



There is an air of dynamism in Hong Kong which few fail to experience soon after landing at Kai Tak Airport, itself soon going to be replaced by an airport for the 21st Century. Perhaps, it is because Hong Kong is the freest and most open international financial centre in the world. Many world renowned studies, such as those conducted by the World Economic Forum, the Hoover Institute, the Heritage Foundation and successive National Treatment Studies by the US Government, have so concluded. As Hong Kong becomes a Special Administrative Region (SAR) of China on 1 July, I am confident that it will continue to grow and prosper not only as the international financial centre for China but as a leading financial centre of Asia.

One need only look at the significant changes in our markets over the last decade to see how far we have come and what great potential we still have. The Stock

Exchange of Hong Kong has moved from 15th to 8th place among world stock markets in terms of capitalisation, and is second in Asia only to Japan. Over the past 10 years, the Hang Seng Index increased more than 6 times and market capitalisation grew 10-fold. The Hong Kong Futures Exchange has also grown from strength to strength; trading in Hang Seng Index Futures Contracts has increased by 19 times since 1989.

### Growing Sophistication

Our markets have grown not only in size but also in sophistication. There is a wide range of derivative instruments traded in both Exchanges

and over-the-counter. Our trading and clearing systems compare very favourably to the state-of-the-art in the most sophisticated markets of the world.

Reflecting this growing sophistication, institutional participation in our growing stock market has grown to over 50%, the highest proportion of institutional participation in any market in Asia outside of Japan. We have not only all the major international securities and investment banking firms represented in Hong Kong but also nearly all of the largest

international investment management firms as well. We also have some 1,300 authorised unit trusts and mutual funds, the largest number authorised in Asia outside of Japan.

### The China Dimension

The strength of the Hong Kong market also comes increasingly from its China

dimension. Since 1993 when the Securities and Futures Commission and the Stock Exchange signed a Memorandum of Regulatory Co-operation with their counterparts in China, 30 H-shares have been listed on the Exchange raising over US\$5 billion in the process.

China's expected infrastructure bill, estimated at US\$774 billion over the next decade, will generate strong demand for capital market instruments. Hong Kong's well-developed systems and structures, as well as its China expertise, make it well placed to serve these needs. As the China market matures, its huge pool of investors and private savings will





represent a tremendous potential market for Hong Kong products. As local intermediaries and those in China develop closer links, the skills and expertise available in Hong Kong and the client connections of Mainland intermediaries will work together, providing new growth opportunities for all.

### Openness in Our Society

All this growth and sophistication would not have been possible if there had been no confidence in our markets. Our regulatory philosophies and our regulatory systems are geared to instilling confidence in our markets while at the same time encouraging innovation. That has been the guiding philosophy of the Commission since its inception.

But it must always be remembered that it is the openness which pervades our society which is truly at the root of our success. This openness is supported by a sense of security which everyone feels - confident that property, life and liberty will be protected, that decisions which affect the commonwealth are publicly discussed and criticism of these may be freely expressed, that public servants are publicly accountable for their actions, that government is unobtrusive and efficient, and that the rule of law is backed by an independent legal profession and an independent judiciary. This is a culture which will continue to evolve.

### The New Era

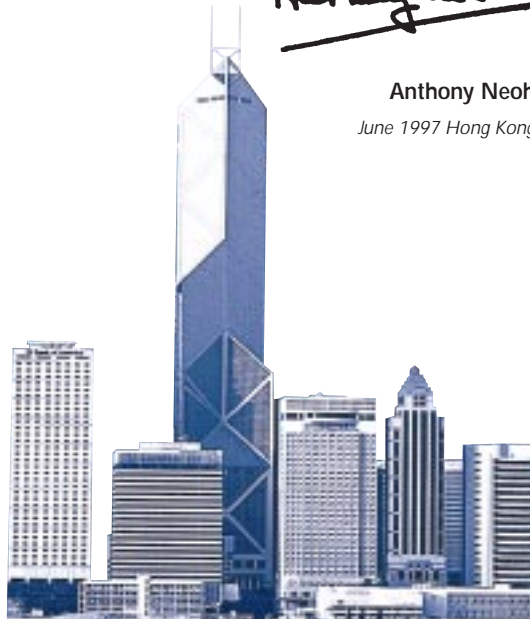
The Joint Declaration between the United Kingdom and the People's Republic of China and the Basic Law, Hong Kong's future constitution, explicitly build on this evolving culture. In 160 articles, the Basic Law sets out the future institutions of the Hong Kong SAR. They are familiar provisions because

they by and large seek to codify our current way of life. In particular, they recognise Hong Kong's position as an international financial centre and mandate the free flow of capital, an independent monetary and taxation system, and a regulatory environment conducive to international transactions. China's 1995 Five-Year Plan and its 2010 Strategic Vision underlined this commitment by pledging to maintain Hong Kong's position as an international financial centre. As the markets of the world globalise, these are essential conditions for Hong Kong to grow in the 21st Century.

The SFC seeks to serve the markets and the community at large by its accumulated experience and expertise. I am proud to be its third Chairman and the person who has the honour and the privilege of taking the organisation into the era of the SAR. **SFC**

**Anthony Neoh**

*June 1997 Hong Kong*





The Securities and Futures Commission (SFC) was established on 1 May 1989. It regulates the securities, futures and leveraged foreign exchange trading markets in Hong Kong. Its aims are to maintain market integrity, provide an appropriate measure of protection to investors, and encourage the sound development of Hong Kong markets.

The SFC has consistently sought to maintain a balance between the need for regulation and the need for markets to have freedom and flexibility to grow and innovate, bearing in mind not only the traditional characteristics which have made Hong Kong successful, but also international regulatory developments in the regulatory environment.

The SFC is an independent statutory body outside the Civil Service. It is accountable to the Government for the discharge of its responsibilities and is obliged to consult the Financial Secretary prior to exercising certain of its powers, and when making certain rules.

The Chairman and Directors of the SFC are appointed by the Governor and its annual budget must be approved by the Governor and tabled before the Legislative Council. After China's resumption of sovereignty over Hong Kong, appointments to the SFC will be made by the Chief Executive of the Hong Kong SAR.

### Functions

The SFC has four operating divisions: The *Intermediaries Division* comprises two departments (i) the Licensing Department administers the licensing requirements for

securities and commodities dealers, investment advisers, leveraged foreign exchange traders, and their representatives; (ii) the Supervision of Intermediaries Department supervises licensed persons to ensure that they are financially sound, adhere to good business practices, and are in compliance with all registration requirements.

The *Corporate Finance Division* is responsible for regulating takeovers and mergers and share repurchase of public companies, administering securities legislation related to listed companies and supervising the listing-related activities of the

Stock Exchange of Hong Kong. It also comprises the Investment Products Division which is responsible for regulating the offering to the public of unit trusts, mutual funds and other collective investment schemes, and the Investor Education Unit.

The *Supervision of Markets Division* is responsible for overseeing the operations of the Stock Exchange, the

Hong Kong Futures Exchange and the Clearing Houses to ensure the sound functioning and development of their trading, settlement and operational systems. It also administers the two statutory Investor Compensation Funds.

The *Enforcement Division* is responsible for ensuring compliance with Hong Kong's securities, futures and leveraged foreign exchange trading legislation, undertaking enquiries into suspected breaches of relevant Ordinances (including insider dealing and market manipulation) and Codes, and monitoring trading on the Exchanges to detect unusual price and volume movements. **SFC**





### **Will the SFC and the Hong Kong markets remain independent after 1 July 1997?**

Under the guarantees enshrined in the Basic Law and the “One Country, Two Systems” concept, the SFC as well as Hong Kong’s other financial institutions will continue to operate as independent bodies after 1 July 1997. The Hong Kong markets will remain separate from the Mainland markets, and Hong Kong regulators will continue to exercise their authority within Hong Kong.

### **What level of co-operation is there between the SFC in Hong Kong and its Chinese counterparts?**

A Memorandum of Regulatory Co-operation was signed between the SFC, the Stock Exchange of Hong Kong (SEHK), the China Securities Regulatory Commission (CSRC), the Shanghai Securities Exchange and the Shenzhen Stock Exchange in 1993, creating the regulatory framework which enabled Chinese enterprises to list in Hong Kong as H-shares. In 1995, an agreement concerning regulatory co-operation on futures was signed between the SFC and the CSRC. These agreements provide the basis for regular co-operation between the various authorities on matters affecting our markets.

As part of this co-operative relationship, the SFC, the SEHK and the Hong Kong Futures Exchange have a training programme for PRC regulators and exchange officials. In addition, we have been strengthening links with the senior executives of H-share companies by reaching out

to them through seminars on our regulatory system, listing rules, takeovers and mergers rules, and investor relations.

### **Over half of Hong Kong’s listed companies are domiciled overseas. Does this reflect a lack of confidence in Hong Kong?**

Domiciling overseas is only a small part of the picture. Most of these companies have their headquarters and their most profitable assets in Hong Kong. As an international financial centre, Hong Kong plays host to all companies and international enterprises, wherever

registered or domiciled. This is why Hong Kong has authorised over 1,300 unit trusts and mutual funds from all over the world and has welcomed overseas companies to list. Our regulatory system applies international standards without discrimination as to domicile.

### **How do H-share and red-chip companies compare with Hong Kong incorporated companies in terms of disclosure, transparency, and general adherence to the rules?**

Hong Kong’s regulatory system, including the Stock Exchange Listing Rules, applies equally to all listed companies generally. However, the Listing Rules contemplate that the listing of non-Hong Kong incorporated issuers may require certain additional requirements, modifications or exceptions in light of specific circumstances. The Stock Exchange applies the Listing Rules as much to Chinese and overseas issuers as they do to Hong Kong issuers.





This framework ensures that the standards of investor protection provided by all listed issuers, irrespective of their places of incorporation, are the same. The PRC enterprises which began listing their H-shares on the SEHK in 1993 have quickly responded to the disciplines of the market, and both H-share and red chip companies generally demonstrate high standards of conduct and disclosure.

**After 1 July 1997, will Shanghai or Shenzhen challenge Hong Kong's role as an international financial centre or the preferred capital formation center for the Mainland?**

The leadership in China, including Vice Premier Zhu Rongji, have stated on many occasions that Hong Kong should be further developed as an international financial centre and that Shanghai and Shenzhen will be primarily domestic markets. As China opens and expands, its capital needs will be such that all three markets will develop their own niches. As Hong Kong becomes part of China, it must develop a better understanding of the opportunities afforded by the China market and take appropriate steps to ensure its continued long-term competitiveness as a capital market for China, including the development of linkages with mainland securities and futures exchanges.



**Rival financial centres will certainly try to exploit the perceived uncertainty surrounding the 1997 issue, offering themselves as a safe haven for investors. How does Hong Kong plan to counter this challenge?**

Hong Kong is fully aware of the competition posed by other Asian markets. However, it is mistaken to link such competition to the 1997 transition; it is natural development that competition is intensifying as other markets in the region mature. The only way for Hong Kong to respond to competitive threats from other markets is to improve its own competitiveness. To that end, many improvements have been made to our financial markets in recent years, including the lowering of transaction costs, introduction of new products, and improved trading, clearing and risk management systems.

**Will there be an increase in corruption after 1 July 1997?**

Through the efforts of the Independent Commission Against Corruption and numerous individuals and organisations, Hong Kong has demonstrated a firm resolve to maintain the rule of law and to fight corruption in both the private and public sectors. Hong Kong benefits from the many checks and balances, and levels of accountability in our system of government and public affairs. Public officers are held accountable for their actions and external scrutiny is also provided by a large concentration of local and international media.





**What are some of the other market development opportunities for Hong Kong as it becomes China's leading financial centre?**

Among the many opportunities which the transition will present to our financial markets, listing and trading of PRC debts in Hong Kong, red chip futures and other "China concept" derivatives, as well as linkages between the Hong Kong and Mainland exchanges all have promising possibilities.



**How are Hong Kong's financial markets prepared to respond if events or uncertainty related to the handover lead to outflows of capital or a significant stock market drop?**

The absence of exchange control and indeed any control over the flow of capital is a crucial factor underlying the success of Hong Kong's financial markets. The Hong Kong currency peg to the US dollar, moreover, has proven to be resilient to external shocks since 1983, including the 1987 market crash, the 1990 Gulf War and the currency speculation in the aftermath of the January 1995 Mexican crisis. Our market infrastructure enables this flow of capital - in and out of Hong Kong - to be undertaken efficiently. Likewise our securities and futures

markets are one of the most liquid and deepest in the region and they have been able to withstand severe shocks in the past 10 years.

**What advantages do Hong Kong's financial markets offer to Mainland companies?**

One of Hong Kong's major attributes as an international financial centre is its ability to serve China's growth. With a large pool of financial and legal professionals, many with

China experience, Hong Kong has a natural competitive advantage for listing and trading of PRC companies, for the pricing of Mainland issues, for the development of derivatives on Mainland financial products, and for the

development of China's fund management industry. (Also see *The Hong Kong Advantages*)

**How would the convertibility of the Renminbi benefit Hong Kong?**

The liberalisation of China's financial markets and the expected convertibility of the Renminbi in the longer term will offer Hong Kong substantial opportunities to create Renminbi-based products, including futures and options contracts. As China's markets and regulatory systems come further into line with international standards and as the Mainland and Hong Kong markets become greater integrated, intermediaries from both jurisdictions will see other new avenues for growth. **SFC**





The Securities and Futures Commission has demonstrated its commitment to international regulatory co-operation through a growing network of bilateral and multilateral agreements, and active participation in regional and international organisations.

To date, the SFC has signed 26 Memoranda of Understanding and similar co-operative agreements with securities and futures regulators worldwide, providing for mutual regulatory assistance and exchange of information, as well as for future market linkages. The SFC is also a signatory to such major multilateral agreements as the 1995 Windsor Declaration, in which the world's leading regulatory bodies proposed steps to strengthen the supervision of the world's futures markets.

The SFC is actively involved in the International Organisation of Securities Commissions (IOSCO), which was established to ensure better regulation of the world's financial markets,

domestically and internationally, and to serve as a forum for exchange of information and the setting of international standards. IOSCO currently has 134 regulatory authority members from 81 jurisdictions representing more than 85% of the world's capital markets. The SFC will continue to be a full independent member of IOSCO after 1 July 1997.

Anthony Neoh, Chairman of the SFC, was in 1996 elected Chairman of the IOSCO Technical Committee, which is comprised of 16 IOSCO members which regulate some of the larger and

more developed securities markets in the world. The SFC's participation in the Technical Committee's Working Parties ensures that it is actively engaged in the formulation of international best practice in regulation and in the harmonisation of standards, now much needed in the light of continuing globalisation of financial markets.

## Commitment to International Regulatory Co-operation

Regulatory co-operation with the Mainland

authorities is also an integral component of the SFC's work. Agreements have been signed to provide the basis for regular co-operation between the SFC, the China Securities Regulatory Commission and the exchanges from both places on matters affecting our markets. **SFC**





## Hong Kong's Financial Markets Key Facts & Statistics

- The Stock Exchange of Hong Kong is the eighth largest in the world and second in Asia only to Japan in terms of market capitalisation, which has grown from US\$78 billion in 1989 to more than US\$500 billion today.
- As of mid-June 1997, 30 Chinese enterprises have listed their H-shares on the Stock Exchange of Hong Kong, raising over US\$5 billion.
- Trading in Hang Seng Index futures contracts on the Hong Kong Futures Exchange has grown from 235,976 in 1989 to 4,656,084 in 1996.
- About 1,900 businesses and 17,000 securities and futures intermediaries are registered in Hong Kong.
- Hong Kong is Asia's largest fund management centre outside Japan, with over 1,300 authorised unit trusts and mutual funds from around the world, and 200 fund management companies operating here.
- Hong Kong is one of the world's largest international banking centres and host to about 500 foreign banks from over 40 countries.

# The Hong Kong Advantages

## **China dimension**

*Increasing economic integration and co-operation between the Mainland and Hong Kong, with Hong Kong's position firmly entrenched as the preferred capital formation center for the nation.*

## **Developed market structures**

*Central clearing, central depository for shares, automated trading systems in the stock and futures exchanges, exchange-traded derivatives, and state-of-the-art risk management systems.*

## **Freedom of movement of capital**

*No exchange controls and an independent, freely convertible currency.*

## **International regulatory standards**

*International standards applied to all companies, regardless of domicile. Regulation kept under constant review.*

## **Large pool of professional skills**

*A "critical mass" of major institutions from around the world employing financial and legal professionals.*

## **Open, accountable and efficient government**

*All major policies open to public consultation, and subject to legislative and media scrutiny. A culture of efficient service to the public.*

## **Pragmatic regulatory philosophies**

*Regulation formed in partnership with the industry to ensure fair, efficient, competitive and transparent markets.*

## **Rule of law**

*A predictable regulatory and legal framework, operated under Common Law principles.*



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