

Speech at Fund Forum Asia 2010 Insight from a Regulator

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Introduction

Good morning ladies and gentlemen.

Thank you for inviting me here today.

I've been asked to provide a regulator's perspective both on investor protection matters and on facilitating development of the securities and futures industry in the current market environment.

We have been through some very turbulent times in the last couple of years, and many challenges persist. It's important to learn from past events, of course, but it's also important to be proactive and to keep looking ahead.

When and where are regulatory responses warranted?

As you know, regulators, governments and supra-national bodies are working on a number of fronts simultaneously looking at the factors that led to the recent financial turmoil and what contributed to its scale and effects, identifying instabilities and imbalances, and proposing various measures in response. Issues have been identified at many levels. These are made much more complex by the cross-border nature of many financial firms and financial transactions, the lack of transparency and degree of interdependence or concentration in some markets and the sheer scale and size of the financial sector.

There are many questions about whether, where and how there should be a regulatory response to these issues. In what areas is regulation-or further regulation-needed or warranted? How should particular areas be regulated, and by whom? Is more regulation necessarily better regulation? This calls for assessment of regulated and unregulated areas, their scope, size and possible impact, and the bases for distinctions between them. It calls for identification of areas of inconsistency and unnecessary fragmentation, or regulatory "gaps". In many areas, it also highlights a need for wider powers or increased capacity on the part of supervisory bodies to collect and share information not only about given activities but also as to their overall scope and extent so that systemic risks can more easily be identified and supervisory and regulatory measures developed if needed. Consideration needs to be given to minimising scope for arbitrage between regulatory requirements covering particular activities or types of products, or applicable in particular countries or jurisdictions. And while international co-operation is very important, the characteristics of national economies and different markets also need to be accommodated.



Regulation is not static, of course. Financial institutions and markets “adapt” to regulation. A blunt regulatory approach would be easiest to administer but would be a highly inefficient tool. Thus we need to consider whether the ideal regulatory approach in a given area should be rules-based or principle-based, or a combination of the two. The importance of focusing on substance rather than form applies not just in the context of setting regulatory policy but also in assessing whether particular business activities are consistent with the intent underpinning regulation.

In the securities and futures area we’ve seen a number of regulatory initiatives in different parts of the world in recent times. Some of these are responses, at least in part, to the financial crisis. Others are aimed at addressing and/or accommodating certain developments in the various markets.

Hong Kong considerations

The Commission’s objectives

Although Hong Kong was by no means the hardest hit in the market turmoil, it did not escape unscathed. Many of the questions I noted earlier have arisen here, at least in relation to some segments of the financial markets.

For its part, the Commission seeks the right balance between an appropriate level of protection for the investing public and scope for the market to operate efficiently and develop within a practical framework of regulation. A knee-jerk response to the recent financial crisis would not have served either purpose. Sound regulation helps to provide the necessary framework for the market to progress.

As I’m sure many of you are aware, the Commission has several specific statutory objectives, and these are set out in the Securities and Futures Ordinance. Investor protection is only one of these statutory objectives. The objectives also include maintaining and promoting the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry.

Taking us back to the two main points I’ve been asked to address, I’d like to share some thoughts with you today on some of the regulatory proposals we’ve recently published for consultation, and I’d like to complement that perspective with a look at the broader picture and initiatives to help fortify Hong Kong’s role as an international financial centre.

Bear with me for a moment while I provide a bit of background and summarise a bit of recent history.

The Hong Kong regulatory framework for the securities and futures industry includes general standards and specific requirements for disclosure of information about products, and rules and regulations governing conduct of intermediaries. These are backed up by strong and effective enforcement action against those who fail to fulfil their obligations, as well as by considerable effort and resources devoted to investor education.

Our September 2009 consultation

At the end of September last year, the Commission published a consultation paper on proposals to enhance protection for the investing public. That paper addressed



requirements for authorization of investment products and their offering documents, where they're proposed to be offered to the retail public in Hong Kong. It reviewed point-of-sale and other intermediary conduct requirements and proposed additional post-sale requirements for some investment products. It also proposed certain measures, particularly in the funds area, to codify existing practices and to provide opportunities for the industry to further mature and develop in Hong Kong.

The consultation period for the proposals in that paper closed at the end of 2009, and we received numerous responses from interested parties. It is evident that much time and effort went into many of these submissions. We would like to thank those of you who sent us responses and suggestions, and those who participated in the soft-consultation process and attended our industry briefing sessions on the various proposals. We are currently finalising our conclusions in respect of that consultation, and expect to publish these within the current quarter.

Staying with our two main themes of investor protection and market development, I'll note a few of the measures proposed in that consultation:

- On the products side, we have proposed bringing the codes covering funds, structured products and investment-linked assurance schemes together in a Products Handbook under a common set of over-arching principles. The Handbook contains a brand new structured products code, and revised codes on unit trusts and mutual funds and investment-linked assurance schemes. The new proposals and planned revisions encompass both enhancements to investor protection and measures designed to accommodate market changes and innovations, to streamline requirements for industry participants and to set out our expectations moving forward, creating a framework within which the market can continue to grow.
- Turning to selling practices, we have proposed enhancements to the "know your client" process required of intermediaries, we have raised for consideration the question of when investors should be viewed as "professional investors", and we have proposed measures aimed at addressing matters such as use of gifts in the sales process and commission disclosure practices.
- For some products, we have proposed additional post-sale requirements, such as ongoing disclosure of relevant information and liquidity provision, to help investors assess the value of their investments and to provide them with reasonable exit mechanisms. We've also looked at the feasibility of a "cooling-off" period for investors or an investor's right to "unwind" a transaction in the case of certain types of investment products.
- To facilitate investors' assessment of the risks and rewards of investment products, we have proposed that summary disclosure documents, or Key Facts Statements, should be prepared for products covered by the Handbook. We provided sample templates as part of the consultation, and these were designed to provide investors with key product information which they can readily understand and compare.

Investor education

I would like to spend some time talking about investor education, because investor financial literacy and investor responsibility are very important considerations relevant to our two themes. I mentioned before that the Commission seeks an appropriate level of protection for the investing public. By this I meant that, within our regulatory framework (which imposes certain safeguards and protections), investors should be able to make their own



investment decisions and bear responsibility for those decisions. Hong Kong's offering of investments regime is disclosure-based, not merit-based. We do not act as a gatekeeper in judging the commercial merits of all investment products offered in the market, but rather our regime requires that product providers give investors the information they need to make the necessary judgments themselves. As I noted, we have identified some areas for improvement and are proposing some enhancements to disclosure requirements for products offered to the retail market. Once the consultation conclusions are finalised and published, we also intend to devote time and resources to aggressive investor education efforts on the various changes proposed. This will be in addition to the considerable amount of work we already do to provide investors with reference materials and information about financial markets and investment products. I'm sure you've noticed that we reach out to the investor population in various different ways, through the press, on radio and television, via our website and through various events that we host.

Market development generally

Our Handbook proposes several measures aimed at facilitating further market development. I'm sure the matters of most interest to most of you here today are those contained in the revised Code on Unit Trusts and Mutual Funds. Here we have sought to level the playing field between local schemes and UCITS III funds that are marketed in Hong Kong, we have codified requirements for structured funds so that clear expectations are set for the market as a whole in this expanding area, and we are proposing to adopt a number of other measures to give fund managers and the schemes they manage more flexibility.

Meanwhile, we're seeing some encouraging signs. According to data released by the Hong Kong Investment Funds Association, the fund industry in Hong Kong has seen a marked recovery in sales of SFC-authorized funds since May 2009, with net sales consistently registered each month. For the 2009 year, net sales of SFC-authorized funds amounted to US\$2,556 million, compared with net redemptions of US\$4,646 million in 2008. Sales of SFC-authorized funds have gained further momentum in 2010, with net sales of these funds reaching an aggregate amount of US\$1,442 million in the first two months of the year, which is more than 50% of the net sales for the whole of 2009.

All of this bodes well for the Hong Kong fund market.

The broader picture

I have so far focused mainly on specific regulatory proposals in Hong Kong. The Commission also does a great deal of work on the international front, of course, and this too is relevant to the points we're looking at, and in particular to market development.

We continue to seek opportunities to broaden and deepen our markets and provide opportunities for market participants and wider choices for investors. In 2009, for example, we exchanged with the Taiwan Financial Supervisory Commission a Side Letter to our 1996 bilateral Memorandum of Understanding to provide for mutual recognition and opportunities for cross-listing of ETFs. We have, as you know, also signed memoranda of understanding with various leading financial regulators for exchange of information and regulatory co-operation.

The Commission also participates in a number of international regulatory forums such as IOSCO and the Financial Stability Board. Through these groups and forums, we exchange views and experiences with national authorities responsible for regulating the financial



markets in other significant international financial centres, co-ordinate with overseas regulators and international standard-setting bodies and contribute to development and implementation of effective regulatory, supervisory and other financial sector policies at the international level. Given the immense amount of work being done at regional and national levels to address matters highlighted by, or resulting from, the financial crisis, these forums play an ever more important role in co-ordinating and securing as much consistency as possible between regulatory measures being adopted in different markets and countries.

Conclusions

To sum up then, we're in a period of change, and we're seeing discussion and implementation of regulatory responses to aspects of the financial crisis in various parts of the world. For its part, the Commission continues to work at various levels, both domestic and international, encompassing both broad policy considerations and specific regulatory matters. We've devoted significant time and effort to measures designed as responses to issues identified as a result of the crisis. One important consideration is the appropriate level of investor protection for given market segments or product areas. However, another important objective is overall development and growth in our markets within reasonable parameters. To this end, we actively pursue avenues which can provide opportunities to enhance Hong Kong's securities and futures markets and are mindful of the need to keep our regulatory regime workable for all who participate in those markets.

Once again, thank you very much for inviting me to share my thoughts with you in the Forum today.