





# We Facilitate

We recognise the importance of effective regulation to the success of the financial markets and our role in supporting Hong Kong's continued development as an international financial centre. In the execution of our regulatory functions and in considering market developments and regulatory changes, we therefore aim to achieve a balance between innovation and appropriate levels of investor protection.

## Last year, we

- implemented initiatives under the Economic Summit Report: adjusted the position limits of H-shares index futures and options, facilitated the launch of CBBCs and Hang Seng China H-Financials Index futures contract, and facilitated the listing of overseas companies and the transfer of HKEx trading rights
- facilitated the first simultaneous offering of A shares and H shares of a company in Shanghai and Hong Kong
- authorised new funds, ETFs, the first REIT in Grade A Central offices, and the first hotel REIT
- successfully hosted the IOSCO Annual Conference 2006
- reduced transaction levies on securities and futures trading by 20%

## Facilitation

While we are conscious of our primary role as a market regulator we also recognise our important role in facilitating market development. As financial markets become more global and competition increases we believe that our facilitation role has become increasingly important. Hong Kong has achieved much in recent years and has achieved recognition for its position as an international financial centre (IFC). However, we still remain some way behind the largest IFCs and the pace of change in financial markets, most importantly in the Mainland, means that we cannot afford to be complacent. We need to work increasingly hard, together with others involved in the financial services market, to ensure that we retain and improve the attractiveness of Hong Kong's financial market. This has required, and will continue to require, us to work closely with industry and Mainland and overseas regulators to ensure that we keep abreast of emerging issues which could have an impact on the attractiveness of our market. Facilitation has been a focus for us over the last year and will be an area of increased effort and focus for us going forward.

During late 2006 the SFC was an active participant in an important facilitation project, initiated by the HKSAR Government, as a member of the Financial Services Focus Group of the **Economic Summit** on "China's 11th Five-Year Plan and the Development of Hong Kong". In January 2007 the group submitted a report to the Government outlining



HKSAR Chief Executive the Hon Donald Tsang presented the Economic Summit Report in January 2007.

80 action items aimed at addressing the challenges and opportunities arising from this Five-Year Plan. Some of these initiatives have already been implemented and are reported in the sections that follow. Others are still being worked on with the SFC leading the effort on a number of important initiatives.

Our role as the regulator of **Hong Kong Exchanges and Clearing Ltd** (HKEx) requires us to balance our regulatory oversight responsibility, including protecting investors' interests, with our shared goal of ensuring the success of Hong Kong's securities and future markets. Over the years we have developed an effective and appropriate relationship with HKEx, which is proving increasingly productive. Last year this resulted in numerous initiatives, described in the sections below, where we have either approved HKEx initiatives or, increasingly, worked together with HKEx on the matter under consideration.

We respond to the needs of the market and facilitate the launch of new investment products to the market. We also meet with prospective issuers of new products, professionals such as valuers, accountants etc to keep abreast of new developments in the market.

We are pleased to set out below a detailed summary of the facilitation activities and results we have seen during the past year.

### Listed companies and the stock exchange

We worked together with HKEx, the China Securities Regulatory Commission (CSRC) and the Shanghai Stock Exchange in a coordinated effort to facilitate the first simultaneous offering of A shares and H shares in Shanghai and Hong Kong. This was also the world's largest public offering.

During the year, the SFC and HKEx jointly issued a policy statement to clarify the Listing Rules requirement governing the **listing of overseas companies** as recommended in the Economic Summit Report. We have provided a clear roadmap to assist overseas companies to deal with shareholder protection matters when seeking a listing in Hong Kong.

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To enable faster disclosures by listed companies and investors' access to information, we worked closely with HKEx to abolish the Main Board requirement for companies to publish **paid announcements** in newspapers. The new information dissemination regime, which will commence on 25 June 2007, will pave way for the development of real time electronic disclosure during trading hours and the elimination of unnecessary suspensions.

Together with HKEx, we also granted listed property developers a conditional **waiver** from the Listing Rules requirement to obtain shareholders' approval for acquiring land or property development projects in Hong Kong from the Government or Government-controlled entities through public auctions or tenders. The waiver provides temporary relief pending Listing Rules amendments.

To facilitate and promote better flow of information to the market, we worked with HKEx on clarification to the market, by way of an announcement, that on the Main Board, reporting accountants are only required to review and report on profit forecasts that are included in listing documents, or documents issued in connection with a notifiable or connected transaction.

We are working on the proposals to simplify the **disclosure requirements** of interests in listed securities to make the regime more user-friendly while still preserving market transparency.

In March 2007, we approved HKEx's launch of **Hang Seng China H-Financials Index (HFI)** futures contract. HFI tracks the performance of Mainland financial stocks listed in Hong Kong.

We worked closely with HKEx to facilitate the launch, in June 2006, of Callable Bull/Bear Contracts (**CBBCs**). The number of stocks that are eligible as underlying asset has since been expanded to 28 from the initial five stocks with the highest turnover.

To meet market needs and promote growth in the futures and options markets, we adjusted the **position limits** of Hang Seng China Enterprises Index (H-shares index) futures and options contracts. The limit changed from 6,000 contracts per futures contract month/options contracts series to an aggregate delta limit of 12,000 applicable to all futures contract months/options series. We are now reviewing the position limits of HSI futures and options contracts and will shortly consult the market regarding proposed changes. These adjustments were

initiatives included in the Economic Summit Report and we are also studying further recommendations relating to contracts limits and reportable positions.

In July 2006, we approved HKEx's rule amendments on the reduction of **minimum trading spreads** for shares trading between \$2 and \$20 to increase the efficiency of order execution.

Hong Kong Securities Clearing Company (HKSCC) operates the **Stock Segregated Account (SSA)** service where an investor's stockholding under a broker's custody can be separated from that of the broker and other investors. Following SFC's approval, HKSCC increased the scope of the service and enabled SSA holders to access stock balance and movements online, receive electronic statements and SMS/email alerts of stock movements. We will continue to work with HKSCC on further enhancements.

To facilitate interested brokers to obtain **trading rights** without having to seek out and bargain with sellers, we worked with HKEx regarding its proposal to introduce a tender process inviting relinquishment of a transferable trading right from an existing holder. This proposal will ensure the availability of trading rights at a reasonable cost as HKEx will be able to issue new trading rights if there is no offer or tender for sale of existing trading rights. The proposal will be conducive to market development of the exchanges.

We are currently working with the market and other regulators on a number of market development issues under the Economic Summit Report including the possibility of setting up a commodity futures market in Hong Kong and the introduction of more Mainland related products.

## Products and intermediaries

As the performance of Mainland markets improved in recent years, there has been increasing interest by funds in exposure to the Mainland **A-share market**. In June 2006 we authorised the first open-ended China A-share fund that primarily invests directly in A shares through Qualified Foreign Institutional Investors (QFII), a scheme which allows approved qualified foreign institutional investors to invest in Mainland securities.

During the year, we authorised three **REITs**, including the first REIT that invests in hotel properties, and one with exposure

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to Grade A offices in Central. At the end of March 2007, six REITs have been listed on HKEx, with an aggregate market capitalisation of \$70 billion and an average daily trading turnover of \$186 million.

We authorised more **exchange traded funds** (ETFs) during the year, including the first ETF that tracks the Indian stock market. The nine ETFs had a total net asset value of US\$9.8 billion as at 31 March 2007. A further six ETFs, including the first ETF that tracks a commodities futures index, were approved in April 2007.

Funds domiciled in the European Union states have to comply with the new European based Undertaking for Collective Investment in Transferable Securities (**UCITS**) III directive. To facilitate these funds being offered in Hong Kong, we issued a guide on risk management process for applications last year, and simplified authorisation procedures for UCITS III funds with special features.

A working group with industry representatives was formed in March 2007 to review existing **advertising guidelines** in the Code on Unit Trusts and Mutual Funds and the process for approval of marketing materials of retail funds.

We continue to focus on the development of the **hedge fund industry** in Hong Kong as an important and emerging growth area. Our specialised team which handles non-conventional fund managers' licences granted 32 licences to hedge fund managers in 2006-07. During the year we conducted a survey of licensed corporations whose business involved the management of and/or provision of advisory services to hedge funds. The results showed that the industry had grown significantly with aggregate assets managed from Hong Kong by licensed hedge fund managers and advisers reaching US\$33.5 billion as at 31 March 2006, up 268% from March 2004. In order to develop our own expertise and to ensure that we are as facilitative as possible in this growth area we have taken opportunities to exchange views on the trends and challenges of the hedge fund industry with the industry and senior officials of the UK Financial Services Authority and the US Securities and Exchange Commission (SEC).

We facilitate business development by flexibly applying our rules and regulations under circumstances where investor protection will not be jeopardised. In this context, we granted

77 **modifications or waivers** regarding licensing conditions and financial resources requirements to licensed persons and applicants during the year.

By working closely with an industry group, a **fidelity insurance** scheme was successfully secured for participants of the stock and futures exchanges. This insurance protects participants from losses due to fidelity risks arising from dealing activities. Under the scheme participants will pay 10% to 20% less in gross premiums than previously.

## Co-operation with Mainland authorities

The activities of the SFC in connection with the Mainland market are in a large part related to our facilitation role. We closely monitor developments in the Mainland financial market, and determine appropriate responses in order that Hong Kong is well positioned to participate in the significant growth of the Mainland financial market.

In order to be able to carry out our role most effectively we continue to be active in promoting exchange of personnel with our counterpart, the CSRC. This year we sent 18 staff for short-term secondments to the CSRC and in return hosted 14 of their staff in Hong Kong to share experience and develop the important personal connections which will facilitate an increasingly interactive and dynamic relationship. During the year we provided training at the CSRC offices and most recently we have agreed to the long-term secondment of a senior member of staff from the CSRC to assist us with the development of our Mainland related activities.

The SFC actively participates in a working group formed with the China Banking Regulatory Commission (CBRC), State Administration of Foreign Exchange and Hong Kong Monetary Authority to study issues of mutual concern regarding the development of China's Qualified Domestic Institutional Investors (**QDII**) scheme for Mainland commercial banks. QDII allows Mainland investors to invest in foreign securities markets via approved financial institutions.

This effort culminated in the signing in April 2007 of a Memorandum of Understanding (MOU) with CBRC for co-operation and information sharing with respect to Hong Kong licensed intermediaries who provide services to Mainland

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SFC Chairman Mr Eddy Fong (right) exchanged the MOU with Mr Liu Mingkang, Chairman of the CBRC.

commercial banks conducting overseas wealth management business on behalf of their clients.

Following the implementation of the commitment under the third phase of the Closer Economic Partnership Arrangement (CEPA) on 1 January 2006, Mainland securities and futures brokers have been able to establish a presence in Hong Kong. As at 31 March 2007, Mainland brokers controlled more than 20 Hong Kong licensed intermediaries engaged in a variety of regulated activities.

## International co-operation and external relations

We work closely with our counterparts worldwide, principally through our active participation in the International Organization of Securities Commissions (IOSCO). IOSCO is the pre-eminent forum for international co-operation among securities regulators and the international standard setter for the securities sector. The SFC is a member of the Technical Committee, which comprises regulators from the major markets. The IOSCO Multilateral Memorandum of Understanding (IOSCO MMOU) is an agreement that allows regulatory co-operation among signatory jurisdictions of which Hong Kong is one. We also have 39 bilateral or multilateral co-operation arrangements with regulatory bodies around the world. Our involvement enables us to participate and influence the emergence of global standards for the securities and futures markets.

In June 2006, we successfully hosted the 31st Annual Conference of IOSCO, the first time that this had been held in Hong Kong. The presence of more than 650 regulators and market practitioners from 135 jurisdictions around the world made the event the largest gathering for an IOSCO Annual Conference in recent years. During the four-day conference, member jurisdictions reached important decisions, including a new resolution that encourages members to examine the legal framework under which they operate and to enable the freezing of assets derived from cross-border securities and derivatives violations.



The Hon Rafael S Y Hui, Acting Chief Executive of HKSAR (third from left), SFC CEO Mr Martin Wheatley (fourth from left) and other international guests officiated at the Opening Ceremony of the IOSCO Annual Conference.



The Hon Henry Tang (right), Financial Secretary, and SFC CEO Mr Martin Wheatley proposed a toast at the Farewell Gala Dinner of the IOSCO Annual Conference.

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We are active participants in all five Standing Committees of IOSCO's Technical Committee which examined a number of issues during the year including: accounting and auditing standards and disclosure; multi-jurisdictional information sharing for market oversight and regulatory issues arising from exchange evolution; regulation of intermediaries, their recordkeeping, security issues and conflicts issues; international asset freezing, cross-border boiler rooms and Internet frauds; hedge fund valuation, distribution costs and soft commission arrangements for collective investment scheme; and disclosure of information at point of sale.

We took part in the IOSCO Asia Pacific Regional Committee Mutual Recognition of Collective Investment Scheme Working Group to enhance regulatory co-operation and to facilitate cross-border marketing of products within the region.

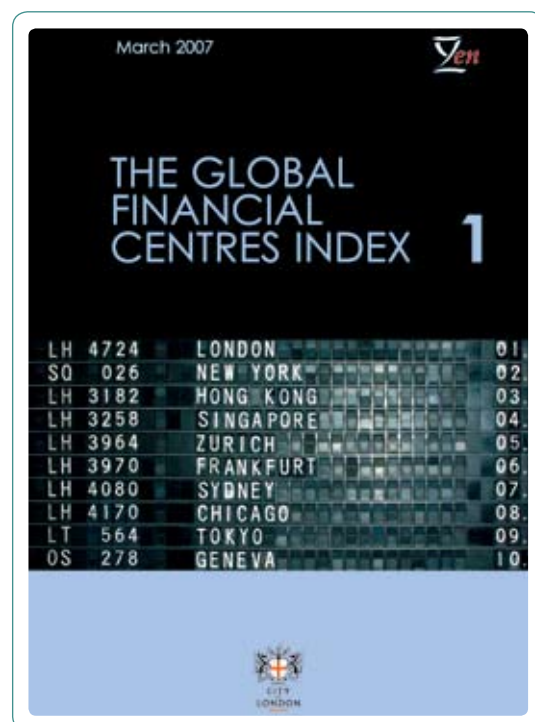
During the year, we met with different governmental or regulatory representatives from Australia, Singapore, Thailand and the US to share our experience and discuss policy issues relating to regulation of retail products. We arranged for staff to be seconded to securities regulators in the US and Australia to update themselves on the latest developments in the global securities industry and to exchange views on each jurisdiction's regulatory approach.

We also met with various overseas industry associations, e.g. the Association of the Luxembourg Fund Industry, Alternative Investment Management Association, Dublin Funds Industry Association, UK Investment Management Association, and the Bond Market Association from New York to exchange views about market developments.

## Communication with the market

We believe that communication with all of our stakeholders, including both practitioners and investors, regarding all of our activities is important in helping develop a robust and well-developed financial market. Greater clarity of rules and regulations will of itself lead to greater confidence in the financial market and promote increased activity. We also use our communications to try and lead by example in the area of enhancing transparency and corporate governance, which are also important to attract investors to our markets.

In 2006-07, we conducted a **Stakeholder Survey**, which found that stakeholders regarded the SFC as Asia's best securities regulator and believed that the SFC's programmes had a positive impact on the securities and futures markets in Hong Kong. They generally wanted the SFC to: ensure the quality of listings, particularly from the Mainland; support Hong Kong's competitiveness in a global market; to be more proactive in developing Hong Kong as a major financial centre and be less conservative in its approach to the introduction of new products; exercise its powers to take on large enforcement cases and in the administration of Dual Filing; address the high turnover of middle and junior level staff and the need to have more experienced/market familiar staff at these levels; improve clarity of rules, speed of response and consistency of decisions; and reduce the need for unnecessary documentation. Whilst we are pleased with the results of the survey we also acknowledge the areas where more needs to be done. In particular a number of comments received appear to want us to increase the facilitation aspects of our work and this will be a focus for us in the immediate future.



According to a report by the City of London Corporation released in March 2007, Hong Kong ranks third, after London and New York, as a world financial centre, and is "a real contender to become a genuinely global financial centre".

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We publish regular **research** papers and market statistics to help the public understand the Hong Kong market. In 2006-07, one report concerned Hong Kong's competitiveness in Asia, which concluded that Hong Kong took the lead in Asia in most factors that are considered important to a financial centre. We also launched an information note series, which aims to provide simple but valuable market information and facts to the public.

We assist the market's understanding of our policies and initiatives through our publications such as circulars and Frequently Asked Questions, and seminars or talks with industry associations, professional bodies or government departments. In 2006-07, we provided guidance on a number of matters including funds authorisation policy, licensing matters concerning insurance requirements, emergency contacts and business premises etc.

In communicating our work and policies to stakeholders, the mass media has been an important partner. During the year, we issued 264 press releases. Our executives gave 21 interviews to local, Mainland and international news organisations and we held 10 press conferences or sharing sessions. We handled 1,112 media enquiries and received 2,336 public enquiries, of which 2,113 were made online (enquiry@sfc.hk). Full replies were given within four days to 99.1% of the email enquiries we received.

The SFC voluntarily publishes a **Quarterly Report** on its work and financial position in order to set a good example for the market. Our **Annual Report** has for many years been recognised for its high standards of disclosure. In the 2006 Hong Kong Management Association's Best Annual Reports Awards, it was awarded the Gold Award (Non-profit Making and Charitable Organisations category) and named the category winner in Citation for Achievement in Corporate Governance Disclosure. Our report also won the Platinum Award (Public Sector/Not-for-profit Organisations category) in the Hong Kong Institute of Certified Public Accountants' Best Corporate Governance Disclosure Awards 2006.

All of our publications are made available online and our corporate website, **www.sfc.hk**, drew a daily average of 378,561 hits during the year. It again received the Gold Award in the e-Inclusion Campaign (formerly known as Web Care Campaign) of the Internet Professional Association, which promotes equal opportunity to Internet access.

We published the fourth edition of the English-Chinese Glossary of Securities, Futures and Financial Terms to provide the public with a practical tool with enhanced content.

## Other measures

**FinNet** is a network run by the SFC which enables the financial community to conduct electronic transactions and information delivery in a secure environment. In 2006-07, FinNet users grew from 144 to 171 and Hong Kong Interbank Clearing Ltd (HKCL) launched a service through FinNet where banks may transfer files of scanned cheques to HKCL and eliminate paper cheque processing. We are currently holding discussions with the fund management industry to establish whether or not FinNet can also be utilised to provide a common order exchange platform.

In 2006-07, we continued to implement measures to enhance market efficiency and reduce transaction costs. Effective from 1 December 2006, investors pay 20% less in **transaction levies**. Under the Securities and Futures (Reduction of Levy) Order 2006, levy rates have been lowered from 0.005% to 0.004% for securities transactions and from \$1 to \$0.80 per futures contract transaction.

To facilitate the provision of **automated trading services** (ATS) in Hong Kong, we authorised three overseas exchanges to operate ATS and are considering two new applications. There were 12 ATS providers at the financial year-end.