

Chairman's Statement

This Statement Is About

- The challenges ahead
- "Investors First"
- Initiatives in 2005-06
- The market and the SFC's financial results
- A year of hard work

This is my first Chairman's Statement. It is a great honour for me to serve the SFC as its fifth Chairman.

I was appointed Executive Director, in charge of the Supervision of Markets Division, in June 2005. As former Chairman, Mr Andrew Sheng, left the SFC after seven years of exemplary service, I was appointed by the HKSAR Chief Executive as Chairman with effect from 1 October.

The challenges ahead

As I assumed my position last October, I set out my mission as follows: to consolidate the SFC's position as a leading securities regulator internationally and help Hong Kong excel as an international financial centre and a premier fund raising centre for the region.

In the following months, I have had the opportunity to consider with my colleagues how that can be achieved. We must fully understand the challenges the SFC and the Hong Kong market face, and ready ourselves to respond.



At the end of March 2006, we published a document on the regulatory challenges and risks in the next three years and the necessary SFC strategic responses. The document, suitably entitled “Regulatory Challenges and Responses”, provides the SFC with timely guidance on how it prioritises and performs its regulatory functions within the statutory objectives under the Securities and Futures Ordinance.

One of our most immediate tasks is the organisation of the Annual Conference of the International Organization of Securities Commissions (IOSCO). In June, the SFC will for the first time host the Annual Conference. Several hundred securities regulators and market practitioners from more than 100 jurisdictions will converge on Hong Kong to tackle the most current securities regulatory challenges.

“Investors First”

In analysing the environment in which we operate and the challenges, and indeed in our daily work, we constantly remind ourselves of the importance of the interest of investors. An avid reader will have noticed that the theme of this year’s Annual Report is “Investors First”; these are the same words that appeared in last year’s report. The continuation of this theme demonstrates the value we attach to this objective.

The strategic plan identifies four main challenges and 21 initiatives to address them. The four challenges, in short, relate to:

- improving standards of corporate governance and behaviour;
- tackling risks arising from complex and structured products, and mis-selling to retail investors;
- addressing the consequences of a market or economic downturn if and when that happens; and
- keeping Hong Kong at the forefront of international financial markets and promoting regulatory best practice.

By allocating appropriate resources to the initiatives, and with the support of the Government, market practitioners and the public, I am confident that we can meet those challenges. Some of the projects have been ongoing and are reviewed in the section below and other parts of this Annual Report.

Initiatives in 2005-06

The SFC’s role may be expressed in four disciplines:

Regulate, Enforce, Facilitate and Educate. We will in the following pages discuss the philosophy behind these four areas of work and last year’s achievements in more details. Some of the more notable work progress:

To Regulate, we

- formulated a Six-Point Plan to strengthen the derivative warrants market and investor education
- reviewed the disclosure of interests requirements

- secured public support for securities margin financing reform
- proposed tighter regulation of sponsors
- continued work on statutory backing for important listing requirements

To Enforce, we:

- successfully prosecuted 72 companies and people for various offences
- took disciplinary action against 98 companies and people
- excluded a sponsor from the listings market for 13 months for due diligence failure
- banned an analyst for five years for conflicts of interest
- substantially concluded three cases before the Insider Dealing Tribunal

“By using our resources appropriately, and with the support of the Government, market bodies, market practitioners and the public, we can confidently meet the regulatory challenges in the next few years.”

Chairman's Statement

- identified 18 cases of suspect warrants market activities for investigation
- investigated 27 cases involving listed companies
- assisted the Court in a successful ICAC prosecution of a high profile market manipulation case
- referred 24 cases to the Police

To Facilitate market development, we:

- authorised the Link REIT, the first listed REIT in Hong Kong
- authorised the first bond index-tracking ETFs in Asia
- approved HKEx's launch of Callable Bull/Bear Contracts
- proposed enhancements to the securities offering prospectus regime
- signed regulatory co-operative agreements with eight jurisdictions
- reviewed the investor compensation levy collection mechanism, resulting in levy exemption since last December
- supported Government's proposal to reduce the transaction levies

To Educate, we:

- reminded investors that "Before you invest, ask the right questions"
- produced new television and radio commercials
- re-launched the investor website as InvestEd with stronger content
- surveyed retail investors, in particular warrant investors, to gauge levels of knowledge and understanding

In the following two parts, I will cover our financial results and the most valuable asset of the SFC, its staff. There is also a new chapter on Staff of the Commission in this Annual Report.

The market and the SFC's financial results

The Hong Kong stock market remained buoyant during 2005-06, despite the uncertainties arising from higher oil prices and interest rates. The Hang Seng Index advanced 17%. The rally was supported by a solid 7.3% GDP growth in 2005 and improving economic fundamentals. Mainland's revaluation of RMB in July 2005 and the move to a more market-based exchange rate system sustained investors' interest in Mainland shares listed in Hong Kong. The gains of the Hong Kong stock market were in line with the performance of major equity markets abroad.

During 2005-06, the average daily turnover of the stock market amounted to \$21.5 billion, 38% higher than the year before.

The China dimension has become increasingly important to the development of the Hong Kong stock market. During the year, the H-shares Index (HSCEI) and the red chips index (HSCCI) rose 39.9% and 42.9% respectively.

Last year, 70 IPOs raised \$171.4 billion (61 IPOs raising \$81.7 billion in 2004-05). Of this, \$142.9 billion (83%) was contributed by Mainland companies, the largest being China Construction Bank's \$71.6 billion. In terms of the total equity funds raised, Hong Kong was ranked fourth in the world after New York, London and Toronto.

As of the end of March 2006, 1,141 companies were listed on the stock exchange with a total market capitalisation of \$9,416 billion, rising 43% from last year. Hong Kong was eighth by market capitalisation amongst world stock exchanges.

Trading of futures and options was active, with a total of 29.5 million contracts traded during 2005-06, 47% higher than the year before.

The brokerage industry is financially more sound, with total shareholders' fund at \$80 billion at the end of 2005, 6% higher than a year ago. The aggregate net asset value of all SFC authorised unit trusts and mutual funds also rose 21% to US\$668 billion.

The SFC's primary source of income is transaction levy. In 2005-06, levy income increased by 41% over a year ago to \$613 million. Together with increases in fees and charges and investment incomes, we recorded total revenue of \$852 million.

We continued to spend carefully. Total expenditure was \$497 million. As a result, the SFC achieved a surplus of \$355 million, lifting the reserves at the end of March 2006 to \$1.2 billion.

A year of hard work

Many achievements of the SFC last year were owing to the leadership of the former Chairman. I would like to pay tribute to Mr Sheng for his tremendous contributions to the SFC and the financial community in Hong Kong as a whole. He has left behind an efficient and respected organisation and a professional, dedicated team. Mr Sheng was Chairman of the IOSCO Technical Committee before stepping down as SFC Chairman, and he has placed Hong Kong more firmly in the league of leading securities regulators of the world.

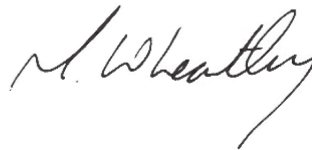
I have assumed the role of executive Chairman under the existing legal provisions of the SFO. At the time of writing, the Securities and Futures (Amendment) Bill 2005, introduced by the HKSAR Government in April 2005, is being considered by the Legislative Council. Under the proposed changes, the Government will be creating the new post of CEO and at the same time designating the Chair as non-executive.

While 2005-06 was a year of considerable achievements, it also was one of hard work. Personally I am grateful for the staff's dedication and, as with any responsible employer, the SFC considers it appropriate to recognise the staff's contribution by making a variable pay award. The Remuneration Committee in March approved using 12% of the 2005-06 revised Remuneration Budget for this purpose.

We have also reviewed fixed pay, in particular taking account of market comparisons and the need for staff retention to ensure the SFC operates effectively. We have used 3% of the 2006-07 proposed Remuneration Budget for fixed pay adjustment to eligible staff with effect from 1 April 2006. This follows a freeze on fixed pay since 2001.

Our volunteers' team has done some worthy social services, which the members themselves have enjoyed tremendously. A new section in the chapter of Corporate Governance discusses the SFC's social responsibility.

Finally, I would like to express my gratitude to the NEDs, our advisers and partners in the various committees, groups and panels, the legislature, the Government, the market, the media and all other people who have steadfastly stood by the SFC.



Martin Wheatley
Chairman