





Development

Flowers will only bloom if they are in a favourable environment with appropriate nutrients. Committed to nurturing a wholesome environment for all market participants, the SFC strives to provide guidance and processes that allow market players of different sizes and forms to achieve healthy growth.



Ensuring continued and sustainable development of the Hong Kong securities and futures markets has always been part of the core mission of the SFC. However, the market downturn and the global upheaval in financial systems have naturally shifted the attention of international regulators and industry participants alike to more immediate and pressing issues. Ever conscious of the need to balance (and rebalance) market development and regulation, our own efforts have also reflected this environment.

Promoting market development

We authorised seven exchange-traded funds (ETFs) during the year, raising the total number of SFC-authorised ETFs to 24. Total market capitalisation (excluding the gold ETF) amounted to US\$13.9 billion as at 31 March 2009, reaffirming Hong Kong's position as the largest ETF market in Asia (excluding Japan). Below is a summary of our efforts in helping to develop the ETF market:

- Since last July, we have extended to all market makers of The Stock Exchange of Hong Kong Ltd (SEHK) the levy exemptions previously available only to market makers of Pilot Programme securities or certain ETFs. This will allow market makers to provide better prices, thus benefiting investors.
- In August 2008, a technical delegation comprising the SFC, Hong Kong Exchanges and Clearing Ltd (HKEx) and Hong Kong ETF issuers met with the regulatory bodies and industry players in Taiwan. Technical studies on regulatory frameworks for cross-straits ETFs have been conducted while a proposal for mutual recognition and cross-listing of ETFs is being finalised. This will help further broaden investors' choices of ETF investments in Hong Kong and facilitate relevant SFC-authorised ETFs to be listed in Taiwan.



CEO Mr Martin Wheatley talks about a regulator's role in the fund management industry at a Hong Kong Investment Funds Association conference.



- We approved exemptions for corporate-form ETFs from the disclosure-of-interests requirements under the Securities and Futures Ordinance (SFO) and the requirement to be or use an approved share registrar under the Securities and Futures (Stock Market Listing) Rules. The exemptions will facilitate the listing of ETFs in different forms in Hong Kong and provide a level-playing field for all forms of ETFs. Hong Kong's approach will broadly be aligned with international practices, thus enhancing the development of the ETFs market in Hong Kong.



Chairman Mr Eddy Fong speaks about rebuilding confidence in the capital market at the Asian Financial Forum.

Meanwhile, we have continued to encourage product variety. The gold ETF was authorised in July 2008. It is a passive investment vehicle investing solely in gold bullion with the aim of tracking the price of gold. The gold futures contract was also launched by Hong Kong Futures Exchange Ltd (HKFE) in October 2008 after obtaining approval from the SFC. We also approved HKFE's proposal to facilitate members of the Chinese Gold and Silver Exchange Society to acquire trading rights of HKFE.

We contributed to developing a policy and approved the Listing Rules amendments proposed by SEHK to re-position the Growth Enterprise Market (GEM) as a stepping stone to the Main Board

and to allow the listing of overseas companies in Hong Kong by way of depositary receipts. Effective since July 2008, the amendments aim to attract more enterprises from overseas to list in Hong Kong and to streamline the transfer of listing from GEM to the Main Board.

We have been working with a mercantile exchange to process its application to operate a futures exchange. We also authorised the 13th provider of automated trading services (ATS) in Hong Kong. With this authorisation, the ATS provider can offer market participants in Hong Kong access to its market for the trading of its product.

The levy on futures contracts is a flat rate per contract. When Mini H-share Index futures contracts were launched in July 2008, we went through a legislative process to cut them to one-fifth of the standard for H-share Index futures contracts, thus lowering the charges of the new mini contracts.

To further enhance market liquidity, we conducted a consultation from February to March 2009 proposing legislative amendments to allow overseas participants remote access to Hong Kong's futures markets, on the condition that they do not establish a place of business nor conduct any dealing activities locally.

Streamlining procedures

We have revised relevant product codes and advertising guidelines so that where permissible under current legislation, certain categories of notices and advertisements of SFC-authorised products no longer require authorisation prior to issue. In addition to streamlining procedures, the revised advertising guidelines also seek to enhance disclosure in marketing materials. Consideration will be given to putting forward the legislative changes necessary to deal with the remaining categories of notices and advertisements based on our initial experience with these changes. All new applicable marketing materials have had to comply with the revised advertising guidelines since 1 January 2009, with certain grace periods for compliance for well justified cases.

Operational Review

The Codes on Takeovers and Mergers and Share Repurchases were amended on 1 August 2008 to provide greater clarity and guidance to the market. The amendments related to (i) dealings by connected discretionary fund managers and principal traders before and during an offer period; (ii) transactions involving



Deputy CEO Mrs Alexa Lam gives a keynote address at the Lipper Funds Award 2009 ceremony.

the disposal by a company of its assets or operations and the possibility of delisting of its shares; and (iii) securities borrowing and lending.

To facilitate submission of financial returns by licensed corporations, we rolled out a new, paperless e-submission system with a built-in validation function and greater flexibility for licensed corporations, in November 2008.

An on-line portal is being developed to facilitate the submission of licensing forms, along with a comprehensive revamp of our licensing process. The first phase will be rolled out during 2009 followed by the launch of the full system in 2010. When fully completed, most parts of the licensing process will be conducted via the Internet.

For the full year, we approved 7,150 licence applications, down 21% from 2007/08 due to market downturn. However, the total number of SFC licensees still grew by 9% to reach 37,310. To help lighten the financial hardship of intermediaries during the downturn, we announced a one-off, one-year waiver of licence fees for over 37,000 licensees from 1 April 2009. This is expected to provide savings of \$138 million to the industry.

Following the conclusion of a public consultation, in which market participants and users indicated their overall support for electronic submission of Disclosure of Interest Notices, we have been working with the Government and HKEx on implementation details. This will further improve the timeliness of disseminating information to the public and promote environmental friendliness.

We applied flexibility to deal with unexpected market changes and demands. When more than 500 ex-Lehman Brothers employees sent in applications to transfer their licence



We consult the public on proposed measures to enhance efficiency of the securities and futures markets.



accreditation, we reallocated resources to cope with the sudden influx efficiently and quickly. We also provided the necessary regulatory approval to the Hong Kong licensed subsidiaries of a number of global financial institutions, after changes to their corporate control as a result of government “bailouts”.

We approved amendments to the rules of SEHK and HKFE to streamline admission and registration of Exchange Participants (EPs) and their staff in May 2008. It is estimated that about 5,000 documents each year will no longer need to be submitted by EPs to HKEx.

Developing closer ties with Mainland China

We continued our efforts to reinforce Hong Kong’s role as a capital-raising centre for Mainland enterprises and strengthened our ties with overseas regulators. We did so via a number of platforms, including explaining Hong Kong’s regulatory regime to prospective players, participating in meetings and task forces, and sharing knowledge and experience with regulatory counterparts through secondments, seminars and training sessions.

“In particular, the CSRC will continue to lend support to qualified Mainland enterprises who are considering a Hong Kong listing, to Mainland securities and futures institutions seeking to set up branch operations in Hong Kong, as well as to qualified Mainland enterprises hoping to achieve synergy through collaboration with Hong Kong listed companies,”

Vice Chairman of the CSRC, Mr Yao Gang, said during his visit to the SFC in December 2008.

We have maintained close dialogue with Mainland authorities and fund management companies qualified to operate in Hong Kong. Initiatives taken during the year include:

- Developing customised licensing materials to facilitate the entry of Mainland firms into the Hong Kong market.
- Participating in a seminar organised by the China Securities Regulatory Commission (CSRC) in Qingdao in May 2008 to share views on foreign advisory entities for qualified domestic institutional investor (QDII) investments.
- A senior SFC representative continued to sit on the CSRC’s QDII expert committee which approves QDII funds.
- Exchanging views on the regulation of investment-linked assurance schemes with the China Insurance Regulatory Commission and participating in the 39th Memorandum of Regulatory Co-operation meeting for Mainland and Hong Kong regulators and stock exchange operators.

In the first quarter of 2009, we participated in two rounds of Senior Official Meeting led by the Government for the signing of Supplement VI of the Closer Economic Partnership Arrangement in order to bring new business opportunities and enhance the existing close economic co-operation and integration between the securities sectors of Mainland and Hong Kong.

Following the release of Pearl River Delta Development Plan 2008-2020 by the National Development and Reform Commission, we have been looking into various initiatives for our securities and futures industry to cooperate with counterparts in neighbouring Pearl River Delta cities. In October 2008, we attended the Hong Kong-Guangdong joint working conference led by the Government. It was agreed that Hong Kong and Guangdong would explore further co-operation concerning financial corporations, markets, businesses and professionals.

Co-operating with overseas authorities

We need to keep Hong Kong's regulatory approach in line with international standards through our involvement in the International Organization of Securities Commissions (IOSCO). During the year, we participated in a self-assessment of an overseas regulator to implement IOSCO principles in its market.

We remained active in all five Standing Committees of IOSCO, which examine many aspects of securities regulation and related issues. In particular, we provided input to set international accounting standards. Our CEO led the Task Force on Short Selling to eliminate gaps in various regulatory approaches to naked short selling, including delivery requirements and disclosure of short positions. The Task Force also examined how to minimise adverse impacts on legitimate securities lending, hedging and other types of transactions that are critical to capital formation. We

participated in other various taskforces and initiatives to identify issues related to disclosure for retail investors, risk management of brokerages, price movements and volatility in commodity futures market as well as transparency and oversight of unregulated financial entities, markets and products.

In April 2008 we signed a memorandum of understanding with the Dubai Financial Services Authority for mutual co-operation on capacity building and human capital development in Islamic finance, as well as the promotion and development of the Islamic capital market.

In July 2008 we signed a Declaration on Mutual Recognition of Cross-border Offering of Collective Investment Schemes with the Australian Securities and Investments Commission (ASIC), providing the framework for the mutual recognition by the SFC and the ASIC of schemes offered to retail investors.

In late 2008, the G-20 Summit agreed on five principles to guide financial reform: strengthening transparency and accountability, enhancing sound regulation, promoting integrity in financial markets, reinforcing international co-operation and reforming international financial institutions. We have provided input to the relevant G-20 working groups to implement these principles.

Separately, we co-hosted the Organisation for Economic Co-operation and Development Asian Roundtable on Corporate Governance in May 2008. Discussion at the Roundtable focused on effective monitoring of related-party transactions of listed companies around the world and recent corporate governance initiatives in the 20 participating countries.

Supporting development of Islamic finance

In support of the Government's initiative to develop Islamic finance, we have been working with different regulators and the Islamic finance community to enhance Hong Kong's



The SFC signs an MOU with the Dubai Financial Services Authority in support of the Government's initiative to develop Islamic finance.



attributes in becoming an Islamic finance platform and to discuss opportunities on developing Islamic products across the border.

Locally, we organised a workshop for our own staff, other regulatory bodies and government agencies. At the workshop, experienced market practitioners of the Islamic finance industry shared the latest developments in Islamic capital markets and case studies on issuance of “sukuk” (an Islamic equivalent of a bond). We spoke at forums on the growth opportunities and value of the Islamic finance industry and Hong Kong’s role as a gateway for Islamic finance in Mainland China.



A declaration of mutual recognition is signed with the Australian Securities and Investments Commission via video link.

To explore avenues for development of Islamic finance with our regulatory counterparts and industry participants, we joined a delegation to Kuala Lumpur led by the Hong Kong Securities Institute in April 2008 and participated in the Malaysia Islamic Capital Market Conference in June 2008 to meet with Malaysia’s securities regulator, its exchange as well as government and market institutions. To raise Hong Kong’s profile, we gave talks

at the Malaysian Islamic Finance Issuers and Investors Forum and the Islamic Funds Asia 2009 in Malaysia. We participated in an Islamic finance road show in Dubai and Jordan. In November 2008, we joined the Government on a visit to Dubai to exchange information and views on developing Islamic finance in Hong Kong and globally.

Communicating with market participants

In addition to our annual and quarterly reports, we also publish the Enforcement Reporter and Takeovers Bulletin, which target market practitioners. The Enforcement Reporter discusses the SFC’s enforcement work and current enforcement issues while the Takeovers Bulletin helps market players better understand takeover matters. We solicit readers’ feedback on all of our publications to help ensure that information provided is helpful. Separately, we regularly update the industry on various areas of concern in listing applications. Issues highlighted included inadequate explanation of historical financial position, future funding sources and requirements as well as insufficient due diligence by sponsors.

We issued the half-yearly “Review of the Hong Kong Securities Industry”, which provided an overview of the aggregate financial position of all licensed securities dealers and securities margin financiers, including those that are not participants of SEHK. We also issued a report on the local trends of short selling and developments in overseas short-selling activities

In July 2008 we published the Fund Management Activity Survey 2007 – an annual SFC survey on fund management activities of licensed corporations, registered institutions and insurance companies in Hong Kong.