SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

SFC Regulatory Forum 2018

Summary of discussions

SFC Regulatory Forum 2018

The SFC Regulatory Forum 2018 was held at the Hong Kong Convention and Exhibition Centre on 14 March. The full-day event was attended by about 900 senior regulators and leaders from the financial industry, listed companies, professional services firms and industry associations.

This year's Forum focused on the role of regulation and the SFC's strategies to address emerging challenges arising from Hong Kong's development as a leading asset management and risk management centre. Forum participants also exchanged views on the latest trends in corporate regulation, intermediary supervision and enforcement.

About the SFC

Established in 1989, the Securities and Futures Commission (SFC) is an independent statutory body set up to regulate the securities and futures markets in Hong Kong.

Our work is defined and governed by the Securities and Futures Ordinance, which sets out our powers, roles and responsibilities.

There are six statutory objectives that underpin the execution of our regulatory work.

- Maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry
- Help the public understand the workings of the industry
- Provide protection for the investing public
- Minimise crime and misconduct in the industry
- Reduce systemic risks in the industry
- Assist the Government in maintaining Hong Kong's financial stability

In carrying out our duties, we strive to strengthen Hong Kong's standing as an international financial centre.

SFC Regulatory Forum 2018

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Opening Remarks

Mr Carlson Tong, SBS, JP, Chairman, SFC

The Financial Secretary, Mr Paul Chan, distinguished guests, ladies and gentlemen, good morning.

It is my great pleasure to welcome you to our third biennial SFC Regulatory Forum.

First, I would like to thank the Financial Secretary for taking time out of his busy schedule to present the keynote address.

I also want to thank all the distinguished panellists and guests for joining us today. I know that some of you are attending this event for the second or even third time in a row. I am truly grateful for your support.

Regulation and market development

Two of the most important developments since our last Forum two years ago were probably the conclusion of the joint HKEX and SFC listing regulatory reform consultation leading to our real-time and front-loaded regulatory approach and the recent publication of HKEX's consultation paper on a new listing regime for emerging and innovative companies which proposes to allow weighted voting rights.

To further develop Hong Kong into a premier capital-raising venue connecting mainland China with the rest of the world, we have to attract a greater variety of listed companies to list.

I think it would be fair to say that neither of these could have been envisaged at our last regulatory Forum back in February 2016. Life is full of surprises!

As a result of the feedback we received from our listing regulatory reform consultation and in order to get ahead of threats to our markets, we decided to more proactively exercise our powers under the statutory listing rules in the Securities and Futures Ordinance, known as the SMLR[1].

This allows us to object to problematic IPOs and direct trading suspensions. We also have a cross-divisional taskforce tackling corporate misconduct. These efforts have already made a positive impact on market behaviour, especially in GEM.

[1] Securities and Futures (Stock Market Listing) Rules.

One thing is very clear. To further develop Hong Kong into a premier capital-raising venue connecting mainland China with the rest of the world, we have to attract a greater variety of listed companies to list here. We have been working to facilitate the listings of infrastructure project companies along the Belt and Road and emerging and innovative companies, such as new economy companies and pre-revenue biotech firms.

Attracting a greater variety of companies is also the reason why we support HKEX's recent public consultation on expanding the listing regime to include weighted voting rights. We would be most interested to hear market feedback on the various proposed safeguards and requirements.

As many of you know, we have also introduced a new Manager-In-Charge regime, also known as MIC, to clarify the accountability of senior management of licensed intermediaries. We find it encouraging that many firms took the opportunity to strengthen their governance structures, and more than 10,000 individuals were appointed as MICs.

We also took steps to stay ahead of potential problems with rapid technological innovation. We introduced new measures to reduce cybersecurity risks and issued guidance on online distribution platforms. We also took regulatory action against a number of cryptocurrency exchanges and initial coin offering issuers and alerted investors to their potential risks.

And we were very glad to see the number of SFC licensees and licensed corporations reach a record high last year. If these numbers are any indication, we are looking at an expanding industry which is dynamic and competitive. We need to be sure our approach to licensing is appropriate to address the risks and achieve the right outcomes.

Closer regulatory collaboration

The past year also saw us working more closely with our regulatory counterparts both locally and from around the world. HKMA and the SFC held a number of joint supervision meetings with banks, and we signed an MOU last year with the Hong Kong Police to formalise and further

strengthen our cooperation in combating financial crime. Recently we carried out a number of joint operations with the ICAC.

Without doubt, the interests of the SFC and the China Securities Regulatory Commission are now increasingly aligned. This will be key as the scope of our mutual market access programmes broaden over time.

Through our Chief Executive Officer Mr Ashley Alder's chairmanship of the IOSCO Board, we have helped Hong Kong play a key role in influencing the global regulatory dialogue.

What to anticipate

So these past two years were eventful for the SFC. And we will be just as busy in the coming months because there is much more to be done.

Our panels today will take on some of the most pressing questions we face, such as what is the best way for Hong Kong to deal with emerging challenges and risks? What is the right regulatory response to increasing market connectivity and disruptive technologies?

We will also be looking at how to strengthen Hong Kong's role as an international asset management centre and risk management hub. Furthermore, we will examine the role of regulation and corporate conduct. How can regulators help change corporate behaviour?

Finally, today's Forum will not be complete without a discussion on effective intermediaries supervision and enforcement.

In closing, I would like to express my gratitude to everyone who took time to attend today, and I hope you find the discussions informative and stimulating. I know I am looking forward to them.

Thank you.

Keynote Address

The Honourable Paul Chan Mo-po, GBM, GBS, MH, JP

Mr Carlson Tong, Mr Ashley Alder, distinguished guests, ladies and gentlemen, Good morning.

It's a great pleasure to be here with you today, a welcome opportunity to share some of my thoughts on developing Hong Kong's financial services and our regulatory environment.

The financial services industry, contributing almost 18 per cent to our GDP, has long been the linchpin of the Hong Kong economy. And as it continues to elevate its game, getting the regulation right, and keeping it right, is no easy trick. The pitting of principles, rules and laws against the very real needs for innovation and freedom requires fine balancing and sometimes creates sparks.

While we are highly committed to protecting investors and also our global reputation as an international financial centre, the last thing this Government wants to do is stifle innovation.

Indeed, in order for Hong Kong to stay competitive and maintain our growth momentum, we need to be innovative as well as proactive.

This is the reason why the current-term Government, which took office in July last year, is adopting a much more proactive role in driving Hong Kong's economy and enhancing our competitiveness. We will be playing the role as a facilitator and a promoter with a forward-looking and strategic perspective. We will introduce measures to support industries where we see development potential and new markets. In this regard, we have been launching new initiatives to promote the development of innovation and technology, as well as financial services.

On financial services, the Government set up the Financial Leaders Forum in August last year, chaired by yours truly and comprising leaders of key stakeholders and the financial regulators. One of the key objectives of the Forum is to examine strategic and forward-looking proposals aiming to further bolster Hong Kong's financial prowess.

Last September, following discussions at the Financial Leaders Forum, we announced enhancements to the Hong Kong Stock Exchange's decision-making and governance structure for listing regulation.

These will enable listing policies and regulatory procedures to respond to market changes more effectively. That can only boost the competitiveness of Hong Kong's listing platform, reinforcing our status as a premier capital-formation centre.

We are also preparing to roll out the expansion of Hong Kong’s listing regime to make it easier for companies from emerging and innovative sectors to list.

Following discussions at the Financial Leaders Forum, the Stock Exchange will create new chapters in the Main Board Listing Rules which will permit the listing of pre-revenue biotech issuers as well as companies from emerging and innovative sectors with weighted voting right structures and will establish a new concessionary secondary listing route for Greater China and international companies that wish to secondary list in Hong Kong.

In doing so, we must of course ensure a fine and proper balance between market development and investor protection. We must ensure that market quality will not be undermined as well.

The Stock Exchange has proposed some safeguards, from imposing requirements for weighted voting rights' beneficiaries and limits on their powers to requiring enhanced corporate governance and disclosure.

The Exchange is now consulting the market on the proposed changes, and I look forward to the implementation of the new listing regime very soon.

Of course, apart from market development, it is equally important that we continue to review our regulatory mechanisms, in order to ensure the smooth and robust functioning of the financial system and markets and the overall financial stability of Hong Kong.

Among other things, that means ensuring that our regulatory regimes are on par with international standards.

To that end, we track developments in such multilateral institutions and forums as the G20, the Financial Stability Board and the International Organization of Securities Commissions. The Securities Commissions, as Carlson has just mentioned, is chaired by Ashley, the CEO of the SFC, our good host today.

The Government has launched a number of new initiatives in recent years to enhance Hong Kong's competitiveness as an international financial centre.

When it comes to our current regulatory environment, some context may be helpful.

This year marks the 10th anniversary of the collapse of Lehman Brothers. In response to the ensuing global financial crisis, Hong Kong established a cross-sectoral resolution regime for financial institutions. It covers the banking, securities and futures and insurance sectors, giving them a set of tools designed to secure the continuity of critical financial services, while minimising risks to the public funds.

This is done by imposing the cost of failure on the shareholders and creditors of the failing financial institution, which significantly mitigates the risks to the overall stability of our financial system.

The resolution regime has been in place since July last year. And we will continue to ensure that it is consistent with the latest international standards.

Hong Kong has also put in place a comprehensive anti-money laundering and counter-terrorist financing regime.

It's built on a robust legal framework, effective law enforcement, rigorous preventive measures, capacity-building efforts and international co-operation.

That said, international standards continue to evolve, which is why we have extended the current customer due diligence and record-keeping requirements to designated non-financial businesses and professions.

These amendments come into operation this month. They will bring Hong Kong's regulatory regime up to date with the requirements of the Financial Action Task Force, further reducing the risk of money laundering and terrorist financing.

These actions will complement the SFC's enforcement work, which includes vigorously pursuing wrongdoers, seeking remedy and deterring misconduct.

Ladies and gentlemen, I would also like to take this opportunity to update you on some of our ongoing efforts on various fronts in broadening and deepening our financial markets.

Strengthening our connectivity with Mainland markets is high on our agenda. The launch of our Stock Connects with Shanghai and Shenzhen and the establishment, last July, of Bond Connect are milestones in the development of capital market access between the Mainland and Hong Kong.

These schemes help strengthen our securities and bond markets, while opening up the Mainland's financial markets to the rest of the world.

Rest assured, we will explore a wider range of mutual-access products, including an exchange-traded fund and extending the Bond Connect to cover southbound trading. That can only create more opportunities for investors and for Hong Kong.

Our city today is the world's leading offshore Renminbi business hub. We count the largest pool of Renminbi liquidity outside the Mainland. About 70 per cent of offshore Renminbi payments are handled by banks right here in Hong Kong.

We value our connectivity with the international market as well. And the SFC is working to expand the distribution network for our fund industry through mutual recognition of funds (MRF) arrangements.

Aside from our breakthrough arrangement with the Mainland, we have signed similar agreements with Switzerland and France. And the SFC will continue its MRF discussions with other major fund jurisdictions.

Then there's Fintech. And I'm pleased to note that our banking, securities and insurance regulators have each launched a sandbox of their own. These provide a welcome and a confined regulatory environment for the testing of Fintech projects before they're rolled out to the public.

Our regulators are also working together to allow the concurrent use of their sandboxes for the pilot trial of cross-sector Fintech products.

Alongside Fintech, green finance is also enjoying increasing visibility. That visibility extends to the Budget that I presented two weeks ago today. In it, I announced that a green bond issuance programme will be launched, providing funding for the Government's green public works projects. The inaugural government green bond will be issued later this year.

Let me add that the Hong Kong Quality Assurance Agency has launched its Green Finance Certification Scheme, offering green finance issuers third-party conformity assessments.

And by introducing a Green Bond Grant Scheme, we will subsidise qualified green bond issuers who use this certification scheme. This will also encourage local, Mainland and overseas enterprises to use our capital markets in financing their green projects.

And mark your calendar green for June 14. On that day, the Hong Kong Monetary Authority (HKMA) and the International Capital Markets Association will host the International Capital Markets Association Green and Social Bond Principles Annual General Meeting and Conference in Hong Kong.

It will, ladies and gentlemen, be the first time this flagship international green finance event has taken place in Asia.

In the Budget, I also highlighted the potential of Asia's rapidly expanding bond market, and the opportunity for us to take on a larger role.

Hong Kong, of course, is already a major regional destination for bond issuance, but we can, and will, do more.

First, I will expand the scope of Qualifying Debt Instruments, making bonds of any duration eligible for tax exemption in Hong Kong - provided they're registered with the Central Moneymarket Unit of the HKMA or listed on the Hong Kong Stock Exchange.

Second, I will subsidise companies issuing a bond in Hong Kong for the first time, assuming up to half of the issuance cost, capped at HK$2.5 million. And they can claim that subsidy a second time within the programme's three-year pilot period.

I believe these measures will boost interest and investment in our bond market. And that can only underscore the competitiveness of Hong Kong as an international financial centre.

Ladies and gentlemen, I know you will enjoy today's Forum, and I wish you all the best of business in 2018.

Thank you.

Panel 1: Taking Stock of Securities Regulation in Hong Kong

Moderator:

Dr Anthony Neoh

Panellists:

Mr Ken Hitchner
Chairman and Chief Executive Officer, Goldman Sachs Asia Pacific ex-Japan

Mr Graham Turl
Managing Director and General Counsel for Asia Pacific Region, BlackRock Asset Management North Asia Limited and Chairman of the Hong Kong Investment Funds Association

Mr Andrew Weir
Regional Senior Partner, KPMG Hong Kong and Chairman, Listing Committee, The Stock Exchange of Hong Kong Limited

Mr Yin Ke
Chief Executive Officer, CITIC Securities International Company Limited

Mr Ashley Alder
Chief Executive Officer, Securities and Futures Commission

The panel examined the current state of securities regulation in Hong Kong in the context of rapid innovation in financial markets and increasing connectivity with mainland China. Panellists discussed how Hong Kong could improve its competitive edge including recent initiatives to introduce new listing rules for weighted voting rights (WVR) and pre-revenue biotech companies.

Connectivity with the Mainland

Mr Ashley Alder began by describing the increasing importance of the relationship between the Securities and Futures Commission (SFC) and its Mainland counterparts as greater connectivity brought significant opportunities as well as risks. The introduction of Stock Connect was a game changer and the SFC and China Securities Regulatory Commission (CSRC) had no choice

but to cooperate to collectively manage common risks, he added.

Responding to a recent comment from an official of a stock exchange in another jurisdiction, Mr Alder stated that Hong Kong's value proposition was as an international financial centre connecting the Mainland to the world and enabling international participation in China with a measure of certainty and predictability. Whilst Hong Kong had a unique ability to bridge the common concerns of Mainland authorities and investors, the SFC operates as an independent regulator under Hong Kong's own legal and regulatory systems.

Mr Graham Turl agreed that Hong Kong's future would be dependent on its relationship with the Mainland.

Echoing Mr Alder's view, Mr Hitchner said that since the first H-share listing in 1993, Hong Kong had become Asia's premier financial centre by playing the unique role of being the gateway to China. Going forward, China's increasingly innovative economy would present new opportunities for Hong Kong's financial sector. In this regard, the recent proposal to introduce WVR was an important step.

Mr Hitchner also highlighted the importance of the connectivity between Hong Kong and Mainland markets, and the need to deepen that connectivity through the Connect schemes.

Describing the relationship between Mainland and Hong Kong capital markets, Mr Yin Ke said they each had a different role to play and one cannot replace the other. The 2005 listings of China Construction Bank and Bank of Communications in Hong Kong were a key step in China's subsequent financial reforms and Hong Kong's contribution to the Mainland economy cannot be overemphasised, he stressed.

Beyond access to capital and overseas business, Hong Kong offered unique advantages for Mainland companies, including strong regulation, an investment community which understands China and a system which made companies focus on better corporate governance, more transparency and the needs of shareholders, Mr Yin said. This was the value of Hong Kong markets for Mainland corporates, and as such corporate governance standards in Hong Kong should be strengthened further, he concluded.

In response to Dr Anthony Neoh's question about regulating the large number of Mainland-based companies listed in Hong Kong, Mr Alder said the interests of the SFC and Mainland authorities had converged as they depended on one another for information and regulatory assistance. They had also learned how to manage regulatory differences without compromising the way they operate under different systems.

Mr Yin added that Mainland companies in Hong Kong could better address challenges if they were more independent and had more communication with their home regulator, which sometimes lacked knowledge about global practice.

Proposed listing reforms

Mr Andrew Weir shared a practical perspective on the proposed listing reforms, which he said struck a sensible balance. However, because the actual rule changes were broad and relatively brief, this heightened the importance of Guidance Letters, submissions, decision making and appeal mechanisms.

He added that biotech companies made up a large proportion of the companies in the pipeline for listing. A key question was how the whole ecosystem ensured that the proposals achieved their market development aims without risking market quality and that safeguards actually worked, Mr Weir continued. He and the Listing Committee understood there were concerns about this and took them very seriously.

There was market acceptance that WVR structures would not become widespread in Hong Kong, said Mr Weir.

Mr Hitchner said his firm's research indicated that of the 27 Chinese WVR issuers in the United States (US) since 2014, about 50% had corporate WVR structures. He added that the corporate WVR debate was very important for Hong Kong to stay competitive.

Mr Weir pointed out that biotech and innovative companies tended to be heavy on intangible assets. Therefore, the valuation of these assets as well as balance sheets in prospectuses would be very important. Panellists cautioned that although biotech companies had a great deal of potential, the risks should be kept clearly in view because many of these companies might fail.

What Hong Kong was about to implement was the world's first set of rules for WVR, Mr Alder observed. He agreed with Mr Weir that the work will have only just started once the rules are in place because applying them in practice was not going to be straightforward.

Mr Hitchner agreed that the WVRs debate was very important for Hong Kong to stay competitive and the proposed system was already being actively discussed by clients.

It was important to establish Hong Kong as an innovative centre and the biotech rules go a long way to doing that, said Mr Turl. He added that he was very optimistic about the success of this because it really showed Hong Kong's 'get up and go' and 'can do' attitude.

In response to a question from the floor about whether Hong Kong was aligning to global international standards by adopting WVR, or sacrificing investor protection for the sake of enhancing its attractiveness, Mr Weir said the challenge was to make sure that the two points were not mutually exclusive.

Regulatory developments

With the SFC's new regulatory approach, Mr Alder said the regulator now interacted directly with the market far more in listing regulation and made clear the reasons for any action taken, adding that companies could challenge the SFC's action or appeal to the Securities and Futures Appeals Tribunal.

Mr Alder also said the SFC could intervene upfront and directly in cases where there was a public interest or similar concern. He was optimistic that under Mr Weir's leadership, the Listing Committee had started to think hard about the difficult task of administering the new rules. The way Listing Committee decisions could be appealed needed to be reviewed to make the process more robust, he added.

Mr Turl referenced the strong reputation of Hong Kong's stable, conservative and transparent legal and regulatory regime and noted the SFC's efforts to keep pace with international standards. He also recognised that the Government did all it could to maintain Hong Kong's status as an international financial centre, such as by encouraging its development as a fund domicile and attracting more private equity business.

However, Mr Turl noted that other financial centres were arguably quicker to keep up with innovation and Hong Kong risked falling behind. The SFC needed to turn its attention to market development and in particular think about broadening the range of ETF products, as it was not healthy to have over 70% of the ETF market focussed either on Hong Kong or Mainland securities, he maintained. The Government needed to play a larger role in policy development and ensure better coordination among regulators.

Panel 2: Hong Kong as an International Asset Management and Risk Management Centre: Opportunities and Challenges

Moderator:

Mr Blair Pickerell
Investment management industry veteran

Panellists:

Dr Au King Lun, MH, Ph.D
Chief Executive Officer, Value Partners Group Limited

Mr Brian D'Rozario
Chief Risk Officer, Asia Pacific ex-Japan, Morgan Stanley Asia Limited

Professor Liu Mingkang
BCT Distinguished Research Fellow, Lau Chor Tak Institute of Global Economics and Finance, Honorary Professor of Business School, The Chinese University of Hong Kong

Ms Christina Choi
Executive Director, Investment Products, Securities and Futures Commission

Mr Keith Lui
Executive Director, Supervision of Markets, Securities and Futures Commission

The panel discussed the opportunities and challenges facing the Hong Kong asset management industry in view of recent cross-border initiatives. Speakers also weighed the potential for Hong Kong to develop as the region's premiere risk management centre and derivatives hub as the city played an increasingly important role in connecting the Mainland and the rest of the world.

Mainland opportunities for the asset management industry

To set the scene, Professor Liu Mingkang, the ex-chairman of the China Banking Regulatory Commission, said he expected spectacular growth in the asset management industry in both

Asia and the Mainland because they currently accounted for a relatively low percentage of global assets under management. At the same time, global investors were underinvested in the Mainland. Noting recent developments and initiatives such as inclusion of China A-Shares in MSCI indices, Stock Connect, Bond Connect and Mainland-Hong Kong mutual recognition of funds (MRF), he said that Hong Kong can help bridge these gaps, with its unique advantages including the rule of law, well-developed asset management infrastructure, large pool of bilingual professionals and access to the Mainland markets.

Professor Liu later emphasised that Hong Kong could provide value-added services which the Mainland did not yet have. In particular, the rest of the world needed information about the risks in the Mainland markets which were still in the process of opening up. In this regard, Hong Kong could provide a platform of quality services including investment banking, brokers' services and independent research.

However, Professor Liu also noted that the migration from active to passive management such as exchange-traded funds (ETFs), the compression of management fees and consolidations, mergers and acquisitions in the industry may have adverse effects.

Mutual market access

To the moderator's question about the progress of Hong Kong's cross-border initiatives, Ms Christina Choi noted that the Mainland-Hong Kong MRF scheme had been operating smoothly. With the stabilisation of capital outflows and more optimistic outlook for the renminbi and the Mainland economy, more Hong Kong MRF funds had been approved by the China Securities Regulatory Commission since last year.

Ms Choi emphasised that these are long-term projects with mutual benefits for both Hong Kong and Mainland markets and a step-by-step approach was needed in order to control risks and ensure financial stability. Recently, Mainland private pension funds were permitted to invest in MRF funds from Hong Kong and this showed the importance of MRF to the Mainland and the industry's growth potential. She urged global asset managers to make good use of the MRF scheme to capture the opportunities. The SFC was also working on ways to expand mutual market access to other products including ETFs, she added.

Mr Keith Lui remarked that a major role of Hong Kong was to bring the Mainland to the rest of the world and vice versa. Stock Connect was the first time the Mainland allowed retail and other investors to invest in the Hong Kong securities market and international investors to directly access the A-share market.

Dr Au King Lun noted that Hong Kong had been playing a super-connector role since the 1990s when H-shares were first listed. Hong Kong was the first renminbi clearing centre and now had

an offshore renminbi bond market and Stock Connect. The fund industry benefited a lot from these initiatives.

Mr Brian D'Rozario agreed, observing that mutual market initiatives were all moving in a positive direction. However, he raised concerns about the quota, liquidity and some administrative issues. He remained positive about Bond Connect's potential despite some technical challenges.

Apart from the Mainland, Ms Choi mentioned that the SFC had been actively pursuing MRF arrangements with other jurisdictions to expand the distribution of Hong Kong funds and enhance Hong Kong's role as a full-service asset management centre. Explaining Hong Kong's involvement in multinational fund distribution agreements, Ms Choi said that the SFC was open to a fund passport scheme and was closely watching the Asian regional fund passport. However, these involved many challenges including tax issues and regulatory differences in various markets. In the absence of an "economic union" in Asia, the SFC believed that MRF arrangements provide the flexibility to reach mutually beneficial bilateral arrangements. Cross-border access to investment products, especially by retail investors, required deep mutual trust, understanding and cooperation between regulators.

Professor Liu added that a fund passport scheme would eventually take off in Hong Kong but it would take a long time because so far the established standards were European and much depended on the scale of the markets.

Risk management

The panel next turned to risk management. Mr Lui explained that a wide range of financial products, including equity, bond and other asset classes in the cash market, as well as their related derivatives, were needed to strengthen Hong Kong's position as a risk management centre. Building different platforms and channels was crucial to connect the Hong Kong and Mainland markets and connect the Mainland through Hong Kong to the world. As a global financial market, Hong Kong should continue to adopt international practices to maintain its advantages. In addition, regulatory cooperation was key to the whole process because markets were linked and regulators need to maintain market stability.

Recognising the importance of the ability to hedge effectively, Mr D'Rozario remarked that Hong Kong should have a broader suite of investment products focussed not only on the Mainland and Hong Kong but also the rest of Asia. Looking at its competitors which offer a wider range of futures and hedging instruments, Hong Kong could broaden the available asset classes to include commodities and fixed income.

Dr Au added that Hong Kong played a very important risk management role from a policy perspective and this included the mutual market access schemes and H-shares. It would continue to play this role until the renminbi became an internationally tradable and reserve currency.

Mr Lui cautioned that if Hong Kong wanted to be a risk management centre, it faced policy constraints relating to how Mainland authorities viewed Hong Kong's role as an offshore centre to facilitate the Mainland's growth and development. Therefore, we needed to work with Mainland counterparts to make them comfortable, and this was a step-by-step process. We also needed to find ways to help Mainland and international investors manage Mainland risks in a way they were comfortable with.

To Mr D'Rozario, one big global opportunity for the financial industry was to create a booking centre in Asia. Mr Lui concurred, adding that the regulator supports capturing the value chain for risk management, with a booking centre being one step. Firms had to decide, from a cost perspective, the pros and cons of booking regional trades in other time zones.

Derivatives

When asked whether over-the-counter (OTC) derivatives were key to risk management, Mr Lui noted this became a global issue after the collapse of Lehman Brothers and AIG which was associated with their huge derivatives positions. Hong Kong had been part of the process for implementing a new global standard for regulating the OTC derivatives market. Some OTC derivative products were now required to be cleared by clearing houses and a trade reporting

requirement had been established, so there was greater transparency in the market. Next, Hong Kong would introduce mandatory trading on recognised platforms.

Mr D'Rozario recognised positive developments in the OTC derivatives market brought about by Hong Kong regulators to ensure that complex products and risks are effectively managed with the right regulatory framework, management accountability and incentives, as well as robust inspections. He also commented that derivatives are very sophisticated products which were mainly available to institutional clients. The issue was more to do with the lack of basic futures instruments. Today, derivatives were actively used to manage risks – taking positions and defending against risks. There was an opportunity for some financial centres to create a cost-effective and efficient platform focussed on the risks which really protected the financial system.

Fintech

The moderator observed that Hong Kong had a relatively small population to run a sizeable financial services industry and had to do a fair amount of exporting of services and products. Financial technology (Fintech) was an important part of this distribution.

Whilst acknowledging the potential benefits of Fintech, Ms Choi cautioned the industry to be aware of the associated risks. In terms of fund distribution, the SFC had consulted the market on proposed guidelines on online distribution which sought to strike a balance between making it easy to distribute simple products which people can choose on their own and distinguishing them from more complex products. Positive feedback and support were received, and there were also calls for extending the proposed suitability requirements for complex products to non-online transactions.

Referencing a market survey, she added that the financial industry, and particularly the asset management industry, lagged behind in the use of Fintech. One issue was that administrative and back-office systems were still quite manual. Therefore, there was a lot of room for the industry to think of how to use Fintech in a responsible way. Regulators encouraged a healthy embrace of technology development in a balanced manner although the industry had to watch out for risks, she concluded.

Professor Liu viewed that Fintech required huge investments and multinationals including Mainland companies were likely to make these investments exclusively from their home offices. It was difficult for Hong Kong to have pure home-grown Fintech. The only viable strategy for Hong Kong was to embrace the Greater Bay Area and work closely with Mainland companies.

Mr D'Rozario concluded that Hong Kong was uniquely positioned and could not be replaced by any of its competitors. If Hong Kong were serious about becoming a true centre, it should consider how to expand products and markets and that included looking beyond the Mainland as well.

Panel 3: Corporate Conduct: The Role of Regulation in Changing Behaviour

Moderator:

Ms Teresa Ko, JP
China Chairman and Partner, Freshfields Bruckhaus Deringer and Non-Executive Director, Securities and Futures Commission

Panellists:

Mr David Graham
Chief Regulatory Officer and Head of Listing, Hong Kong Exchanges and Clearing Limited

Mr Manuel Schlabbers
Chief Executive Officer, Accudo Capital Limited

Mr David Webb
Founder, Webb-site.com

Mr Brian Ho
Executive Director, Corporate Finance, Securities and Futures Commission

The panel discussed shell manufacturing, backdoor listings and warehousing of shares, as well as the effectiveness of listing regulation in shaping corporate conduct.

The moderator Ms Teresa Ko began by asking whether recent problems in the market were problems of the rules, problems of the administration of the rules, problems of the enforcement of the rules or actually not problems at all.

Backdoor listings

To provide some context, Mr Brian Ho presented observations and statistics on the development of Hong Kong's listed market and the current challenges faced by regulators. In the past ten years, market capitalisation increased by 64% and the number of listed companies grew by 71%. It was worth noting that the proportion of GEM listings and small cap listings increased substantially between 2007 and 2017.

But market capitalisation alone cannot be viewed as an indicator of market quality, Mr Ho noted. About 45% of companies listed in 2017 recorded declining profits in the financial year immediately before listing, compared to only 10% in 2007. Only one construction company listed in 2007. However, 61 were listed between 2013 and 2016, and 30% of these companies already experienced a change in controlling shareholders or single largest shareholder. Mr Ho questioned whether business owners were incentivised by the "shell value" to list their business and sell their stakes shortly after listing.

Mr Ho then presented case studies to illustrate the SFC's front-loaded approach to regulation, including against highly dilutive rights issues and warehousing of shares, as well as the limitations it faces.

Mr David Graham responded that there were issues to address but emphasised that Hong Kong had a high quality, well-regulated market. The problems affected only a small number of companies and had a disproportionate effect on the market's reputation. Over-regulation was as dangerous as under-regulation, and we should avoid a situation where legitimate business activity was unable to take place in Hong Kong, he added.

Mr Graham also pointed out that the 61 construction companies newly listed between 2013 and 2016 may represent a meaningful percentage in terms of number of IPOs, but

it was a very small percentage in terms of market capitalisation. Hong Kong Exchanges and Clearing Limited (HKEX) had looked into problematic transactions, and in some cases required them to proceed as reverse takeovers and effectively put a halt to the transactions. He further explained that declining profits before listing could be partly attributable to the significant cost of the listing process for the smaller companies seeking a listing.

Mr David Webb gave two reasons why the Listing Rules did not work and that backdoor listings still occurred. The front door was under tighter scrutiny and more lengthy and expensive, and people knew how to structure transactions to get around the existing requirements for reverse takeovers at the back door. This was like putting bouncers on the front door of a night club while leaving the back door open.

A second issue was dragging shareholders into a new venture after disposing of the original business without returning their capital. He proposed a "cash shell test" which would instil capital discipline and prevent transactions, including disposals and fundraising, or simply hoarding of profits, which would leave the listed company with more than 50% of its net assets in net cash.

He also proposed to narrow the gap between front-door and backdoor standards. The pre-IPO profit and revenue criterion and the requirement for a public offer tranche should be removed, making the front door more accessible without lowering corporate governance. All Very Substantial Acquisitions under the Listing Rules should be treated as a new listing application and be subject to the same disclosure standard as prospectuses, whether or not they involved a change of control.

Mr Manuel Schlabbers argued from an investor's perspective that in cases of small cap companies, the prospect of the assets being sold could lead to a rerating of the assets, which in turn could be beneficial to shareholders. He was positive about backdoor listing provided that all shareholders benefited equally. However, he recognised that existing loopholes for listings attracted some companies with questionable standards. The key was ongoing regulation and minority shareholder protection, he added.

The panellists agreed that shell manufacturing was detrimental to Hong Kong's reputation as an international financial centre.

Mr Ho agreed that it was essential to tackle problems arising from backdoor listings. He explained that it was difficult to set up principles-based rules to completely eliminate backdoor listings given the variety of possible scenarios. He also pointed out that over time, market sentiment shifted from demanding room for legitimate transactions to ensuring certainty of compliance of the rules.

Mr Graham echoed Mr Ho's view, adding that recent actions by the SFC and HKEX, including a Guidance Letter issued in 2016, were effective in combating shell manufacturing.

INEDs and directors' training

Next, Ms Ko asked the panel to identify the effect of regulation on corporate governance and areas for improvement. Ms Ko noted that HKEX launched a very resourceful directors' training webcast in 2017.

Mr Schlabbers acknowledged that regulation played an important role in shaping corporate behaviour, particularly in ensuring that management acted to protect minority shareholders' interests. He cited share placements and highly dilutive rights issues as areas which required stricter regulation in Hong Kong.

Mr Webb stated that independent non-executive directors (INEDs) should be elected by independent shareholders and not by controlling shareholders to allow effective checks and balances and avoid conflicts of interest.

Mr Graham and Mr Ho held a different view, as the current rules already set out independence requirements and specified that INEDs should be accountable to all shareholders and not only controlling or minority shareholders. Mr Graham was concerned that independent shareholders might elect INEDs who would act against the interests of the company. Mr Ho opined that other policies, including a whistle-blower policy, could be more effective to improve corporate behaviour.

The panel had mixed opinions about how directors' training enhanced corporate governance. Mr Schlabbers said training would provide the board with a better understanding of finance and capital management, but it had a limited impact on enhancing business operations and how minority shareholders were treated.

Mr Graham questioned the value of mandating the amount of training required. He thought the focus should be on driving cultural change, which was hard to achieve by regulation alone. Mr Ho shared the view that these requirements may not be the most effective tool to enhance corporate governance.

Mr Webb added that while training may not guarantee a competent board, at least one INED should understand the Listing Rules to advise on the requirements. On the whole, the panellists agreed that imposing a licensing system on directors would not be the right solution.

The ideal market for Hong Kong

Turning to a wider question, Ms Ko asked panellists what their vision for the market in Hong Kong was.

Mr Schlabbers started with fair asset valuations. Small cap companies often experienced valuation discounts because small companies generally had less favourable corporate governance records which drove away foreign and institutional investors. In his view, higher market turnover and solid minority shareholder protection would make the market more attractive. It was also important to have fair treatment for all market participants, including short sellers, he added.

In Mr Webb's view, the essence of a quality market was to produce and maintain a trustworthy legal and regulatory framework, attracting good issuers which were willing to sign up to those standards in return for a premium valuation and hence a lower cost of capital, making them more economically competitive. Investors priced the risks of the framework into the price they were willing to pay. Lowering the bar only raced to the bottom and harmed Hong Kong's economic competitiveness. He also said that a class action system with litigation financing available should be introduced to allow shareholders to bring litigation against directors and companies rather than leaving the full burden of civil deterrence with the SFC.

Mr Ho considered that comprehensive deterrence comprising both statutory consequences and criminal sanctions was essential. He added that given the more interconnected markets between the Mainland and Hong Kong, regulators faced difficulty in imposing criminal sanctions on wrong-doers, and hence cross-boundary cooperation between the Mainland and Hong Kong was increasingly crucial.

Drivers of good corporate behaviour

In concluding the discussion, Ms Ko asked the panellists to prioritise their top choice of tools to deter bad corporate behaviour. To Mr Webb, moving the listing regulation entirely under the SFC and opening up the market to more than one stock exchange would avoid conflicts of interest and introduce competition, and in turn eliminate the "for-profit" element in regulation, tighten up rules and bring about better corporate conduct.

Mr Graham disagreed. He thought that rules have to work in combination with enforcement to drive behavioural change effectively, as some market participants have found ways to get around the rules. He did not believe a faster delisting process was the right tool to deter misconduct as it could harm investors' interests.

Mr Schlabbers focused on mitigating fraud and inefficient capital allocation. He suggested reducing the general mandate and tightening rules on highly dilutive rights issues and entitlement offers. He also supported the proposal to bar controlling shareholders from voting on INEDs, as well as the introduction of a cash shell test.

Mr Ho thought that the SFC's front-loaded, "One SFC" regulatory approach had proven to be effective in improving market conduct, adding that the regulator would continue with this approach.

Red flags

In response to an audience question about how to avoid investing in scam stocks, Mr Webb noted that there was a pool of independent directors, auditors and advisers who were frequently associated with problematic companies. He cited his website as a source for analysing these associations and said investors should do research and avoid companies with those directors and auditors.

Mr Schlabbers added that it was instrumental to check how the management team reinvested past profits for any sign of fraud and whether minority shareholders shared in the growth.

Panel 4: Supervision and Enforcement – Two Pillars of Securities Regulation

Moderator:

Mr Peter Stein
Managing Director, Private Wealth Management Association

Panellists:

Dr Chu Gang
Chief Operating Officer and Chairman of Capital Markets Committee, China International Capital Corporation Limited

Mr Andrew Procter
Partner, Financial Services Regulation, Herbert Smith Freehills LLP

Mr Thomas Atkinson
Executive Director, Enforcement, Securities and Futures Commission

Ms Julia Leung, SBS
Deputy Chief Executive Officer and Executive Director, Intermediaries, Securities and Futures Commission

The final panel focused on the SFC's recent supervisory and enforcement efforts to ensure firms' compliance and deter market misconduct. Panellists discussed senior management accountability, corporate fraud and manipulation, communication and deterrence, as well as keeping up with technological developments in financial services.

Senior management responsibility

Moderator Mr Peter Stein began by asking about the purpose of the SFC's Manager-In-Charge (MIC) regime and whether it achieved the desired results. Ms Julia Leung explained that the regime aimed to enhance senior management accountability by addressing some issues prevalent in the market. This was achieved by obtaining structured information on who was in charge of key business lines

and also by identifying the genuine decision-makers which the existing Responsible Officer (RO) regime had not always been able to identify. Following the regime's introduction, firms' governance and management structures had vastly improved. Some firms appointed MICs to their boards and operating committees to enhance their governance structures. Ms Leung also saw a much better alignment of ROs and senior management, with the SFC receiving some 1,300 RO applications from MICs of overall management oversight and key business lines.

Dr Chu Gang added that financial institutions needed to be held to a higher standard and that managers should not hide behind ROs. He stressed the importance of local governance, a clear management structure and individual accountability, particularly for Hong Kong where the mix of intermediaries had been changing, with local, Mainland and global firms in various stages of development with different degrees of business complexity. He thought the MIC regime was a tremendous help to companies like his in making sure that Hong Kong operations were up to standard. It also helped managers and ROs better understand the big picture and their own responsibilities.

Drawing on similar examples abroad, Mr Andrew Procter commended Hong Kong's efforts to move quickly with minimum complexity and broad coverage. He remarked that a level of prescription might be good for firms. For example, the management responsibilities maps in the United Kingdom compelled firms to focus on consistency in governance. The MIC and comparable regimes were generally described as being about governance and clearer accountability rather than enforcement. But for that to be the case, MICs needed to be given space to do what was expected of them and engage in a supervisory dialogue when something went wrong, not just be dragged into the enforcement process.

Corporate fraud and market manipulation

The moderator then turned to the SFC's recent handling of cases involving the use of "networks of companies" to commit fraud and market manipulation. Mr Thomas Atkinson highlighted that these cases allowed the SFC to cooperate with local regulatory partners, noting that its interests overlapped with those of the Independent Commission Against Corruption and the Hong Kong Police. It also helped the SFC learn new ways to gather and analyse evidence and better identify targets. When asked what could have been done to deal with those problematic companies earlier, Mr Atkinson pointed out that the SFC moved as quickly as it could by focusing on high-priority matters.

Mr Procter added that one key challenge facing global regulators was to stay on top of available intelligence. Specifically, more needed to be done to keep up with cybercriminals and share intelligence to obtain insights earlier. Mr Atkinson responded that the SFC was in talks with global regulators about intelligence sharing and kicked off a data project looking at systemic, prudential and conduct risks. It first sought to digitise information within the SFC, and would deal with external market data as a next step.

Speaking of recent enforcement actions targeting initial public offering (IPO) sponsors, Mr Atkinson revealed that the regulator was investigating 15 sponsors firms and the next round of actions would focus on sponsor principals. He cautioned that if sponsors did not do their jobs right, it would cause serious reputational damage to Hong Kong.

Ms Leung then shared the findings from the SFC's recent thematic review of sponsors which exposed continued deficiencies in their work, particularly in performing reasonable due diligence and over-relying on third parties' work. She stressed that sponsors should never abrogate their due diligence responsibilities. Insufficient management supervision also remained a persistent problem, as many new smaller-sized sponsors, which were mainly sponsors of GEM IPOs, were very aggressive in taking on new business. Since 2013, 44 IPO applications were returned or rejected due to regulators' concerns about sponsors' substandard work. She remarked that those with a history of returned or

rejected listing applications might expect more frequent inspection visits. She also noted that the SFC would soon issue a circular and a thematic report to remind sponsors of the SFC's expected standards and their responsibilities.

The SFC's recent actions served as a good reminder that sponsors should be vigilant because even some industry leaders could fail, Dr Chu added. It was therefore important for his company to be very selective in sponsoring listing applicants. Mr Stein noted that it was somewhat difficult to draw the line between not doing enough work and willfully looking the other way and asked Dr Chu how one could ensure that staff were doing what was expected of them. Dr Chu believed that it all came down to the basics: to perform thorough due diligence and set the tone from the top.

Communication and deterrence

Mr Stein then moved on to cooperation with the SFC. Mr Atkinson emphasised that the regulator would be more willing to consider reducing the penalty to be imposed if firms and individuals showed a willingness to remediate the problems. Getting the most senior people involved from the start was also useful as it would allow the SFC to better utilise its resources.

On incentives to cooperate, Mr Procter thought the SFC should make firms and individuals understand the seriousness of its concerns, and they could then react fairly and benefit from the "discount" offered. After the Global Financial Crisis, he observed a tendency in some jurisdictions for cases previously dealt with as supervisory issues to be quickly moved into enforcement, which he described as "a pendulum swung too far".

As a regulator, Ms Leung remarked that the key consideration for changing problematic behaviour was what would be the best outcome. For serious breaches and misconduct, such as reckless risk management, she would take "front-loaded" regulatory action and, depending on the facts of the case, refer it to the SFC's Enforcement Division.

Asked when the regulator expected a firm to self-report, Mr Atkinson reaffirmed that when in doubt, firms were encouraged to contact the SFC and

provide information about what was happening. Ms Leung shared that one firm, to her dismay, self-reported to the regulator after spending one-and-a-half years on an internal investigation. She clarified that the SFC welcomed early alerts even if the firm did not yet have all the facts of the case. However, Dr Chu noted that some cases might not be so straightforward, as sometimes very experienced, well-trained professionals did not always agree with one another. He recommended that the SFC publish companies' self-reporting statistics to provide guidance for the industry. Ms Leung remarked that the SFC's self-reporting portal was undergoing a revamp and Dr Chu's suggestion would be considered.

Technological developments

Mr Stein cited critics who said that Hong Kong was not doing enough to promote innovation and in fact regulation might be making it too difficult. Ms Leung replied that the SFC provided the policy platform, rules and codes for the use of technology to assist with compliance and deliver better financial services. It also supported the principle that technology would undoubtedly improve financial inclusion. The SFC was "technology-neutral" and "a principles-based supervisor", which meant that it applied the same investor protection principles regardless of whether financial services were delivered face-to-face or online. Its recent consultation to clarify and update the suitability requirements and their application in an online environment was a response to the sea change it expected in this area.

To move with the times, the SFC was also reviewing the regulatory implications of order placement methods via social media, cloud services and cybersecurity—currently a top risk for most firms. It was also talking with the industry about data analytics and regulatory technology, and one initiative was to develop a common industry standard for the format of trade-related data, said Ms Leung.

Dr Chu noted that the industry needed to move fast, or else it might be disrupted by technology as clients demanded convenience and a better overall experience. He called for tighter regulation in view of the point-to-point fiascos which led to huge investor losses in many markets. Quoting The Economist as saying that "data is the new oil", he confessed that the industry found it hard to compete against tech giants which enjoyed a monopoly in data collection.

Big data also affected the SFC's surveillance systems, which looked into erratic movements in the market, particularly those which were unexplained, and sometimes into the involvement of multiple parties. Mr Atkinson said that these systems could be more sophisticated, adding that investor identification was another area the SFC was working on. The next step was to harvest big data to try to understand market developments in a much more meaningful way.

Citing examples from abroad, Mr Procter remarked that attempts to pull together disparate bits of information had so far failed as the data was not in the right form. He proposed three policy choices for Hong Kong: first, to put more emphasis and pressure on the manufacturer, as was the case in Europe under MiFID II[1], with all the cost and liability implications; second, to facilitate the use of cloud outsourcing and chains of this technology and lastly to adopt open banking, as in some jurisdictions which were working to allow one firm to demand and authenticate information from another.

To the question of whether sanctions in Hong Kong were tough enough to change the behaviour of bad actors, Mr Atkinson responded that it was important to recognise individual accountability, but thought that the regulator could raise its fining powers in line with other international financial centres. Mr Procter opined that the SFC was making greater use of redress strategies than its regulatory counterpart in the US. He urged the SFC to look at what level of individual accountability was being weighed on the persons at the top.

On the development and sale of cryptocurrencies, Ms Leung stated that this pointed to significant investor protection issues which prompted the SFC to step up its regulatory and enforcement actions. In one recent case, the SFC sent a warning letter to an offshore initial coin offering issuer. As a result, the tokens bought by Hong Kong investors were unwound and the company's website was no longer accessible by them. Moreover, actions had been taken against several cryptocurrency exchanges which resulted in the removal of security tokens from the exchanges. Mr Procter pointed out that regulators around the world were struggling with cryptocurrency regulation. They might need to think of a new way or obtain new powers to effectively regulate cryptocurrencies.

[1] The European Union's revised Markets in Financial Instruments Directive (MiFID) and Markets in Financial Instruments Regulation which came into effect on 3 January 2018.

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