordinance (Cap. 361) to establish, operate and maintain a stock exchange in Hong Kong and the HKFE is licensed under the Commodities Trading Ordinance (Cap. 250) to establish and operate a commodity exchange. The HKSCC, SEOCH and HKCC are the recognised clearing houses for the purposes of the Securities and Futures (Clearing Houses) Ordinance (Cap. 420).

6. Although the SFC has been entrusted with the statutory responsibility to oversee the securities and futures markets, the government is ultimately responsible for stability of the financial markets. According to Articles 109 and 110 of the Basic Law, the Government of the Hong Kong Special Administrative Region (HKSAR) shall provide an appropriate economic and legal environment to maintain Hong Kong's status as an international financial centre, and safeguard the free operation of financial business and financial markets, and regulate and supervise them in accordance with law. Section 11 of the SFO empowers the Chief Executive of the HKSAR to give written instructions to the SFC in extraordinary emergencies to safeguard public interest. The directions must be related to the functions of the SFC and in the public interest, and only issued after the Chief Executive has consulted the Chairman of the SFC.

7. The securities and futures markets are therefore regulated under a three-tier regulatory structure, namely, self-regulation by front line market operators, market regulation by the SFC and government supervision at the third level to ensure effective regulation by the SFC and sufficient coordination with other regulatory organisations.

THE LISTING REGIME

8. Under the Amended and Restated Memorandum of Understanding (MOU) Governing Listing Matters signed between the SFC and the SEHK on 6 March 2000, the date on which the SEHK

became a wholly-owned subsidiary of the HKEx following the demutualisation and merger of the two exchanges and three clearing houses, the SFC has agreed to the SEHK continuing to be solely responsible for the day-to-day administration of all listing-related matters (except for the functions performed by the SFC), acting as the primary front line regulator responsible for the supervision and regulation of listed companies, including their directors and controlling shareholders, and market users. Within the regulatory framework, the SFC has the following functions –

- (a) administering relevant ordinances and the rules and regulations made thereunder;
- (b) supervising and monitoring the activities of the SEHK to ensure that it discharges its regulatory responsibilities in a professional and impartial manner;
- (c) taking measures to safeguard the interests of persons dealing in securities;
- (d) providing policy advice on the regulatory regime for listed and other public companies;
- (e) proposing reforms of securities laws;
- (f) promoting and developing self-regulation by market participants in the securities industry;
- (g) administering the Takeovers and Mergers Code and the Share Repurchases Code;
- (h) administering the Code on Unit Trusts and Mutual Funds which establishes guidelines for the authorisation of collective investment schemes;
- (i) investigating alleged breaches of relevant laws and the Codes mentioned in (g) and (h); and
- (j) encouraging the development of the securities market and the use of the market by local and overseas investors.

9. According to the MOU, the SEHK is responsible for –
- (a) establishing and operating a fair, orderly and efficient stock exchange for the trading of securities, protecting the interests of the investing public;
 - (b) making and promulgating rules prescribing listing requirements for the quotation of securities on and for the proper and efficient operation and management of the stock market;
 - (c) establishing a Listing Committee (for the Main Board) and a Growth Enterprise Market (GEM) Listing Committee (with respect to the GEM) whose membership is broadly representative of the various securities industry groups with interests in the proper regulation of the securities market, to discharge the listing functions and powers impartially, independently and professionally; and
 - (d) establishing fair and clear procedural rules for discharging listing functions.

10. The Board of the SEHK has arranged for all of its powers and functions in respect of all listing matters to be discharged by the Listing Committee, subject to certain review procedures. Accordingly, the Listing Committee and, in relation to certain powers of review, the Listing Review Committee have sole power and authority to act on all listing matters to the exclusion of the Board, unless and until the Board revokes these arrangements. In addition to the powers to suspend or cancel a listing, the Listing Committee can impose the following sanctions for non-compliance with the Listing Rules –

- (a) private reprimand;
- (b) public criticism;
- (c) public censure;
- (d) reporting the offender's conduct to the SFC or another regulatory authority;

- (e) banning a professional adviser or an individual employed by a professional adviser from representing a specific party;
- (f) requiring a breach to be rectified or other remedial action to be taken within a specified period;
- (g) in the case of wilful or persistent failure by a director of a listed issuer to discharge his/her responsibilities under the Listing Rules, stating publicly the retention of the office by the director is prejudicial to the interests of investors; and
- (h) in the case of wilful or persistent failure by a listed issuer to discharge its responsibilities under the Listing Rules, disallowing that issuer access to the facilities of the market and prohibiting dealers and financial advisers from acting or continuing to act for that issuer.

11. The Listing Committee has delegated most of these powers and functions to the Listing Division and the Chief Executive of the SEHK, subject to certain reservations and review procedures. The Listing Division therefore deals with all matters concerning listing in the first instance; and interprets, administers and enforces the Listing Rules. It can propose new rules and amendments to the existing rules for the Listing Committee's consideration. Changes to the Listing Rules have to be approved by the SFC before they can come into effect.

12. To provide for the listing of the HKEx on the SEHK and to ensure that the primary regulatory listing functions are not compromised by the HKEx's becoming a publicly listed for-profit company, the SFC has signed with the HKEx and the SEHK on 19 June 2000 a Memorandum of Understanding for the Listing of Hong Kong Exchanges and Clearing Limited on the Stock Exchange of Hong Kong Limited. The MOU sets out the way the parties involved will relate to one another regarding: (i) the HKEx's and other applicants' and issuers' compliance with the Listing Rules, (ii) the SEHK's enforcement of the Rules of the Exchange in relation to the securities of the HKEx and other applicants and issuers, (iii) the SFC's supervision and regulation of the HKEx as a listed issuer, (iv) conflicts of interests that may arise between the interests of the HKEx as a listed company and companies of which it is a controller, and the interests of such companies in the proper performance of the regulatory functions, and (v) market integrity.

13. The MOU also stipulates the arrangements and relationship between the parties acting in different capacities, including: (i) the SFC acting as the statutory regulator of Hong Kong's securities and futures markets and, where a conflict of interests may arise between the HKEx as a listed company and other companies or persons, as the front line regulator of those companies or persons, (ii) the SEHK acting as the front line regulator of listed issuers and exchange participants (except with respect to the HKEx and other companies or persons where a conflict of interests may arise) and as a securities exchange, (iii) the HKEx acting as an applicant for listing, a listed issuer and the holding company of the SEHK and other companies of which the HKEx is the controller, and (iv) the subsidiaries of the HKEx performing regulatory functions and exercising regulatory powers.

14. The SFC signed a further MOU with the HKEx and the SEHK on 22 August 2001 to replace the earlier one, mainly to extend the scope to cover the GEM as well and bring up-to-date the provisions therein. The text of the MOU can be found at the HKEx and SFC websites at www.hkex.com.hk and www.hksfc.org.hk respectively.

15. As measures to ensure that the regulatory functions are properly carried out and the public interest is duly protected, the majority of the HKEx Board are non-executive directors appointed by the Financial Secretary and the election of the Chairman is subject to the approval of the Chief Executive of the HKSAR. The Board has undertaken not to revoke or vary the delegation of the functions and powers in respect of all listing matters to the Listing Committee, unless in exceptional circumstances and only after having given written notice to the SFC and the Listing Committee. The Listing Committee and the Listing Division operate apart from the for-profit business units of the HKEx.

NEW DEVELOPMENT

16. The Secretary for Financial Services and the Treasury announced at a press conference on 24 July 2002 the introduction of a package of measures to improve the present listing structure and procedures, with the aim to create a market environment that is conducive to the listing of high quality companies and strengthen Hong Kong's position as an international financial centre.

17. The main features of the new listing package include –
- (a) Establishment of an integrated Listing Committee with remit to decide on Main Board and GEM listings and delistings. The Committee would have broadly based participation of market users.
 - (b) Streamlined listing process administered by high calibre experts with overseas experience. Senior executives would vet all applications to identify key issues. This would shorten approval time and help reduce the overall listing costs.
 - (c) Strengthened back-end enforcement of disclosure requirements to ensure quality of information under the streamlined regime.

18. In relation to back-end enforcement, the new SFO, together with the Securities and Futures (Stock Market Listing) Rules made under the Ordinance, provides for a new dual-filing requirement on listing applicants and listed issuers whereby the same information in relation to initial public offerings and ongoing corporate disclosure will have to be filed with both the HKEx and the SFC. This will enable the SFC to exercise statutory enforcement powers where it has reasons to believe that disclosure documents as filed contain false or misleading information. The SFC may ask a listing applicant to provide more information and may object to listing if the applicant fails to comply with such a requirement or if it appears to the SFC that the applicant has supplied false or misleading information in its application, or if listing of the security is not in the public interest or the interest of the investing public. Similar requirement will apply to public statements and other ongoing disclosure of information by listed companies to the public. The SFC may direct the SEHK to suspend dealings in the securities of a listed company, if the company is found to have supplied or disclosed false or misleading information in its listing documents or other public announcements or publications. To facilitate compliance, the applicant can fulfil the disclosure obligation by authorising the SEHK to file the materials with the SFC on its behalf. Detailed arrangements between the SFC and the HKEx in respect of the dual-filing requirement are set out in the new Memorandum of Understanding Governing Listing

Matters signed on 28 January 2003 between the SFC and the SEHK (the full text is available at www.hkex.com.hk or www.hksfc.org.hk). By allowing the SFC to ask for more information, to object to listing and to impose sanctions against non-compliance and where appropriate bring offenders to court, there would be a more effective deterrent against disclosure of false or misleading information, and the quality of corporate information disclosure could hopefully be improved.