

CEO's Statement

This is my first statement as CEO. I joined the SFC last October, and I was, of course, aware that the Commission had been through a challenging period dealing with the local effects of the collapse of Lehman Brothers as well as the implications of the wider global financial crisis for Hong Kong. And I should say upfront that I have been extremely impressed with the evident resilience, hard work, commitment and intellectual rigour with which SFC staff – at all levels and across all divisions – have been dealing with the extremely difficult issues arising from the crisis.

My predecessor, Martin Wheatley, led the Commission through this period in a clear-sighted and unwavering manner. He is now at the United Kingdom's Financial Services Authority and will lead the Financial Conduct Authority next year under the new "twin-peaks" financial regulation model. We owe Martin a huge debt of gratitude and wish him well in his new role, in which I am sure he will be very successful.

The effects of the crisis still make themselves felt; no region is immune from the continuing problems in Europe. Even an economy as large as that of mainland China is discussed in the context of overseas demand for its products, its own investment abroad as well as the international significance of the renminbi. China is both globally significant and interconnected and its own economic rebalancing has profound implications for local and global investors and enterprises.

Against this backdrop, I believe that the next few years will be seen as pivotal for the evolution and long-term position of Hong Kong as a leading international financial centre. For

many years, Hong Kong has acted as the principal gateway allowing overseas investors to gain exposure to China and enabling Chinese enterprises to attract foreign investment and to extend their operations abroad. The fact that a majority of the market capitalisation of Hong Kong's stock exchange now consists of Mainland enterprises is a testament to the success of Hong Kong's transformation over a relatively short period from a financial centre for local companies and investors to its present position as the pre-eminent crossroads for global investment in China's future development.

The next stage is crucial: Hong Kong's opportunity is to align the development of its own financial markets with the increased sophistication of China's interaction with global investors and markets. The most recent example is the growing significance of renminbi trade and issuance of renminbi products. Internationalisation of the renminbi will inevitably have small beginnings and is a long-term project, but its significance for Hong Kong as a major hub through much of this business will flow is plain, and is founded on our geographical advantage as well as our unique "one country, two systems" political and legal system.

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So the preservation and enhancement of Hong Kong’s market quality is an objective underlying all that we do, from enforcement against market misconduct to the regulation of intermediaries, the authorization of funds and financial products and the regulation of listed companies and market operators. Any suggestion that this objective should be subordinate to superficial, risky market development opportunities would be misconceived, given that the long-term reputational impact would eclipse any perceived gain. All key stakeholders in Hong Kong’s securities market subscribe fully to this principle.

Regulatory approach

But what do these high-level developments mean for the SFC, Hong Kong’s securities markets regulator? I believe that there are two answers to this.

Upholding market quality

First, and regardless of the nature of future innovations in Hong Kong’s financial markets, our role is to ensure that market development is accompanied at all times by standards of market quality and investor protection which are no lower than – and in some areas exceed – leading international benchmarks. Although financial investments carry varying degrees of risk in all markets, investors tell us repeatedly that a key attribute that continues to attract them to invest in and through Hong Kong is the confidence they can place in the clarity, consistency and credibility of our rule of law and regulatory system. This operates in the interests of all investors, from retail to the largest global financial institutions. It also operates in the interests of business enterprises raising capital and funding, lowering costs and providing a secure base to connect investors with investment opportunities.

Recognising interconnectivity

Secondly, following the maxim that every crisis presents an opportunity, the efforts of the international community to tackle the causes and effects of the global financial crisis has laid bare the fact that we cannot operate effectively without close, continual and effective communication and co-operation between local regulators and with the broader international regulatory community. This reflects the transformation of financial services and markets into highly connected cross-border businesses where transmission mechanisms ensure that market failures ripple throughout the financial system.

The need to develop meaningful cross-border relationships and reach is likely to be of even greater significance for Hong Kong than for many countries. Hong Kong’s domestic market will continue to be small compared to its significance as a venue for overseas investors, intermediaries and funds wishing to gain exposure to enterprises that also are offshore, predominantly on the Mainland, and more recently businesses from elsewhere with a China or Asian strategy or connection.

This will continue to be a major opportunity, but it poses an additional challenge for the SFC. Although many of our market participants originate or have set up in Hong Kong, many are from overseas. This means that international collaboration is crucial to our regulatory efforts, and it also means that we develop regulatory policies specifically to address the risks arising from the significant international dimension of our markets.

The financial crisis also has led to another realisation – different regulators with remits to regulate different types of financial business must co-operate closely to address the inevitable gaps and overlaps that arise between them. This is simply a question of addressing risk properly in modern markets. Interconnected financial markets and the sophistication of financial institutions mean that, for example, banking regulators must understand capital markets and securities regulators must understand banking operations.

It is for these reasons that we have chosen “interconnectivity” as the theme for this year’s report.

Staying committed to collaboration

Local collaboration is essential in a system like Hong Kong’s where a number of regulators have responsibility for different aspects of financial markets. I am pleased to say that we maintain a constructive and regular dialogue with all of them. The leaders of each of the key authorities, namely, the Hong Kong Monetary Authority, the Insurance Authority, and the Mandatory Provident Fund Schemes Authority, are committed to working even closer together in the future. Each regulator carries out functions that are of direct relevance to others. For instance, with enhanced regulation of mandatory provident fund (MPF) intermediaries under consideration, banks, brokerages, insurance companies and independent financial advisers marketing MPF products will be subject to supervision by their frontline regulators. For this regulatory model to be effective, close collaboration among regulators will be paramount. To do anything else is simply not an option.

Collaboration within the SFC is also vital. Every effort should be made to resist a “silo” mentality within any organisation. Again, I am pleased to say that inter-divisional co-operation and information sharing is high and improves day by day. We recently set up a number of cross-divisional project groups. These deal with topics such as sponsors for initial public offerings, direct access to the Market Misconduct Tribunal and over-the-counter (OTC) derivatives, all of which involve the work of more than one division. The fundamental goal is to ensure that the right expertise is channelled at the right time to the more difficult aspects of our work. We have also established a centralised risk and strategy function to assess external market risks and to work with our front-line operational units in determining how our priorities should be assessed to address those risks most effectively.

Forging closer ties with China

Our ties with Mainland regulators and authorities are of prime importance in light of Hong Kong’s transformation into a hub for Mainland business and as an offshore centre for developing renminbi products. We have a close relationship with our counterpart, the China Securities Regulatory Commission (CSRC), which is particularly important for renminbi product development and cross-border enforcement. We are now working with the CSRC on the introduction of physical A-share exchange-traded funds to our stock exchange.

Our work

Much of our work is to do with addressing the risks and opportunities stemming from a highly interconnected global financial marketplace. In the past year, we continued to collaborate with overseas and local counterparts to contribute to global regulatory efforts, focusing on a number of areas deemed to pose the most imminent risks. For details, please refer to the Operational Review chapter (pages 27-54).

Our priorities

Going forward, the following areas will take precedence in terms of our work:

- *Improve market resilience* by making markets more responsive to changes and to better prepare them to withstand volatility and disruptions;
- *Identify and reduce systemic risks*, given that the global financial crisis has made clear the importance of risk transmission across regulated and unregulated markets;
- *Continue to strengthen investor protection and take decisive enforcement action against market misconduct*, given that the credibility of our regulatory work is essential to the quality of Hong Kong's markets; and
- *Continue to contribute to global efforts* to address the regulation of financial markets, especially those implementing the objectives set by the Group of Twenty.

In line with these priorities, we are engaged in a number of policy and legislative programmes. These include implementing the new short-position reporting regime, enhancing the standards of initial public offering sponsors, working on the enabling legislation of the OTC derivatives regulatory regime, introducing a "paperless" electronic securities market and reviewing the professional investor regime. More details are described in the Corporate Outlook chapter (pages 23-26).

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Finally, I would like to thank all my colleagues for their hard work and dedication over the past year. Although we are still dealing with the effects of a financial crisis of unprecedented scale and scope, I am confident that we have the drive and ability to operate in a challenging environment in the interest of investors and Hong Kong's continuing development as an international financial centre of global significance.



Ashley Alder
Chief Executive Officer