

Towards the Unified Exchange

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*"Crisis and Change", Longman
1992*

Geography and history have made Hong Kong a home for the largest congregation of Chinese outside China. They live in a British colony under its own peculiar system of government and owe a transitory allegiance to the British Crown. This highly anomalous community has achieved a remarkable level of prosperity and economic development which, in turn, has generated important and perhaps unexpected secondary developments, including an important international securities market. Dealing in securities is almost as old as the colony itself. But the pre-war history of stockbroking in Hong Kong has little relevance to today's international market. The origin of the modern market is as recent as the opening by Ronald Li of the Far East Stock Exchange on 17 December 1969. The relevance of its early history is that securities issuance and dealing developed within the British system, particularly company and contractual law and financial practices. More relevant by far than its own history is the remarkable general level of prosperity achieved by 1969. This achievement created not only a more plausible need and base for a securities market but also, and simultaneously, the supply of disposable wealth to provide the liquidity necessary for trading in size.

Trading in Hong Kong in company shares can in fact be traced back to about 1860. In 1891 the Association of Stockbrokers in Hong Kong was formed, changing its name to the Hong Kong Stock Exchange in 1914. From that association, Hong Kong can trace 100 years of

development for its stock exchange even though the original exchange was exclusive, representing only the British and international community. A second exchange, called the Hong Kong Sharebrokers' Association, was started in 1921, giving for the first time a wider membership from the local Chinese population. The two exchanges merged in 1947, and under the name 'Hong Kong Stock Exchange', held a monopoly until 1969. This Hong Kong Stock Exchange, with its 90 registered brokers, dealt professionally with the then existing market and the economic demands placed on the market. Its ethos was recognised and appreciated in London, and the exchange enjoyed admission as a member to the International Federation of Stock Exchanges. With a degree of care about membership and the listing of securities, the exchange fulfilled the classic functions of a stock exchange - the raising of capital for business in exchange for securities and the provision of a secondary market in which holders of existing securities can sell to those who want to invest their savings. The exchange, was, however, predominantly a local secondary market. Before 1942 Shanghai was by far the larger market in the Far East in line with the comparative size and nature of the two economies.

Immediately after the war there was a burst of activity following the flow of migrants from Shanghai. Gradually, however, the annual turnover on the exchange steadied at less than HK\$200 million. As the Companies Law Revision Committee later recorded, the market was 'in the doldrums' for about 12 years. Modern activity began in about 1959 when a number of companies, mainly utilities, went public. Small investors were attracted to the market, as offers were made at a low price which quickly went to a premium. Hong Kong's early industrial growth led to the first of its post-war booms. In 1969, 32 new banks and branches were opened in Hong Kong, bringing the total to 86 licensed banks with 142 branches. The exchange reflected this financial growth with a fourfold increase in turnover and a peak in 1961 of HK\$1,414 million as the market attracted some of the influx of foreign capital attracted by Hong Kong's rapid development. Taking

advantage of the interest in the market which coincided with a wish of some of the original shareholders to sell their shares, Jardines offered shares to the public for the first time. In June 1961, 900,000 shares comprising 25 per cent of the issued capital were offered at HK\$16 a share. The issue was oversubscribed 56 times, causing a minor bank run. At the end of the first day of dealing, the shares stood at HK\$31.25, a premium of 92 per cent over the issue price, and the return of the oversubscriptions further fuelled the market boom.

A banking problem brought this bull market to an end. At times the market became static. Over periods of months in 1965 Jardines stock, for instance, moved hardly at all at quotations of HK\$12/12.5 to 12/12.75. In 1967 there was the additional political aggravation with the spillover from the Cultural Revolution which caused the Hong Kong Stock Exchange to close twice for periods of ten days in order to avoid panic selling during the civil disturbances.

Even a small market has its excesses provoking calls for intervention, but the stock market at that time was not of immediate concern to the government. Only some 65 securities were listed, with active share dealing in only 25 stocks, particularly in the eight utility companies. Overall, as Mary Higgins points out in her study entitled *Securities Regulation in Hong Kong*, capital in Hong Kong did not move through the stock market: it moved through the banks. From 1955 to 1964 full employment with high wages brought increasing bank deposits, and 'the banks drew on these funds to finance trade and corporate expansion. Hong Kong operated on a smooth system of indirect financing.'

It was the rapid development of the banking sector which was of concern, with an inquiry in 1962 into the appropriate regulation for banks in Hong Kong. The inquiry led to the *Banking Ordinance* of 1964, but despite one of the findings of the inquiry being that some banks were overcommitted to the property and securities markets, no action was taken directly in securities regulation. Exchange companies were unregulated and yet in a sense enjoyed special privileges. Anyone could form a company to run a stock exchange. In addition, the

Companies Ordinance, which restricted offers in writing to the public of shares for purchase, did not apply to shares quoted on or permitted to be dealt in by a recognised stock exchange. Even the apparent restriction of a stock exchange being 'recognised' was in effect no restriction as, until 1970, there was no legal definition of such recognition.

But the market was changing. The economic recession of 1965 led to the failure of two banks. Then came a severe general bank run with the takeover of the Hang Seng Bank by the Hongkong Bank to rescue it from the consequential liquidity problem. The banking crisis was contained by the end of 1965 but, following the crisis, financial and business circles anticipated a period of tight money, particularly in light of new government requirements for minimum reserves for banks. As a result, a few listed companies attempted the path of rights issues, and their success produced something of a shift to equity financing. The number of rights issues increased and a number of family-owned companies took advantage of the liberal listing rules to put 25 percent of their companies into public ownership. In 1968 turnover had reached HK\$944 million, its second highest level.

Then came the dynamic shift of the Hong Kong market. Once the overflow from the Cultural Revolution had been contained, the prosperity of the decade became apparent, with increased savings seeking a form of investment more profitable than deposits in a bank. Hong Kong was seen for the time being as no longer the priority matter for Beijing, and the political climate permitted investors to relax. Ronald Li, sensing the market potential, at first attempted a change of membership in the Hong Kong Stock Exchange. Failing in this, he opened the Far East Exchange, a Cantonese exchange and avowedly of more speculative intent than the original exchange. In 1969 a bull market was already under way, with securities turnover reaching HK\$2,125 million; in 1970, the first full year of the Far East Exchange, turnover rose to about HK\$6,000 million, an increase in the year of 135 per cent. The securities revolution had started.

The pickings were too good to be left to the two exchanges. At the end of 1970 seven companies formed for the purpose of running stock exchanges were incorporated under the *Companies Ordinance*. This incorporation meant that they had formed the company structure and completed the necessary procedures for registration as companies. Four of the seven were incorporated in 1970, although only two of the seven were trading in that year - the original Hong Kong Stock Exchange, with its lineage to 1891, and the Far East Exchange, which had opened its doors at the end of 1969. The next to start trading, the Kam Ngan Stock Exchange, formed basically from members of the gold market, opened its doors on 15 March 1971. With three exchanges now offering their services, total turnover in 1971 approached HK\$15,000 million, a further increase of 150 per cent on the previous year. The Kowloon Stock Exchange, the fourth exchange, opened on 5 January 1972 but never became a serious contender for share of turnover. Altogether, however, the exchanges generated a turnover of HK\$49,000 million in 1973 - almost 25 times the level in 1969 before the advent of the Far East Exchange. By 1973 Hong Kong found itself with 1,006 men and women who had decided to style themselves as stockbrokers!

A major lasting innovation arising from the popular interest in market activity was the introduction of the Hang Seng Index. The Hang Seng Bank, very much the people's bank, had begun to computerise and had developed the index for its own internal measure. The index was opened to the public in November 1969. The starting measure was of 33 constituent stocks as at 31 July 1964, which were given a value of 100 points at a quiet time without any particular activity influencing the market. Q.W. Lee, the innovator, did not realise the part he would later play at the exchange.

A huge speculative bubble had now been blown up by the exchanges from the new layer of savings and also from the support of banks which, having recovered their liquidity, began to lend on an unprecedented scale for stock exchange activity. The timing had been near perfect. The New York Stock Exchange, which had traditionally

attracted Hong Kong investors, had become a bear market early in 1969, and overseas mutual funds had also run into trouble. New listings appeared to absorb the furious rate of subscription. In 1973 the exchanges produced 53 public offers and 48 placements. This was Hong Kong's period of excess, comparable with the beginnings of the London market at the end of the 17th century. Some sensible companies were floated, while other listings were strange and offered on curious terms. Some new issues reached levels of 500 per cent of the issue price. Queues formed for prospectuses - not to read the small print, but to obtain the subscription form. As one observer at the time put it, the value of a share had nothing to do with economic ratios; it was merely the price it could be traded at in the next day's session. By early 1973 the Hang Seng Index had reached a record high of 1,775 points.

Probably the most important listing in this period was of the Hang Seng Bank itself on the Hong Kong Stock Exchange, the first bank since the war to seek a listing. Depositors queued at other banks to withdraw their money and apply for the one million \$100 shares on offer. When the lists closed on 6 June 1972 the offer was oversubscribed 29 times with an amount in excess of HK\$2,800 million, equal to nearly half the government's revenue in 1971. When the shares were traded on 13 June 1972 the price went to a high of HK\$186. As the *South China Morning Post* reported, 'Great wads of folding money for lucky investors and a stampede on the Hong Kong Stock Market marked yesterday's triumphant debut for the Hang Seng Bank.' No doubt there were also quiet celebrations in the boardroom at No. 1 Queen's Road, the Hongkong Bank having taken 51 per cent of the equity of Hang Seng in 1965.

At the outset the attitude of the government was one of benevolent neutrality. The immediate benefit for government was the sudden increase in revenue from stamp duty. The general climate was still one of non-intervention. The government had, however, not been absolutely caught out. In 1962, at the same time as the government reviewed its banking legislation, it had set up the Companies Law

Revision Committee. Company law at that time was based on the United Kingdom legislation of 1929. The idea in 1962 was that a group in Hong Kong would receive the seminal report of the British Jenkins Committee and revise Hong Kong's legislation in light of Jenkins. Unfortunately, the Hong Kong committee put off its work in the expectation of swift action in London with new company legislation. The London action fell foul of political changes and, in the meantime, the Hong Kong government had to divert its scarce resources to dealing with the banking problems of the mid-1960s.

The Companies Law Revision Committee was reconstituted in 1969 and set to work with public consultation in 1970. The committee thus had the benefit of sitting while the securities revolution developed and the new exchanges were writing their large new business. The chairman was W.K. Thomson, representing the Attorney General, and members included C.H. Wong representing the lawyers, who later was chairman of the Securities Commission at the time of the 1987 market collapse, Gordon McWhinnie representing the accountants, who was a prominent member of the commission when I arrived in Hong Kong and, representing company secretaries, Peter Scales. Their first report, on investor protection, was presented in June 1971 and its 252 pages are a model of clarity giving a historical insight into informed Hong Kong thought at that time.

The committee examined the investment opportunities offered to the Hong Kong public and the forms of protection afforded similar investors in the major overseas centres. Basically, the committee was against statutory intervention but was attracted to the fashionable wave in London, Singapore, and New South Wales of protection by registration of dealers and documents. Recommendations were framed in the Hong Kong context. As there was no equivalent in Hong Kong of the British Board of Trade, the committee deliberated as to whether the registration protection should be administered by the Registrar General with his general company law responsibilities. By that time a new government post, The Commissioner of Banking, had been created to supervise the regulation of banks. Taking this post as their model,

the committee recommended the appointment of a Commissioner for Securities to assume the registration and monitoring process. Other duties could be added, such as the monitoring of unit trusts and mutual funds, and the general promotion of investment opportunities.

As with the banking regulation, there would be no commission. Instead, there would be an advisory committee composed of men knowledgeable in the securities industry, with the commissioner as an *ex officio* member and providing the secretariat. The committee noted the growth of business in the new stock exchanges but did not see any need for government intervention. Their considered view was:

We are fully convinced that Government should not get deeply involved in attempts to regulate and supervise stock exchanges and should confine its activities in the main to ensuring that stock exchanges take action through regulation to remedy abuses whenever they occur or show signs of developing.

Nor were they concerned at the multiplicity of exchanges. The number, they concluded, would eventually be settled by economics: exchanges would succeed or fail according to whether they achieved a viable market share of business.

The committee considered, however, that statutory regulation should be applied to company takeovers. Their novel reasoning was that as the London 'City' infrastructure did not exist in Hong Kong, the City type of a code of practice for takeovers could not be effective in the Hong Kong market. The government reacted quickly to the report, no doubt stirred by the excesses now apparent. The first step was to create a Securities Advisory Council, more to give 'authoritative guidance' to the exchanges in the spirit of the dictum of the Companies Law Revision Committee than to apply detailed regulation. In January 1973 the first Commissioner for Securities was appointed.

Towards the end of 1973 came the Yom Kippur war and the massive increase in the price of oil. World inflation and general economic conditions meant the end of the bull market. The immediate

prick in the Hong Kong bubble was the discovery of forged share certificates. By 1974, with the general tightening of credit conditions, the bubble was well and truly burst, with annual turnover falling to HK\$11 billion, less than a quarter of the 1973 peak. By December 1973 the Hang Seng Index had dropped to 400 from the record high at the beginning of the year, and by December 1974 it reached a record low of 150 points. Although there were few broking failures, many people had lost money and left the market. Following the classic pattern of government being forced to act after the event, the new system of regulation was given statutory form after the collapse of the market, and from 1 March 1974 the *Securities Ordinance* and the *Protection of Investors Ordinance* became effective. A government machine was now involved in the securities market. Dealers had to be registered, and 1,200 applications were received.

In the *Hong Kong Annual Report, 1981*, Robin Hutcheon described the bubble as:

a brief era of madness that neither the government nor the people will soon forget. ... Certainly many fortunes were made. Just as certainly many were lost. And while many big companies and knowing individuals creamed large profits from this speculative aberration, the small investor was to learn a lesson that would last for many years. ... It was an era of much more than bruised pride and burnt fingers. Many, including some who had lost everything in the Sino-Japanese war, made it up in the post-war years, lost it again in the Chinese civil war, made it up again in 25 years of prosperity in Hong Kong, lost it all in 1973. And the share market was to remain in the doldrums for five years.

It was not only the stock market which was in trouble: Hong Kong began to experience its only deep recession in the post-war period. In 1972 China began to charge international prices for the basic goods it supplied to the colony. The fourfold increase in oil prices also hit the world economy. The sharp drop in trade and industrial production caused widespread unemployment and cuts in

earnings. Between March 1973 and March 1975, real wages fell by more than 18 per cent.

There was fortunately another side to the gloomy coin. Out of the securities excess, Hong Kong was left with a more experienced market, a change in membership of the exchanges with the injection of overseas interests and, through the genius of Fung King-hai, the establishment of Hong Kong's largest broker. In addition, the securities activity produced an opening for merchant banks. In 1971 Schrodgers began business in partnership with the Chartered Bank and the Kadoories. Robert Fleming followed to combine with Jardines to form Jardine Fleming, and the Hongkong Bank formed its own subsidiary, Wardley Limited. The 'City' infrastructure found absent by the Companies Law Revision Committee was beginning to form. On the wider front, there was an impetus to devise new products and Hong Kong moved successfully into plastics, electronics, and watches. A hungry industry searched for new markets. In 1976 per capita GDP surged with a growth of 25 per cent. Hong Kong was on the march again. Wages in 1978 recovered their 1973 levels and continued to move sharply upwards.

Against this background the first Commissioner for Securities began his stint. The immediate jobs for James Selwyn, a former economist of the Bank of England, were the creation of the office under his new powers and putting into some sort of shape the hitherto unregulated market. The Report of the Companies Law Revision committee gave him a useful reference guide, as it detailed the regulatory practices in other markets. The report had also drawn attention to the New South Wales legislation, which was used by the Hong Kong law draftsman as his guide. The severity of the crash, however, jolted confidence in the ability of the exchanges to reform themselves without intervention, and decisions were taken contrary to the recommendations in the report. The *Stock Exchange Control Ordinance* was enacted to prevent any additional exchanges being opened, and the advisory committee gave way to a full commission.

The commission members were the 'great and the good' from the business community but there was little cohesion at the outset.

Nevertheless, the commission did work remarkably quickly given the unpromising background. By August 1975, again contrary to the report but because an infrastructure was now in place, a code modelled on the London practice was issued to guide takeovers and mergers. The main strategic thrust, however, was the drive to replace the four exchanges by a single, unified exchange. Given that the exchanges were four separate companies each competing for market share and its own profitability, the steady and successful progress over six years was, in retrospect, a solid achievement.

In July 1974 the four exchanges came together to form the Hong Kong Federation of Stock Exchanges. Each chairman took turns in the office as chairman of the federation. While the resolutions of the federation had no legal force, the body became something more than a talking shop. By May 1977 a working party was set up of the exchanges specifically to work with the commissioner to establish a unified exchange. In July 1980 The Stock Exchange of Hong Kong Limited was formed as the incorporated basis for the projected exchange, and in the following month the Legislative Council enacted the necessary legislation for the unification process.

With securities trading comparatively quiet in the years following the collapse of 1973 and 1974, attention focused sharply on membership of the exchanges, particularly in an effort to protect existing restrictive practices in a dull market and, consequentially, the right of entry to and the market share in the projected unified exchange. In 1969 a London broker had been admitted to the Hong Kong Stock Exchange on the basis that his business would be executed by a local member who would receive full brokerage. Hoping to become full members in due course, other London brokers took up similar associate membership, although they paid full membership terms on admission. The *Securities Ordinance*, however, permitted under the law the admission of corporate members regardless of exchange practice. On its enactment, the London brokers applied for full membership.

Such a move would have changed at an early date the basis of membership of the four exchanges, but a poll of local brokers showed an overwhelming objection to the full admission of overseas members. The Hong Kong Federation of Stock Exchanges therefore resolved in February 1975 that overseas members of exchanges should be advised that they would not be accepted as full members. A reasonable conclusion was that membership of the unified exchange would be based on the traditional Hong Kong basis of local sole traders with overseas membership on associate terms. Another possible membership change, a move by the then chairmen of the Hong Kong Stock Exchange and the Far East Exchange to amalgamate, failed because of opposition from the members of the older institution.

In 1979, however, Ronald Li produced the next innovation, with the Far East Exchange breaking ranks and admitting Evans Lowe of Richardson Securities of Canada as a full member. The Hong Kong Stock Exchange, as guardians of the principle of only local full membership, complained to the Financial Secretary and to the Securities Commission. The commission, however, had no statutory standing: the federation resolutions were not legally binding and, in any case, the *Securities Ordinance* had permitted corporate membership without any nationality barrier. The federation then attempted to resolve the difficulty by enforcing a membership cordon around the single breach of its rules. In July 1979 it resolved that:

... any approach by an overseas member, or a person reasonably suspected to be acting on behalf of an overseas member, to any member Exchange seeking full membership would immediately be brought to the attention of the Council [of the federation].

To underline the purpose of the resolution, the federation minutes recorded:

The intention of the resolution is to deny overseas members, or overseas member firms, or persons reasonably suspected to be acting on behalf of an overseas member or overseas member firm, full membership of any stock exchange in Hong Kong.

The Securities Commission took this clear and firm resolution as their guide in drafting the unification legislation. Taking note of their strong opposition to overseas members, the commission formed the view that the local brokers needed some protection from overseas competitors and recommended membership of the new exchange to be on the long-accepted basis of local sole traders with only associate membership for overseas interests. The view was accepted by government and became the basis of the Unification Ordinance enacted in August 1980.

But in October 1980 - that is, after the policy for the new exchange had been formulated, accepted, and enshrined in legislation - the Far East Exchange again broke ranks and admitted as a full member the local director of the London firm of Vickers, da Costa who, up until that time, had been an associate member of the Hong Kong Stock Exchange. A miniature membership war had broken out. There was no new appeal to the federation. Instead, the Hong Kong and Kam Ngan exchanges retaliated by offering full membership to their overseas members. Ten overseas members accepted and became full members with the intention, supported by their exchanges, of gaining the same status in the unified exchange. The fact that the unification legislation made such membership impossible was disregarded.

The gulf between what was legally permitted under the *Unification Ordinance* and what had actually developed in the membership of the exchanges was wider than either the commission or the exchanges had realised. Under the legislation, no corporations or partnerships could be members of the unified exchange. In reality, the exchanges had a variety of corporate and partnership members. A seat might be in the name of a single person but be bound to the beneficial owner by a deed of trust or by some covert agreement. The beneficial owner might be a partnership or company domiciled in Hong Kong or overseas. Any deeds of trust were subject under the legislation to the agreement of the committee of the unified exchange, which had complete discretion regarding their approval. Legally, a deed of trust with a non-member was likely to be declared invalid, as

the basis of the legislation was to guarantee a closed membership of local sole traders. The barrier was not against the foreigner; for instance, it would have operated equally against the largest local broker who was the beneficial owner of a seat on each exchange controlled by deeds of trust. While some brokers, mainly the London brokers, were uneasy about the divergence between legislation and reality, the outsiders took comfort from an opinion that their deeds of trust would be approved because their seat on an existing exchange appeared to guarantee the offer of a seat on the unified exchange. This 'natural justice' comfort evaporated at the first test.

Until the first committee of the unified exchange had been elected, the legislation provided for its management to be rested in a transitional committee consisting of members of the Federation of Stock Exchanges. The Transitional Committee, with Woo Hon-fai in the chair, had the duty to receive applications for membership of the new exchange and to grant membership if they approved. Woo Hon-fai and the members of his exchange took their philosophy from their base, the Chinese Gold and Silver Society. Their attitude was partly chauvinistic but mainly coloured by the benefits they calculated flowed from a tightly controlled and Chinese membership.

On 30 September 1981 the Transitional Committee in screening applications for membership, acting within their discretion and their interpretation of the law, followed their natural instincts and decided to reject all applications involving a deed of trust with a non-member. In other words, a reversion of policy was intended to return to the position before the admission of Evans Lowe and Vickers, da Costa into the Far East Exchange. In line with this reversion of policy, the committee intended to reject about 50 applications, including the representatives of the local Sun Hung Kai as well as the overseas brokers. The commission at this stage was in some disarray with the absence of the commissioner. Fortunately, Derek Murphy, then a senior staff member, appreciated the crisis which such a decision would have created and persuaded the committee to accept a holding compromise. On his advice, the committee accepted the individuals

making the applications as members on the basis that the applicants were exercising their options as members of an existing exchange, but the approval would be conditional on a later review of the deed of trust by the committee. Public confrontation was thus avoided and the dilemma of the criteria of membership was left for the incoming committee and the new commissioner to solve.

With John Bremridge, the Financial Secretary, I met the new committee with its officers at their inauguration ceremony on 3 December 1981. The dilemma was now on my table: the first wok to need attention. It was more than patching the wok; it was the preparation of the sort of stock exchange whose utility would become a crucial factor in maintaining Hong Kong as an international financial centre after 1997.

A crucial lesson I had learned in London from the amalgamation of the British and Irish stock exchanges was that membership was easily the most sensitive matter of any exchange. Membership is the basic bread-and-butter issue, defining the parameters of competition in a national monopoly market. But probably more than economics, membership carries the history of and the prejudices arising from the development of the exchange. It is about how members have worked together and their degree of trust in each other. The spirit of membership is almost as important as the material reward.

Taking note of this sensitivity in Hong Kong was essential, if only because at the end of the day any solution to the membership dilemma required a change in the articles of association of the exchange to be approved by a 75 per cent majority of the members. On the other hand, I was confronted by the interested London parties rightly concerned at the thought of losing their seats but taking comfort from their legal advisers who questioned the construction the Exchange Committee was placing on the law and the exchange's articles. On the other hand, there was this deep-seated and emotional resistance to change, even to the point of not recognising the changes which had already occurred in the individual exchanges and which were

bringing new business for all members. My predilection was to gain the confidence of the committee. The majority had to be won.

Writing now, it is impossible to give the correct weight to the reasons behind the first change in attitude of the committee. I was fortunate that I took office in the middle of the bull market of 1979-82. Members are easier to convince about change when they are busy making money. I suspect also that the committee was beginning to feel more comfortable after a couple of months in office. Just before their formal inauguration, the committee had signed an agreement with the government under which the successful bidder for the Crown lease of what became known as Exchange Square would be required to assign to the government a floor area of some 4,000 square metres in the proposed building which would in turn be leased by the government to the stock exchange for its new trading hall and offices. The committee, looking to the eventual terms of that lease, may have considered it expedient to return a favour to the government. It may also have thought that a gesture of goodwill would be appropriate to the new commissioner who was publicly expressing a wish to apply regulation through and not against the exchange. By this gesture he would be placed in the position of 'owing a return'. Within the committee, Ronald Li must have resumed his persuasive ways. And, probably of most importance, the committee must have realised that while the Far East and Kam Ngan tickets ran, they would easily remain in control over a minority of corporate members. Woo Hon-fai and Ronald Li would be chairman on a revolving two-year basis as far ahead as they could see.

Whatever the motives, the breakthrough came on 21 January 1982, when Woo Hon-fai with his deputies Chan Siu-leun, Ronald Li, and Kenneth Wong called on me with a radical proposal. They agreed that the existing membership rules were riddled with a series of hidden arrangements. Some individual brokers were financed by an outside sleeping partner. More obviously, the position in limbo of corporate and foreign members was better resolved by agreement than by action in the courts. The new and radical proposal was that all hidden

arrangements should be abolished. Instead, there should be an open and registered permission for partnership between members and between members and non-members even if the non-member was a partnership or company. The committee drew the line at participation by banks or deposit-taking companies. At the end of a most profitable discussion, the committee said that they considered they could bring the general body of members to the necessary favourable vote on a proposal along these lines.

The skilful Woo Hon-fai followed this approach by a series of letters. The substantive letter to me was to confirm our discussion, stating clearly:

The Committee takes the views that membership should also be open to corporations, and reputable overseas dealers (corporate or individual) of substantial size. ... As the leading financial centre in South East Asia, Hong Kong should take pride in its open door policy. Participation by substantial foreign dealers will bring foreign capital and international expertise.

At the same time, on 3 February, Woo and his deputy chairmen wrote to the Financial Secretary and to the Secretary for the Civil Service to recommend that I should be appointed substantively as commissioner because, 'We sincerely believe that Mr. Fell's unique experience and expertise are invaluable to the Government as well as the securities industry here.' My first year had started on a most propitious note!

Unfortunately, the speedy solution which now seemed possible ran into the sands of bank participation in the market. Around the world the accepted barriers between broking and banking were changing. In 1982 in Hong Kong we were ahead of the international game in the permitted membership of our exchanges. Starting from scratch, but seeing the opportunities presented by the new exchanges, Fung King-hai had founded in Sun Hung Kai the company which became Hong Kong's largest broker. Ronald Li had started the revolution. Fung, more than any other single person, had brought

share dealing to the general populace. In 1977 his stockbroking company was of such a size as to be itself listed, with a substantial capital and offices overseas. As an adjunct to the securities business, a finance company was formed which in 1982 had grown sufficiently to gain recognition as a bank. Sun Hung Kai next took in as partners the then largest international broker, Merrill Lynch, and also the French bank Paribas, which had already been part of the finance company. We had no need to look overseas: our own home-grown company presented under one roof the membership dilemma with all the possible complications.

In addition, Jardine Fleming, which locally was regarded as the merchant banking arm of Jardines, controlled a stockbroking seat in each of the three main exchanges. A second merchant bank, Schrodgers, also decided in 1982 to form a broking arm and took a seat on the Far East Exchange. (Schrodgers' action illustrated the latent hostility to change. Their first application was rejected by the balloting committee of the Hong Kong Stock Exchange which had been Schrodgers' initial preference.) As a further complication, the leading Japanese brokers, Nomura and Daiwa, were run as deposit-taking companies in Hong Kong, with their deposit-taking and securities business not separated either in management or accounts. To top off the problem, the Hongkong and Shanghai Bank decided to become stockbrokers in a most bizarre manner.

The Hongkong Bank, with their subsidiary, the Hang Seng Bank, formed a company with Evans Lowe to deal in securities and commodities. The first overseas member to be admitted by Ronald Li in 1979, Lowe owned seats on the Far East Exchange and the Hong Kong Exchange and his associate, Irene So, owned a seat on the Kam Ngan Exchange. Each of the seats had an entitlement to entry to the unified exchange. Peter Wrangham, appointed as chairman of the securities company, was at the same time the head of Hongkong Bank's Hong Kong operations, a permanent representative on the Hong Kong Association of Banks which fixed local interest rates, and with his office at the same address as the new company, Mansion House

Securities Limited. The venture was probably aimed at competing with Sun Hung Kai which had started in securities and had become bankers as well as being the largest broker in Hong Kong. The immediate effect was to cause a major alarm among the brokers, who envisaged all the branches of the Hongkong and Hang Seng banks channelling customer business through their own dealer.

This move brought a further complication. The Bank of China generally tried to emulate the operations of the Hongkong Bank, maintaining, for instance, through its sister banks the same size of branch network in Hong Kong. One of its sister banks, the Po Sang Bank, had had for a long time connections with the gold market. To match the new enterprise, this bank with another of the sister banks and a local broker, Mr. Cheung of the Kam Ngan Exchange, formed Chung Mao Securities and obtained a second seat on the Far East Exchange. I had the novel experience of officiating at the inaugural party of a stockbroker whose ultimate controller was the communist government of China. While it was amusing to reflect that only in capitalist Hong Kong was such an event possible, the reality was that our membership plot had materially thickened.

Times were also changing internationally and, in particular, in London as the brokers there began to sell themselves to American banks. Two large players in the Hong Kong market were immediately affected. Hoare Govett began to pass to Security Pacific Bank and Vickers, da Costa, at that time the most influential of the foreign brokers in Hong Kong, began to pass to Citicorp. At a minor level, Hong Leong Securities, with seats on two exchanges, was controlled by a Singapore group which had purchased the Dao Heng Bank in 1982.

Looking at stamp duty paid, we calculated that seats controlled by banks accounted for some 20 per cent of turnover. On this basis, it was clear that an agreement solely between the commission and the Exchange Committee was not a tenable solution. There had to be a solution which met all the diverse interests and which also retained some coherence in the Hong Kong market. The widest possible consultation was necessary to air the problem fully and by that process

arrive, hopefully, at a consensus. The exchanges, individual brokers, banks, deposit-taking companies, lawyers, accountants, universities, and the polytechnic college were all invited to give their views. Written and oral evidence was taken. My own preference was for a stock exchange which, while meeting local criteria, would attract interest and investment from a securities industry which was rapidly moving to its predicted global basis. To gain acceptance of such a view, we needed and succeeded in stimulating a major debate.

In the end, with the agreement of the Exchange Committee, we were able in March 1984 to formulate proposals which became the basis of Hong Kong's own 'Big Bang' when the unified exchange was opened in April 1986. Through the wide consultation and preaching of our gospel, we had arrived at the necessary consensus. To gain the day, two concessions were made to the Exchange Committee.

In the first place, the committee held the strong view that no corporate member should stand for election for the committee. The commission decided that this sort of barrier was not a matter for legislation but could be dealt with in the articles of the exchange company. We took refuge in the fact that the committee's view was in line with company law in Hong Kong, which at that time prohibited a corporation itself from becoming a director of a company. We were content that corporate members would have full voting rights. There was, in any case, no head of steam from potential corporate members in 1984 for membership of the committee. A seat in the exchange was the pecuniary aim of potential members; a wider membership was the aim of the commission.

While we wanted Hong Kong to be an open market, we saw its economic purpose as meeting local and regional needs. For this reason we welcomed the mainland interest in membership and investment. The complementary overseas market at that stage was London, where the jobbers made markets in the principal Hong Kong stocks. London brokers, although the most active of overseas brokers, were nevertheless spasmodic in their trading in Hong Kong. As one London broker put it to the commission in oral evidence, they put their net down and

caught the fish as the tide came in and then put down their net again when the tide went out. In other words, they took advantage of and encouraged the volatility of the market. Nomura had, in the dark days of 1983, taken the brave step of opening large new offices, but the Japanese and American brokers were more interested in trading their own domestic securities and operated in Hong Kong through local brokers.

The second concession was an agreement about the initial market share of bank-owned companies. The committee had put forward a variety of proposals to limit trading by these companies, all of which could, in our view, have been easily circumvented. In the end, the committee agreed that there should be no legal limitation. In return, the commission assisted in negotiating a voluntary agreement between the committee and the banks on the direction of business for an initial period in the exchange while mutual trust was generated.

By these concessions we had succeeded in the proposals we had envisaged at the outset. We proposed, and it was accepted, that membership would be on a mixed basis of sole traders, partnerships, and corporate members each with its own appropriate financial structure. Ownership could be foreign, but management had to be exercised through a registered Hong Kong entity. Any financial conglomerate member had to operate through a similar separate entity for its securities business. In August 1985 the Legislative Council put these decisions into legal form, and in April 1986 the new membership began to trade in the new exchange. The membership dilemma had been solved. The main ingredient for Hong Kong's eventual 'Big Bang' had been formed.

The work on this basic question stretched from 1981, when the dilemma emerged, until well into 1984, when the solution was generally accepted. Much more work was accomplished, mainly by the Exchange Committee supported by the commission. A floor slightly larger than London's had to be designed and constructed, with a trading desk for each shareholder and space for an outcry market. A vast communication system had to be installed. Above all, an acceptable

electronic information system had to be invented in place of the much-loved chalk boards now impracticable with possibly 500 members trading.

It appears now as a smoothly conducted operation. In fact, the background from 1982 to 1984 was completely unsettled, encompassing a property and stock-market collapse, the murder of a banker, the suicide of a leading lawyer, the flight from the territory of two of his partners and a variety of developers, the defrocking and later imprisonment of the first chairman of the Hong Kong Commodity Exchange, the collapse of banks and indeed the currency, the negotiations with China, a major typhoon, and the visit of Margaret Thatcher to Beijing. As will be seen, the times were indeed interesting, but the commission had succeeded in the first of its major goals. The second but newly found goal was the matching of the stock market with a financial futures market.