

Chief Executive Officer's statement



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Even the most seasoned observers would have found it difficult to watch the past 12 months unfold without a hint of trepidation as Hong Kong's stock market provided an animated year of record highs, high volatility and unprecedented turnover.

Amid global volatility, our market absorbed sudden shocks, fluctuations and growing uncertainties with a resilience characteristic of Hong Kong. Its ability to adapt and unlock opportunities in the face of global challenges is what helps make our city one of the world's top financial centres.

A major part of our work during the year has been to reinforce this status as an international financial centre by providing a regulatory backdrop which is fair, efficient and conducive to market development. We are constantly working to position ourselves to best support the growth of the Hong Kong market as the global environment becomes increasingly competitive.

At the same time, we spent a great deal of time talking to the regulated community about how they manage risks as our concern grew that a healthy scepticism was declining. It became clear early last year that risks were not being properly priced globally – the subsequent seizing up of credit markets has affected both global growth and local markets.

Hong Kong's position as the gateway to the Mainland was likewise affected by developments across the border and we have been working very closely with our counterparts at the China Securities Regulatory Commission to understand their needs and to exchange views on some of the issues we are each dealing with.

As more Mainland enterprises seek to raise capital in our markets, it has been a core part of our work to make sure our standards are understood, respected and suitable to a continuous flow of Mainland IPOs into Hong Kong. We have also worked hard to explain our system to Mainland financial institutions as they stretch their wings globally, using Hong Kong as their first port of call.

An active year

Against the backdrop of the United States subprime crisis and uncertainty over monetary policies in the Mainland, Hong Kong's securities and futures markets faced a challenging operating environment, with the Hang Seng Index experiencing its biggest-ever point loss and gain in January 2008.

Turnover was unprecedented, totalling \$24,309 billion to the end of March 2008, with listing applications remaining healthy at 134 and the number of products authorised reaching 2,881. 442 Mainland enterprises (including H-shares, red chips and mining companies) have now been listed in Hong Kong and in total account for 57% and 52% respectively of market capital and turnover. Hong Kong also saw healthy growth in newcomers to the market, with 8,615 licences issued this year, up 44% over the previous year.

Facilitating growth

To meet the challenge of increasingly competitive markets in New York and London, products and services are becoming more complex. The SFC has been reviewing regulatory rules, structures and procedures to identify any barriers to market innovation and growth.

A decade after the Asian financial crisis, it is clear that some of the measures brought in during those times may have lost their benefit in today's markets. We have made changes where we believed the market had moved on, such as the introduction of flexibility to the derivative position limits regime. We are also studying the feasibility of suspending the application of the tick rule in normal market situations.

Our approval processes have been made more efficient, enabling more diverse types of entities and products to enter the market. This streamlined regulatory framework has been achieved without dropping standards.

It has been a process which involved being close to the market to identify and understand any blocks to development, and conducting a cost and benefit analysis where there are apparent hindrances. This has helped encourage a steady flow of players into our market. As we were able to streamline licensing processes and promote a more market-friendly operating environment, a number of hedge fund managers have approached us to discuss expansion plans in Hong Kong.

Regulating the market

As we continue with our efforts to make it easier and more economical for market players and intermediaries to set up in Hong Kong and carry out their business, the SFC remains vigilant in protecting investors' interests.

The monitoring of the market and intermediaries took on increasing significance amid fierce volatility, with particular attention paid to possible strains on the players and their financial operations.

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A pragmatic shift in our enforcement activities over the past 12 months saw us become more resourceful in the type of actions we took to address unacceptable behaviour in the market. At the same time our aim has been to send a potent message when breaches occur.

Our Enforcement team took strong action where we felt misconduct was significant and particularly harmful to the market. Our objective is to take action which drives changes in behaviour. During the year we invoked a wider range of legal remedies to further this goal. It was a year where we saw the first criminal insider dealing prosecution launched and the first immediate custodial sentence for market misconduct secured.

Educating the public

Keeping the public alert to potential areas of concern is a critical part of our education role and the SFC made full use of the mass media and internet resources to encourage investors to make informed investment choices.

Through a variety of investor education programmes developed along the theme 'Know Your Risk', we emphasised the need to take greater responsibility for investment decisions in a volatile environment and to fully understand the risks involved. We took a proactive approach in providing investors with information and timely advice on new types of investment funds and complex structured products as they were introduced to the retail market. We also issued public warnings when we noticed suspicious practices or misdeeds that warranted attention.

Our InvestEd website targeting both local and overseas investors recorded a 30% increase in hits last year. We have started a revamp of the website to give it a new look and to prepare for the launch of more interactive features.

Keeping close ties with the Mainland

As the Mainland continues to open up its financial markets, Hong Kong is well positioned to benefit. The past 12 months have seen opportunities presented by the entry of Mainland brokers into Hong Kong and by Mainland regulators' decision to allow asset managers set up a presence here.

To explain our regulatory framework and ensure the process is as smooth as possible, we brought together our Mainland focused activities and established a new division, with a specific focus on the Mainland as well as the regulation and approval of investment products.

We will continue our close ties with the Mainland and will deepen co-operation with our counterparts across the border and broaden existing exchanges in relation to regulation and future market development.

The Memorandum of Understanding (MOU) signed with the Mainland's insurance regulator is an important recent development, which provides another opportunity for our financial markets.

Existing MOUs with the securities and banking regulators in the Mainland likewise allow us to co-operate on a number of fronts, providing a strong regulatory backdrop for further initiatives. We were also pleased to see the Mainland becoming a full signatory of the International Organization of Securities Commissions (IOSCO) MOU which signifies its mature status in terms of global regulatory co-operation.

Finances

The SFC's revenue reached \$2,546 million on the back of robust market activities, an increase of 95 per cent from a year ago. Operating expenditure was \$585 million, marginally below our approved budget for the year, leaving a surplus of \$1,961 million.

The SFC is forecasting income of \$2,776 million for 2008-09. Total operating expenses are budgeted at \$780 million, reflecting a need for personnel increases to deal with increasing workload brought about by higher volumes and increased complexity of market activities, as well as increased premises expenses.

We continue to tightly monitor expenditure to ensure that our costs stay within budget commitments.

Our team

The achievements we made during the course of the year would not be possible without the dedication and hard work

of our staff. It has been our aim to reward high performance with competitive salaries and benefits and we place emphasis on individual career development within the SFC, promoting internally whenever possible.

Employees have been given the chance to advance both upwards and laterally as they explore a wide range of opportunities and experiences at the SFC.

Our performance appraisal system has been overhauled to make sure that staff members benefit fairly and predictably from their endeavours. We emphasise clear and effective communication to keep staff well informed of what we are doing and exactly how much we value their contribution.

Looking ahead

The year ahead will be full of challenges brought by the growing competitiveness of the global market, current economic uncertainties and the ever increasing complexity of market activities. As a management team we will focus on four main areas.

Facilitating Hong Kong's evolution as an international financial centre and a key financial market in China is a priority for the SFC. We will further develop ties with Mainland regulators and other stakeholders. The SFC will help build the Hong Kong platform to support the flow of funds from the Mainland and the setting up of offices for Mainland brokers and asset managers. The growth of products and markets will be a top priority in the year ahead and without compromising investor protection, we will work with the industry and Hong Kong Exchanges and Clearing Limited to respond to the needs and challenges of the market.

Promoting an efficient, fair, and orderly securities market is paramount and the SFC will hone its monitoring tools for regulated entities while allowing ample flexibility for market development. Our enforcement efforts will focus on delivering clear messages to the market on unacceptable behaviour building on the successful changes we introduced this year.

Educating and protecting investors in Hong Kong's securities markets will be a key part of our work as we see more and more complex and sophisticated products being offered to investors. To this end, additional resources will be added to allow us to clearly establish the needs of the investing public and to deliver our education messages most effectively.

Improving our business capacity and effectiveness will be a constant focus. We recognise the need to review our capability against the increasing demands on our resources and the expectations of our stakeholders. To that end we have commenced a review of our own processes and procedures and initiated improvement projects which will bear fruit over the next 12 to 18 months. We will be upgrading our resources and capabilities in a number of areas, in particular the further streamlining of our licensing and product authorisation processes, while ensuring that our regulatory priorities are not compromised or standards lowered.

With the challenges we face in the coming year, the volume and complexity of our work will increase further. I take this opportunity to thank all my colleagues for their commitment and hard work and I look forward to working closely with them to contribute to the continuous success of Hong Kong's financial markets.



Martin Wheatley

Chief Executive Officer

