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Hong Kong Maintains Tradition of Light-Handed Regulation

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The SFC has existed 17 months. It feels like more. The number of developments which have occurred in that time, both of a regulatory nature and in the marketplace itself, is large by the standards of any market. It is easy to reel off a list of the achievements of the Stock Exchange and the SFC in the past year or so. Even easier to list the still considerable agenda of initiatives which remain to be completed. But that ground is covered in the SFC's recently published annual report. More interesting is perhaps to look at the regulatory philosophy of the SFC and to reflect on some of the issues which have been the subject of recent public debate.

Earlier this year, there was much talk of "overregulation" of Hong Kong's securities market. In Hong Kong more than elsewhere, public perceptions can easily be created by a spate of strong and sometimes not very analytical talk on the luncheon-cocktail circuit. Whether the charges of overregulation were aimed at the Stock Exchange, Government or SFC (and the latter was perhaps the most popular target), there does not appear to have been much evidence to support them. What I think prompted them was partly a natural human reaction to the rapid pace of change in the regulatory framework generally over the past three years, including measures which had been in the pipeline some time previously (such as the Disclosure of Interests Ordinance and the new Insider Trading legislation). It is true that much change was, of necessity, 'bunched' into this period.

However, an objective look at the current 'level' of regulation in Hong Kong relative to other markets (even allowing for the difficulties of making such comparisons) shows clearly that we are still very much at the lightly regulated end of the spectrum compared with other international markets, including others in this region. This is particularly true in relation to rules governing the conduct of business by brokers and dealers. While I firmly believe this is the right end of the spectrum for us to be at, I do not think many market participants realise the extent to which (relative to other markets) Hong Kong is still maintaining its tradition of light-handed regulation and non-interventionism by the authorities.

In the early days of the SFC, I also think fear of the unknown (and particularly the "foreign") played a part in influencing attitudes towards regulation. We have sought to address this through communication. I hope market participants now have a better idea who we are and what we are trying to do.

As stated in its corporate plan, the SFC is guided by the belief that the primary purposes of regulation are to ensure that the integrity of markets is maintained and that they grow and perform efficiently their function of facilitating economic development and the creation of wealth.

The SFC is particularly mindful of its statutory function to promote the development of Hong Kong's markets. Some financial markets derive their strength from the size and vigour of their domestic economies. Others from attracting international business through being open and providing more efficient, sophisticated, convenient services and products. Hong Kong is in the second category. Although the domestic economy is indeed vigorous, it is not large enough to be the engine for a financial market to the extent that the economies of more populous South East Asian countries can be.

The main potential source of growth (whether in fund management or securities trading) is regional and international business attracted to Hong Kong by the advantages it offers as a marketplace and regional centre. This includes particularly business related to

China. The attraction of international business can create a virtuous circle (as London found in the European context).

In the banking and fund management areas, Hong Kong has already become a fully international centre and prospered as a result. Although our stock market is moving in a similar direction, it is still only part of the way down the road. The moves towards internationalisation have inevitably set up certain stresses and conflicts of commercial interest. Similar stresses arose in other equity markets which have undergone a process of internationalisation. These should not cause us to lose sight of the strategic objective and of the long-term benefits for the great majority of market participants, and the economy as a whole, of succeeding in making Hong Kong the predominant international equity market in this region.

Key factors which will determine success in this effort are the liquidity of the market (in turn influenced by the range and number of investors and intermediaries, and the roles they play), the efficiency of trading and settlement systems, dealing costs (relative to other centres), the range and sophistication of products available, and confidence in the stability and fairness of the market. The SFC bears all these factors much in mind when considering its various decisions and actions. Hong Kong has many natural advantages (including its well-known entrepreneurial skills, superior communications, well developed range of professional services and the presence here of most of the leading regional fund managers). Unless it shoots itself in the foot by adopting narrow inward-looking policies, it is the natural choice to become the principal regional pole in an increasingly international market. This is perfectly consistent with continuing to trade a range of securities whose appeal is mainly local.

The SFC also takes very seriously its responsibility to promote the development of self-regulation by market bodies and firms. Unfortunately, there is considerable variety in the interpretation placed on the term 'self-regulation' by different market participants. Self-regulation of the type envisaged by the Securities Review Committee involves the voluntary maintenance by practitioners of high standards of business conduct (particularly in relation to the treatment accorded to investors) and willingness by market bodies to ensure that their members adhere to such standards, by (among other things) taking disciplinary action without fear or favour, or concerns about popularity, when lapses occur.

The independence and objectivity of the executive arm of self-regulatory organisations such as the Stock Exchange lie at the core of any self-regulatory system. So do the professional and ethical standards maintained within individual firms of brokers, dealers and advisers. The success of any self-regulatory system depends on the extent to which practitioners recognise that their own long-term interest is served by the maintenance of such standards, and that sacrifices in short-term profit are often necessary to achieve this. It is not easy to persuade practitioners to moderate the pursuit of short-term profit in this way in any market. It is a particularly challenging task for the leaders of the Exchange community in Hong Kong at the present time.

The SFC recognises that perfection cannot be achieved in any market, and changes in behavioural patterns occur slowly. Responsible self-regulation has taken many years to grow in the world's most mature markets and even then has shown lapses. This is one of the reasons for requiring a properly-equipped statutory watchdog. But the Commission is sincerely committed to encouraging the performance of real self-regulatory functions by the Exchanges and to the development of self-regulatory organisations in other sectors of the market.

The role of the SFC in relation to the Stock Exchange has been the subject of various public comments by Exchange representatives, particularly in the context of alleged overlap of functions. Actual overlap occurs in one area and is well on the way to elimination. The main roles of the Stock Exchange are to regulate and develop its market, to regulate the conduct of business and financial soundness of its members, and (in the listing area) to develop and administer listing rules which ensure correct and fair treatment for public shareholders. The latter function is sometimes mistakenly referred to as self-regulation; in fact it is regulation of other people (listed companies) on behalf of the investing public.

The Stock Exchange is a public utility, enjoying a statutory monopoly and financed predominantly by a statutory levy paid by investors and by fees paid by listed companies. In carrying out its functions it has an important duty (in common with exchanges elsewhere) to represent the public interest, particularly that of investors, and to act in the best interests of the market as a whole, irrespective of the interests of particular practitioner groups.

The SFC's functions include administering the licensing system for brokers, dealers and advisers (about a third of whom are stock exchange members), supervising the conduct of business and financial status of non-exchange members, regulating the offer of investment arrangements to the public, enforcing statutory provisions relating to securities and futures dealing, advising the government on legislation and administering the Takeover Code. In relation to the Stock Exchange, the SFC is a watchdog whose function is to ensure that the Exchange is effectively and impartially carrying out its regulatory and self-regulatory functions (for which purpose the Commission must keep itself properly informed and conduct occasional checks and reviews to establish how the Stock Exchange's systems are working).

The only area in which there is currently overlap of functions is in relation to listing matters, where historically the Office of the Commissioner for Securities exercised concurrently with the Stock Exchange the function of approving corporate transactions and documents. A major part of this overlap was eliminated in 1989 when the new Stock Exchange Listing Rules came into effect. The bulk of the remaining areas of overlap (mainly approval of new listings, rights offerings and other financings, and connected or very large corporate transactions) are scheduled to be eliminated during the next few months, subject to the conclusion of a Memorandum of Understanding between the Exchange and the Commission on listing matters and the satisfactory outcome of a review of the Stock Exchange's listing function which is currently under way. The SFC's objective is to reach a situation where the Stock Exchange is responsible for the day-to-day administration of all listing matters.

In general, the SFC is no friend of regulation for its own sake. Nor is the SFC in business to inflict punishment for technical peccadillos. Cases in which real abuse may be involved are still plentiful enough. We try to be flexible and practical, to adopt Hong Kong solutions rather than imported rules, and to remove regulatory controls wherever they do not serve a clear and useful purpose (and a considerable number of rules have been removed or relaxed in the past 17 months). On some important matters, however, we are not susceptible to compromise.

A feature I have observed in Hong Kong is that where personal or commercial interests of market participants are at stake, resort to the media tends to be a reflex action (and often finds a rather uncritical reception), arguments are more than usually prone to be simplistic or designed to appeal to instinct, and debate tends to focus on individuals rather than issues. This affects not only the SFC, but it has not simplified our first year of existence. We nevertheless try not to lose our balance. Nor are we deflected from the aim of maintaining the integrity of our markets here and promoting their development in the direction that will contribute most to Hong Kong's overall prosperity.