

SEC Regulation Outside the United States

The 6th Annual Conference, Hong Kong Convention and Exhibition Centre, Tuesday 9 October 2007

Ladies and gentlemen, it is my great pleasure to address you this morning at this, the sixth annual conference of SEC Regulation Outside the United States.

During today's sessions, you will be examining a range of topics, including hedge funds and compliance and regulatory matters. In keeping with these particular themes, I feel it appropriate to speak to you concerning the efforts that we have recently made to clarify the regulatory approach that the Securities and Futures Commission takes to the licensing of hedge fund managers in Hong Kong.

In June this year, we issued a circular, which is available for viewing on the SFC's website, concerning our general approach to the licensing of hedge fund managers. We decided to do this because we had received numerous comments in the preceding months that some hedge fund managers were choosing not to become licensed in Hong Kong as a result of the perceived difficulties that were placed in the way of applicants applying for Hong Kong licences. We were told that instead of coming to Hong Kong, people were tending to set up business elsewhere in Asia where a different and very much more relaxed licensing regime is in existence. Hong Kong is a very important market for international fund managers. We would be doing them a disservice if we did not clarify the position for them and they ended up missing the exciting opportunities here because they chose to locate in a smaller or less

vibrant market as a result of anecdotal stories they heard about perceived difficulties in Hong Kong.

It may be true that there are other jurisdictions in Asia where it is not difficult for a hedge fund manager to become licensed. We are not competing with those jurisdictions to become the Asian jurisdiction with the most relaxed licensing standards for hedge fund managers. This, we believe, would not be in the best interests of Hong Kong and would not preserve its reputation for having regulatory standards that strike an appropriate balance between allowing intermediaries to have access to our market while, at the same time, protecting investors. Having said this, however, it is not as difficult to become licensed in Hong Kong as some people appear to believe.

Our licensing system allows us a good measure of discretion in deciding whether to grant a licence. We are obliged by statute to satisfy ourselves that applicants are fit and proper persons to be licensed in Hong Kong. The notion of whether a person is fit and proper involves making determinations in relation to matters such as an applicant's financial status, integrity, reputation, character and reliability. In addition, and importantly, we must satisfy ourselves as to an applicant's qualifications, experience and ability to carry on business in a competent and appropriate manner.

When considering qualifications, experience and competence, we have always been prepared to entertain requests from applicants that their qualifications and experience in other jurisdictions be taken into account when deciding whether some of our normal requirements, such as passing local regulatory examinations, should be waived or relaxed. In exercising our discretion in these areas, we have always taken a sensible and pragmatic approach.

Earlier this year we began to realise that more overseas hedge fund managers were unaware of this flexibility than we had previously believed. Moreover, we also realised that some of their professional advisers in Hong Kong were actually misleading them as to our requirements. Because we were aware that most substantial and reputable European and US hedge fund managers knew of the advantages of being licensed in Hong Kong and that most of them started from the position that they preferred to be in Hong Kong, we decided to take steps to correct the misinformation and misunderstandings swirling around the world concerning our licensing requirements. We felt that this was important, to ensure that hedge fund managers did not choose to locate their businesses elsewhere in Asia by default, through a lack of awareness of our requirements.

In May this year, we invited a group of Hong Kong lawyers and prime brokers to our office to clarify our licensing requirements in relation to hedge fund managers. We followed this up in June by issuing the circular to which I have already referred. The main points that we communicated to the market at that time concerned the following matters:

Research Offices

Under Hong Kong law, it is usually unnecessary for an overseas hedge fund manager to be licensed if its Hong Kong office is merely providing advice on securities and/or futures contracts to its holding company, the wholly owned subsidiaries of its holding company and its own wholly owned subsidiaries.

Essentially, the position is that a licensing requirement will arise in Hong Kong if the Hong Kong office provides research analysis and/or investment

advice to external clients, but normally a requirement to be licensed will not arise if this is merely being provided to group companies.

US and UK Hedge Fund Managers

Firms that are already licensed or registered by the United States SEC or the United Kingdom FSA as investment managers or advisers can expect to benefit from a streamlined licensing process in Hong Kong if they have good compliance records and they serve only professional investors.

Firms that have not been licensed or registered with the SEC or the FSA can still benefit from the same streamlined licensing process if they have proven track records.

Competence Requirements for Responsible Officers

Each corporation licensed in Hong Kong must have at least two responsible officers, approved by the SFC, for each regulated activity for which it is licensed. Our Guidelines on Competence require a responsible officer to have at least 3 years' relevant industry experience during the 6 years immediately preceding the date of his or her application to be approved as a responsible officer.

Because of the unique nature of the business conducted by hedge fund managers, we are flexible as to the experience (including overseas experience) that we will regard as relevant experience. Experience of a broad range of activities and investment strategies, such as asset management, proprietary trading, research, private equity, special situations and alternative investments,

is regarded by us as industry experience directly relevant to hedge fund management.

We regard other experience in areas such as sales, marketing or risk management as being less directly relevant to the business of a hedge fund management. Accordingly, a responsible officer with this type of experience who is approved by the SFC is likely to have a condition attached to his or her licence to the effect that he or she must, when performing the firm's business, do so under the guidance of another responsible officer whose licence is not subject to such a condition.

A responsible officer is able to request exemption from the normal requirement to pass the local Hong Kong regulatory examinations where he or she can demonstrate 8 years of industry experience in other recognised markets, or that he or she has already been licensed or registered in the US or the UK. In these cases, there will normally be a requirement that the responsible officer should be able to demonstrate that the firm has suitable regulatory and compliance support and he or she is likely to be required to attend a post-licensing refresher course on our local regulatory requirements.

We insist that at least one responsible officer be based in Hong Kong and we recognise that there will be times when both responsible officers are absent from Hong Kong. In that event, our requirement is that one of them must be contactable at all times during any such period of absence.

Office Space

Setting up and maintaining an office in Hong Kong can be expensive. We recognise this and are content to see hedge fund managers establish their

businesses in serviced offices, provided these comply with our requirements concerning matters such as security and client privacy. Suitable serviced office accommodation is readily available in Hong Kong.

As hedge fund managers grow, we have noticed a tendency for them to take their own office space. However, we do not insist upon this if the serviced office accommodation that they occupy is suitable.

Meeting Us

We actively encourage potential licence applicants to visit us prior to submitting their licence applications. We find these meetings useful because they enable us to identify any possible difficulties before the applicant goes to the trouble of submitting its licence application. We are also able to indicate whether there will be any requirements for the key personnel of hedge fund managers to pass our local regulatory examinations.

By engaging in this dialogue, we find that we simplify the licensing process for applicants and that we tend to receive applications from them which fulfil all of our requirements. This, in turn, simplifies and accelerates our licensing process. Our experience since June has been that reputable and experienced US and UK hedge fund managers receive their licences in 3-4 weeks of submitting their applications to us.

Since June, we have noticed increasing numbers of overseas hedge fund managers visiting us to discuss our licensing requirements. Interestingly, we are noticing Singapore based hedge fund managers looking to establish themselves in Hong Kong. The reasons that we are most frequently given for choosing Hong Kong in preference to other Asian jurisdictions are:

- Hong Kong's proximity to China and the vast potential that it offers to investors.
- Hong Kong's geographical location in Asia and in relation to Japan, Europe and North America.
- Access to greater levels of capital.
- Access to superior professional support.
- The availability of superior infrastructure.
- The advantage of being able to brand oneself as being the holder of a Hong Kong licence.

In concluding, I hope and trust that you will find this conference informative and beneficial. I would especially hope that those of you who are visiting Hong Kong from overseas will have an enjoyable and memorable time here. We welcome you to Hong Kong, just as we welcome intermediaries contemplating establishing a presence in our free and well regulated market who, by doing so, are wishing to benefit from the huge potential advantages that are offered by having a presence in Hong Kong.