chief executive officer's statement

"It is my firm belief that we should not lose track of what is best and most appropriate for Hong Kong while we continue to participate in global efforts to harmonise standards and approaches to financial regulation."

The global financial crisis has continued to present challenges both to financial markets and to regulators worldwide. Whilst concerted government action in Western economies has provided stimulus packages to cushion the economic impact, much uncertainty remains as these stimulus packages are gradually withdrawn and markets have to look again at the fundamentals of economic growth, earnings, debt, employment etc. Against this backdrop of economic uncertainty, regulators worldwide have been looking at rules and structures with the hope that such devastation to our financial infrastructure can never happen again. History, of course, tells us otherwise – time and time again, global imbalances, credit expansion and excess valuations build up in the system to the point where something bursts, potentially, as in the current crisis, with far reaching effects.

Risk despite recovery

From many perspectives, Hong Kong and indeed, much of Asia, has survived the immediate financial crisis relatively well. We have not experienced the collapse of a major bank or broker. We have not seen the massive write-down of impaired assets that other markets have. We have not been exposed to the collapse of elaborate "ponzi" schemes and the implosion of hedge funds. What we have had, is the impact of the collapse of the Lehman Brothers (LB) group, which affected every market in the world in ways not expected or predicted. In the case of Hong Kong, this exposed the fact that very complex structured products, often linked to credit and supported by complex collateral arrangements, were being sold to small and unsophisticated investors.

The resolution of this issue has occupied much of our time and focus over the past year and we are still in the process of determining how the rules and regulations regarding products and selling conduct need to change to reflect the complexity of products now available. Having been through the Asian financial crisis a little more than a decade ago, Hong Kong and the other economies in the region had put in place sturdier financial infrastructures and were in a stronger position to weather this other storm. We had few heavily leveraged instruments in the market, and our institutional investors were holding fewer complex products than their Western counterparts.

Nevertheless, we should never lose sight of risks and the fact that many of the world's major economies are still being supported by central governments' stimulus measures. There is still a clear and present danger that if the global economy slips back into recession, every economy, including Hong Kong's, will be affected.

Individuals and businesses alike should recognise that risk is ever-present in financial markets. As the saying goes, "Once burnt, twice shy." It will take some time to restore confidence in the market. It will also be a long road with many challenges to solid recovery. Hence we need to keep a close tab on the global market and to manage it to our advantage.

Progress amid difficulties

Last year was another demanding year for the SFC. I am pleased to report that we managed to maintain a strong grip on our core work, making sure that business could be conducted as usual.

Our staff carried out their duties conscientiously, despite the huge increase in work load stemming from the investigations and inquiries related to Minibonds. By looking into the policies and practices of distributors collectively, we were able to conclude by December 2009 our investigations into organisations that had distributed Minibonds. Those organisations made offers to repurchase Minibonds in settlement of issues arising out of our investigations and also agreed to rectify deficiencies in their internal controls, upgrade their selling processes and improve their complaints-handling procedures.

In addition to dealing with the fallout from the collapse of the LB group, we stepped up our work to act on market abuse, in particular insider dealing and market manipulation. Our success in prosecuting 17 cases of market manipulation and 12 charges against those suspected of insider dealing has sent very strong messages to the market that we are determined to combat market misconduct.

We remained vigilant in monitoring market activities so that when a stock listed by introduction experienced unusual price movements on debut last November, we promptly worked with Hong Kong Exchanges and Clearing Ltd to improve the process of information dissemination related to such listings.

Meanwhile, we continued to encourage depth and breadth in market activities to raise Hong Kong's standing as an international financial centre. During the year, we made further inroads to promote exchange-traded funds (ETFs) in Hong Kong by launching a series of China A-share ETFs and arranging with Taiwan to cross-list ETFs. As of 31 March, 2010, both the market capitalisation and turnover of ETFs in Hong Kong were second only to those of Japan in Asia.

At the organisational level, we continued to raise operational efficiency and streamline internal processes. As the crux to our "business process re-engineering" project, we launched an online portal to handle licensing-related matters last September and will expand its functions in the coming year to make the portal more convenient for intermediaries.

We were encouraged to learn from a recent survey that industry participants continue to rate our work positively. Our survey asked a random sample of industry participants to indicate their satisfaction level with us in various dealings over a 12-month period. Out of 586 responses, 76% rated our overall performance as "satisfied" and "very satisfied." More importantly, the survey has provided us with helpful indicators for further improvement on our operations.

Forging regulatory changes

As many would have expected, we spent considerable time and effort to address concerns over the selling practices of intermediaries and the adequacy of Hong Kong's regulatory structure. The result was a set of co-ordinated proposals that we believe will not only help shape the way retail investment business is conducted, but also give further guidance to the industry to cater for market development.

For any regulatory measure to be effective, it will have to be perceived as sensible. To help the industry understand the rationale behind the proposed changes while addressing their concerns, we engaged industry practitioners and different stakeholder groups in a three-month consultation process. The objective is to create, through regulatory changes, an environment that is safer for investors without stifling market activities.

Although it will be some time before regulatory changes can be implemented, we have already seen the effects of certain proposed enhancements. Financial institutions have been reviewing their selling practices and processes and the way they handle client complaints. Some measures are well underway. There will be some teething issues, but if they are managed properly, sensibly and transparently, we will find new business opportunities and re-build investor confidence.

Customising solutions

All in all, our approach to regulatory changes is pragmatic. Although we operate in an integrated world, we recognise that no single solution is perfect for all. Various radical proposals to tighten regulation have emerged in Europe and the United States and many of these have strong political overtones, given that so much of taxpayers' money has gone into bailing out failing financial institutions and corporations.

We are not solely a principle-based regulator; nor are we solely enforcement-led. Believing that both are important to achieve regulatory results, we prefer to remain pragmatic. An example is the way we managed short selling. We did not ban short selling as many other economies did. Knowing that our short-selling regime has worked well since the Asian financial crisis, we studied carefully the issues and conclusions made by international groups, then led the move to implement solutions in the best interests of Hong Kong.

It is my firm belief that we should not lose track of what is best and most appropriate for Hong Kong while we continue to participate in global efforts to harmonise standards and approaches to financial regulation.

Bigger role in international collaboration

Keeping pace with world standards and trends is an ongoing commitment. Last year, we participated more actively in initiatives led by the International Organization of Securities Commissions (IOSCO) through a number of task forces and committees. My chairing of the Task Force on Short Selling and the appointment of one of our senior directors to chair the Standing Committee 3 on Regulation of Market Intermediaries have allowed the SFC to further contribute to upgrading global standards.

In the past year, international regulatory agencies have had a lot of discussions on topics such as regulating credit rating agencies and hedge funds and reining in the conduct of intermediaries. But dark pools have been the subject of much debate. The SFC is part of the IOSCO team set up to examine potential regulatory issues of dark pools such as price discovery, market fragmentation and fair access. In Hong Kong, dark pools are still at a preliminary stage. Even so, we have begun studying the future development and possible impact of these activities on Hong Kong's stock market. We will continue to assess the risks and merits of these operations.

Meeting more challenges

On the front of investor education, we continued with the mass-media and interactive approaches adopted two years ago. Last year, we extended our reach to a much broader section of the community. We continue to attach great importance to cultivating a proper investing attitude, which is a continual and time-consuming process. As Hong Kong takes a step forward towards founding the Government-proposed Investor Education Council, we stand ready to further collaborate with relevant parties.

Devoting more formalised efforts to our corporate social responsibilities (CSR) initiatives will be another of our organisation's priorities next year. Our recently established CSR Committee has started implementing programmes to expand the scope of our past endeavours and to make our efforts more quantifiable and achievable. In the coming months, we can expect to see more initiatives being launched. More than a means to communicate to the public and stakeholders our accountability for the community, CSR is also an important organisational culture and value that we are keen to further develop on our existing foundation.

As financial markets evolve, we see a need to be flexible, open-minded, and self-critical to keep Hong Kong competitive as an international financial centre. Since it is our staff who will have to put our vision into action, we must foster the culture of a learning organisation. We also need to recruit, not just people, but people who are prepared to challenge the status quo, and to learn from what we do well as well as from mistakes.

It has been another hectic year for all my colleagues. I would like to extend my sincerest gratitude to them for their hard work and unquestionable devotion. There will be continual demand on us from different directions as the local and global regulatory climate changes. But I am comforted that given our staff's unwavering support, we shall be in a better position to face more challenges ahead.

M. Wheatley

Martin Wheatley
Chief Executive Officer