IFex Globalisation – 8th Annual Forum
East Meeting West –
Competing Directions Within The Capital Markets

"***Regulation: Facilitating or Frustrating Trade***"
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24 April 2007

Good afternoon Ladies and Gentleman,

1. I like to thank the organiser of this event for inviting me to speak today. The theme du jour today– and for tomorrow - is globalisation and I have been asked to talk about the role of regulation in the midst of globalisation in relation to the financial securities industry.

2. Regulation – facilitating or frustrating trade? To address this question, I would like to set the context first by discussing the challenges securities regulators face and what they do to address those challenges, and then address this question at the end of my presentation.

3. The benefits of globalisation are obvious and highly visible to, I think, most people here today but maybe not the challenges. So I like to discuss a few of the key challenges that securities regulators face and talk about some of the global regulatory trends that are taking shape in the midst of increasing globalisation. And given that we all here in Hong Kong, I also like to discuss that in the context of Hong Kong. Next, I want to touch on how Hong Kong positions herself in the global market place and vis-à-vis Mainland China, which is becoming an increasingly important topic. Finally, I want to share some of the regulatory trends that are happening in Hong Kong.

4. Globalisation – welcomed by many but feared and despised by some – is a fact of life that securities regulators world wide, like it or not, have to face and embrace. Over the past years, globalisation of financial services has been growing at a fast pace. We now have many international brokers/dealers operating in all major markets to facilitate investors' entry into global markets. Global Capital – often in the form of Hedge Funds or Private Equity is not tied to any one market – it will seek returns globally in many diverse instrument classes. Recently, the rise in the demutualisation and listing of exchanges has led to an increasing trend towards exchange consolidation on a global scale. It appears that globalisation of financial markets is evolving to the next level where global market operators are emerging.

5. Regulators have mixed feelings about globalisation – they see the potential of globalisation that can help to generate and sustain domestic economic growth but that comes with a price. The price is often that the capital flows originate outside of any one jurisdiction. This is a particular concern in Asia due to the financial

crisis in 1998. So, what are the key regulatory challenges imposed by globalisation? I like to discuss two challenges of globalisation faced by securities regulators that we should pay more attention to.

Increased risks and enhanced vulnerabilities

6. The first challenge: international capital flows. As financial services become global, market participants can easily invest in overseas markets to search for better returns. This gives rise to heightened concern over the interdependence between securities markets. The global stock markets today operate like a web of network where any of the individual markets has the potential to affect the others. What we witnessed happened on 27 February demonstrates this point. On that day, the Mainland markets lost 8.8% first, followed by the European markets and then Wall Street. Hong Kong was affected too. Our Hang Seng Index dropped 1.8% and H-shares index fell 3.1 % that day.

7. There is much speculation about what caused the plunge. Some argued it was driven by Mainland China while others attributed it to the unwinding of yen carry trade (just for those who are not familiar with the term – yen carry trade refers to deals in which investors borrow yen with low interest rate to invest in other markets that pay higher rates) or maybe it is a combination of factors. Another example was the collapse of Amaranth last year. This was a so-called multi-strategy fund that got its bets badly wrong in natural gas futures. In meeting its margin calls it had to sell off positions in markets as far afield as the German mortgage backed securities market. Both of these are good examples to illustrate the far-reaching ripple effects of globalisation - how the rapid growth of cross-border trading and investment, and the growing integration and correlation between different markets in various different jurisdictions, increased the risks and enhanced the vulnerabilities of local markets from international capital flows.

Cross-border enforcement

8. Against this background, let me refer to the second challenge commonly faced by securities regulators. In globalised capital markets, the costs and effects of poor market conduct are no longer contained within domestic markets. They are usually many times magnified when investors are global. With the increasing globalisation of capital markets, it has made it harder for regulators to detect and combat poor market conduct. Further, the proliferation of new and increasingly complex financial products, traded overseas or over-the-counter (OTC), has given rise to another level of difficulties in market abuse investigation.

9. What all this means is that national securities regulators need to extend their concerns well beyond their respective geographical boundaries. We, I mean the securities regulators, need to work together to promote and protect the integrity and stability of our own markets which in turn will ensure the global capital market will operate with integrity and stability. And on this point, I am pleased to say there is a very strong collective focus among the securities regulators on raising standards of conduct within their own markets. This convergence towards global standards is advocated by the International Organization of Securities

Commissions (IOSCO for short), and on increasing cross-border cooperation for regulatory enforcement.

Global regulatory trends

10. Since I have mentioned the regulatory standards advocated by IOSCO, I should at this point provide some relevant information. IOSCO is the world's primary forum for cooperation among securities regulators. Regulatory standards set by IOSCO are recognised and accepted as international standards on securities regulation. Its members comprise securities regulators and other national bodies from more than 100 countries which cover more than 90% of the world's securities markets. So it is a very well represented and respected organisation in the securities industry.

11. IOSCO examines issues relating to the regulation of securities markets and sets international principles and standards based on its three core objectives namely: to protect investors, to make markets fair, efficient and transparent and to reduce systemic risks. IOSCO's members (of which Hong Kong is one) are expected to implement the IOSCO principles and standards in their respective jurisdictions. I will mention later some initiatives that Hong Kong has undertaken to align its regulatory framework with these international best practice standards.

12. To address the regulatory challenge of cross-border enforcement actions, IOSCO has adopted a multilateral memorandum of understanding (commonly referred to as the MMOU) in May 2002. The aim of the MMOU is to facilitate cross border enforcement and exchange of information among the securities regulators. Signatories to the MMOU will get assistance from other foreign signatories in investigations. There are currently 41 members (of which Hong Kong is one of them and I am pleased to say that Mainland China has recently joined as a signatory to the MMOU) who have signed the MMOU, while 15 have expressed commitment to obtaining legal authority to become a signatory to the MMOU.

13. With globalisation, IOSCO felt that there is a sense of urgency to improve enforcement cross border cooperation. The deadline of 1 January 2010 has been set for all IOSCO members to become signatories to the MMOU or to make a firm commitment to join. Securities regulators are also making collective efforts to improve the cross-border enforcement activities.

In the context of Hong Kong

14. So that is what is happening on the international side of things. Let me now briefly touch on how Hong Kong addresses the two regulatory challenges I mentioned earlier.

15. As at the end of March 2007, about 20% of the companies listed on the Stock Exchange of Hong Kong Limited (SEHK) are Mainland enterprises. Currently, these Mainland enterprises account for about half of the total market capitalisation and turnover. As a result of the increasing presence of Mainland enterprises in our market, the stock market in Hong Kong is not only correlated with major international stock markets, but is also increasingly affected by the Mainland

stock markets. This has made structural changes to our market and contributed to the increasing volatility. To address this issue, the Securities and Futures Commission of Hong Kong (SFC), work very closely with the Hong Kong Exchanges and Clearing Limited (HKEx) to ensure that they have a robust risk management system that can withstand highly volatile markets. And within the SFC, we have also set up a special risk monitoring team that keeps a very close eye on the market situations.

16. To conduct any investigation on the listed Mainland enterprises, we often require the assistance from Mainland regulators such as the China Securities Regulatory Commission (CSRC). And in terms of regulatory cooperation on cross border investigation and enforcement between the SFC and the CSRC, we have made a huge step progress. Both regulators have on 30 March 2007 agreed to expand their cooperation in relation to cross-border enforcement. Under the newly agreed arrangement, the SFC may request assistance from CSRC in obtaining information in the Mainland for SFC investigations. Some recent changes to the Mainland securities law have enabled the CSRC to compel persons to provide the information where previously, CSRC had to rely on voluntary cooperation. Likewise, the SFC will also exercise its investigatory powers to help CSRC. This new arrangement will enhance both securities regulators' investigation reach.

Positioning of Hong Kong in the global market place

17. Having covered the regulatory challenges and the steps taken by regulators to address those challenges, I will now move on to share with you how Hong Kong positions herself in the midst of globalisation. What I like to do is to talk about positioning of Hong Kong, first in the global market place and second, vis-à-vis Mainland China.

18. In March this year, the City of London released a report on an index of competitiveness of 46 world financial centres (the report called it the Global Financial Centre Index, GFCI for short). That report confirms London and New York as the two leading global financial centres and I am proud to say that Hong Kong has been ranked third after London and New York, ahead of Tokyo and Singapore in the region. The report states that Hong Kong has done well in all key areas which include skilled workers, free market access, regulatory balance and strong market infrastructure. The report also concludes that Hong Kong, leading the Asia markets, is a real contender to be a true global financial centre. So, Hong Kong is actually well positioned in the global market place. But of course this does not mean that we can now sit back and be complacent. In fact, we might have to do more to maintain our competitiveness since I envisage the other markets will probably be thinking along the same line to improve their market position.

19. Let's now talk about the position of Hong Kong vis-à-vis Mainland China. The Mainland's economic reform and transformation over the last two decades has offered many opportunities for partnership and cooperation between Hong Kong and Mainland China. Hong Kong has been serving as the premier fund raising centre for Mainland enterprises and as an investment platform for Mainland investors. By doing so, Hong Kong becomes the gateway between global financial

markets and China financial markets. This arrangement has benefited all parties concerned.

20. In September 2006, the Government of Hong Kong conducted an Economic Summit on "China's 11th Five-Year Plan and the Development of Hong Kong". The objective of the Economic Summit was to provide a platform for the Government, the industrial and business, professional sectors and all other stakeholders to discuss how Hong Kong should respond to the challenges and capture the opportunities arising from China's 11th Five-Year Plan. Following from that Economic Summit, the Government of Hong Kong published, earlier this year, an Action Agenda in relation to the financial services sector in its Report on the Economic Summit. The Action Agenda proposes a set of recommendations for the development of the Hong Kong financial services market, putting Hong Kong in a better position to play a strategic role in the Mainland China's financial reform and development. The SFC is already working very closely with the HKEx and market participants on a number of these initiatives.

21. One of the underlying premises of these initiatives is to put in place regulation of world-class standards. This brings me to some of the recent regulatory initiatives that we have undertaken to align our regulatory framework with international best practice standards that I alluded to earlier.

22. The higher we can elevate our regulation to international best standards, the better we can perform our role in this global market. For example, we are working to give statutory backing to certain important listing rules of the SEHK. This will significantly enhance our listing regulatory regime and improve the quality of our market. It will also bring the regulatory regime in Hong Kong more in line with international best practice. By giving statutory backing to listing rules will extend the market sanctioning regime to cover breaches of listing rules which will address the current limitations under the existing listing rules which only provide limited investigation powers to SEHK and sanctions.

23. This brings me to the end of my agenda today. But before I close my speech, I like to address the question posed at the beginning – regulation: facilitating or frustrating trade?

24. In my view, regulation does both. Hopefully by now you have a general idea of the challenges that securities regulators face today. With the barriers of international trade remove and with the aid of technology, the financial industry has been able to move and innovate at such an impressive speed that regulation has a tendency to lag behind the markets. Perhaps this is where frustrations occur. As a regulator, we welcome market developments from market participants but on the other hand, market integrity and stability are key to the continuous prosperity of the industry. We are always mindful of the need to strike a proper balance between market development and market stability.

25. With that, I end my talk today. Thank you.