

**Bills Committee on  
Securities and Futures Bill 2000 and Banking (Amendment) Bill 2000**

**International regulatory reform comparison**

This is a paper presented by the Securities and Futures Commission (SFC) at the request of the Legislative Council Bills Committee on the Securities and Futures Bill 2000 (S&F Bill) and Banking (Amendment) Bill 2000 for the meeting on 5 January 2001.

2. The paper briefly summarises securities and futures related regulatory and legislative reforms in the leading international financial centres of the United States (US) and United Kingdom (UK) and Hong Kong's key developed regional competitors, Singapore, Japan and Australia.

**United Kingdom**

*Existing regulation*

3. The existing UK securities and futures regulation is the subject of an impending revolutionary change, owing to the Financial Services and Markets Act 2000 (FSMA). However, while the UK parliament has passed the FSMA, it will not become effective until summer 2001. UK regulation is therefore in a transitional state.

4. The present UK regulatory system is a mixture of statutory and self-regulatory schemes created under the auspices of the Financial Services Act and other legislation. The system under the Financial Services Act dates from 1986. Under that system, different aspects of the securities and futures markets were regulated by different self-regulatory organisations (SROs) under a mix of contractual and non-legal rules. There were separate SROs to deal with the licensing of securities and futures intermediaries and their conduct, supervision of the funds management industry, supervision of individual financial advisers and so on. All these SROs operated under the supervision of an independent, non-statutory regulator, the Securities Investments Board granted statutory powers.

5. With the election of the Labor government in 1997, major reforms were announced to harmonise securities, futures, banking, and insurance

regulation under a single statutory regulator. In practice, the single statutory regulator, the Financial Services Authority (FSA), has already been created by absorbing the staff and roles of all the previous regulators both statutory and non-statutory. However, legally, the FSA mainly continues to administer the patchwork of old statutory and self-regulatory powers and operates under contractual agreements with some of its predecessors. The FSA also:

- supervises banks, a function transferred to the FSA under the Bank of England Act 1998
- regulates investment business under the Financial Services Act
- exercises the majority of the UK Treasury's functions under insurance legislation and
- since May 2000, approves and supervises the listing of securities, as the UK Listing Authority.

### ***Markets and intermediaries***

6. The leading UK stock exchange, the London Stock Exchange (LSE or Ix now) is the 4<sup>th</sup> largest in the world with a total market capitalisation of over US\$ 2,626 billion. This consists of 2,274 entities of which 448 originate from overseas. It is the 8<sup>th</sup> least concentrated market in the world.<sup>1</sup>

7. UK futures markets are also significant in world terms. They have the 6<sup>th</sup> largest turnover in the world in equity futures contracts, 2<sup>nd</sup> largest turnover in the world in money market futures contracts and 4<sup>th</sup> largest in the world in terms of bond futures contracts. The UK OTC derivatives markets are the most prominent in the world, ranking 1<sup>st</sup> in terms of turnover in both foreign exchange OTC derivatives and interest rate OTC derivatives.

8. The UK market has 53 complex groups, which are defined as large firms with multiple regulated groups undertaking complex and sophisticated business under the FSA supervisory umbrella. There are over 22,000 firms that are authorised to carry out investment business in the UK. Most investment business is carried out by approximately 6,000 firms which are regulated by 3 SROs which are recognised and supervised by the FSA. Banks in the UK can conduct securities dealing subject to the FSA's supervision in the same manner as securities dealers.

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<sup>1</sup> Concentration is measured by expressing the market capitalisation of the 10 largest listed entities as a percentage of the total market capitalisation of all listed entities.

9. The FSA recognises 2 UK clearing houses and 9 ‘service companies’ providing infrastructure services such as order-routing and settlement services.

10 Information on the origin of regulated securities and futures intermediaries was not available at the time of writing.

### ***Effects of globalisation: threats, opportunities and regulatory response***

11. The UK is the second most significant financial centre in the world. It is regarded by some as the most international financial centre, owing to the extent to which the domestic US economy dominates the US financial markets. The UK is also the financial centre for Europe. Owing to this and the light regulatory touch of the UK authorities to date, the UK financial markets have benefited from globalisation. However, the UK financial markets are still dwarfed by those in the US and, to a degree, those in Japan, owing to the medium sized UK domestic economy. As such, UK financial markets remain more vulnerable to the threats of globalisation than those of either the US or Japan, which are, to a degree, insulated by their very large domestic economies.

12. Owing to the factors mentioned above, and the UK’s professional intermediaries and service industries, the UK financial markets are poised to benefit substantially from globalisation.

13. Tempering this are two possible threats.

14. The first comes from Europe and the damage that any need to harmonise European business laws might do to UK regulation. UK regulation has always been lighter and more flexible than regulation in other European jurisdictions and there is a possibility that, if the UK is compelled to adopt generic European standards through EU directives, that will harm the regulatory environment in the UK and drive business offshore. (Balancing this is a fear that, if the UK remains too much outside the general drive for European economic and regulatory integration (eg continuing to opt out of European Monetary Union), Europe focused business will migrate from the UK to another European country more integrated into the European economy.)

15. The other threat is domestic. While UK regulation has generally been viewed as light but credible, this has always been tempered by the doubts of some as to the credibility of its enforcement (eg the lack of a statutory regulator with strong powers like the US Securities and Exchange Commission and the lack of success in securing insider dealing and market manipulation prosecutions). To a degree, these doubts prompted the setting up of the FSA. However, there are doubts expressed by some, particularly on the conservative

side of politics, that some aspects of the new regulatory structure are an over-reaction and amount to over-regulation which will drive business away from the UK.

16. Nevertheless, the Labor government elected in 1997 viewed the then existing UK financial markets regulatory system as confusing, inefficient and incapable of adequately protecting investors. The government believed that an efficient, effective financial services sector was vital for the UK's continued international competitiveness and prosperity. They believed a new regulatory system was necessary that would give a high level of market confidence and investor protection and that would effectively combat market abuse and financial crime.

17. The creation of a single statutory regulator, the FSA, was thought to be the best way to tackle overlaps, gaps and inconsistencies in financial regulation and to improve accountability and clarity of purpose in financial regulation. It was also thought a single regulator would clarify regulation and improve supervision of intermediaries that increasingly operated across all financial market sectors. In addition, it was thought that unified supervision of complex financial groups would strengthen regulation of UK and international financial markets generally and strengthen investor protection.

18. While the UK has adopted a "super-regulator" model with the creation of the FSA, in continental Europe, no consensus exists as to whether this is the best. For example, in Germany and the Netherlands, there are no plans to merge the individual industry based regulators. Instead, their actions are being better co-ordinated by forming bodies such as councils or committees to encourage better co-operation and co-ordination. Hong Kong recently adopted this model, with the creation of the Council of Financial Regulators chaired by the Financial Secretary.

### ***Proposed regulatory reform***

19. The main purpose of the FSMA is to provide a single legal framework for all financial market sectors in place of the different frameworks under which the UK financial markets and intermediaries previously operated. As a result, it mainly *consolidates* existing law or self-regulatory requirements, including:

- arrangements for the authorisation of securities, futures, banking and insurance intermediaries
- arrangements for approval of individuals employed as representatives by intermediaries in these sectors

- rulemaking powers across all sectors
- information gathering and investigation powers across all sectors
- intervention powers, for example to require an intermediary to stop taking on new business
- powers to impose financial penalties on authorised intermediaries and their approved representatives, currently administered by securities and futures SROs. The FSA will replace these regimes with a statutory disciplinary regime with a right to a full hearing before an independent tribunal.

20. The main new powers provided by the FSMA are:

- powers for the FSA to impose under a non-statutory code financial penalties on those who abuse securities and futures markets, for example through insider dealing or market manipulation. FSA decisions to fine will be referable to an independent tribunal for final adjudication.
- the assumption by the FSA of the role of the UK Listing Authority on substantially the same basis as currently exercised by the LSE.

21. In addition, the FSMA gives the FSA the ability to make statutory rules following the model of the Financial Services Act and also gives it the power to prosecute insider dealing and market manipulation criminal offences.

## **United States**

### ***Existing regulation***

22. The US is widely seen as having the best regulated markets in the world. Nevertheless, regulation in the United States is complex. This is, in part, a reflection of the complexity and diversity of the US' financial markets and also the long heritage of financial regulation.<sup>2</sup> However, the complexity is also a result of financial market regulation being split between different levels of government and many different regulatory agencies. Securities regulation is split between federal and state governments. However, the federal Securities and Exchange Commission (SEC) is the major securities regulator.<sup>3</sup> The SEC administers the major US securities statutes (including the Securities Act, the Securities Exchange Act, Investment Company Act and associated rules and

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<sup>2</sup> The US securities legislation dates back until the 1930s.

<sup>3</sup> The many state agencies generally regulate less widely traded securities. The regulation administered by each agency is broadly similar but differs in the detail. There is a national association for these agencies to co-operate in their work.

regulations). The federal Commodities Futures Trading Commission (CFTC) is the major futures regulator and administers the major US federal futures laws (the Commodity Exchange Act and associated rules and regulations).

23. The nature of US regulatory legislation also contributes to the complexity. The securities and futures legislation often takes the form of broad, vaguely worded principles with the details being found in extensive rules and regulations made by the SEC or CFTC, respectively. Further, extensive judge-made case law fleshes out many aspects of the law, particularly with regard to securities law.

### ***Markets and intermediaries***

24. The two leading US securities exchanges, the New York Stock Exchange (NYSE) and NASDAQ were ranked 1<sup>st</sup> and 2<sup>nd</sup> in the world in terms of market capitalisation. The NYSE with a market capitalisation of US\$11,675 billion is more than three times larger than the Tokyo Stock Exchange and over 4 times larger than the London Stock Exchange. Annual turnover on the NYSE is the greatest in the world at \$8,945 billion, giving it over 4 times the market turnover of the next most active exchange, the Tokyo Stock Exchange. The NYSE and NASDAQ are the 1<sup>st</sup> and 5<sup>th</sup> least concentrated markets in the world. At the end of 1999, there were 3,035 entities listed on the NYSE and 4,829 listed on NASDAQ of which 409 and 429, respectively, were from overseas.

25. US futures exchanges account for the largest turnover in the world in relation to equity and money market contracts and 2<sup>nd</sup> largest turnover in relation to bond contracts. In relation to OTC markets, the US foreign exchange and interest rate OTC derivatives markets are the 2<sup>nd</sup> largest in the world by turnover.

26. Information on the number of regulated securities and futures intermediaries and their origin was not available at the time of writing.

### ***Effects of globalisation: threats, opportunities and regulatory response***

27. The depth and liquidity of US securities markets are unrivalled. US intermediaries are among the most prominent in the world, and dominate the securities and futures markets not only in the US, but also in many other jurisdictions. US market practices, market infrastructure and professional service providers are very sophisticated and competitive owing to the status and features of the US markets. Owing to these factors, the US is poised to be a major beneficiary of globalisation.

28. Already, US markets are the capital raising venue of choice for most sizeable international businesses. The US futures markets are also very strong. US intermediaries dominate the higher echelon of deal making in most major markets. The competitive US domestic environment has made US markets and intermediaries world leaders which can only benefit from technological advances eliminating the problems of distance and also from the general lowering of regulatory barriers to foreign competition in markets around the world.

29. The major threats to US markets and intermediaries might be seen as arising from two factors. To a degree, the US has a high cost structure. However, the competitive dynamism of the US economy moderates this. Secondly, owing to the US regulatory system's long history, it is somewhat resistant to major change. This is partially a result of the US political-constitutional system, where governmental power is shared between the legislature and executive and major change is difficult to effect. It is also partially a result of the large historical investment in the existing regulatory system which has continued largely unchanged for 70 years in the case of securities regulation and 30 years in the case of futures regulation.

30. Owing to its unique position at the apex of world financial markets, the need for the US to reform its approach to regulating its markets and intermediaries is less dramatic than that for the other jurisdictions considered in this paper. The issue for the US is more how to maintain its lead by dealing with new developments and eliminating or redressing the uncompetitive parts of its regulatory system.

31. Given this, the complexity of the existing regulatory system and the finely balanced legislative process needed to amend US laws, the US has not witnessed proposals for such seismic change as other jurisdictions have. Rather, the proposals for regulatory reform in the US have been more piecemeal and incremental.

### ***Proposed regulatory reform***

32. In the securities field, the major reforms completed or underway or reform proposals include:

- the regulation of electronic automated trading systems under rules made by the SEC in 1998. The rules provide a flexible system under which ATSS will be regulated as either intermediaries or exchanges depending on their features. (The regulatory system has served as a model for that proposed in Part III of the S&F Bill.)

- proposals for wide ranging reform and simplification of the securities disclosure laws under the so-called “Aircraft Carrier” proposal released in late 1998. This would amend or do away with many long-standing features of securities disclosure regulation to ease the burden on securities issuers. The proposals have, to a degree, been controversial and the subject of extensive comment from industry and investor representatives and are presently being considered by the SEC.
- the elimination of the prohibition on commercial banks engaging in securities underwriting business and vice versa with the repeal of the Glass-Steagal Act earlier this year. Banks and securities underwriting firms may now affiliate under financial holding company structures with each form of business subject to functional regulation.
- an ongoing debate on the degree to which the OTC derivatives market should be regulated and how best to achieve this. As yet, no formal legislative proposals have emerged.

33. In addition, there are a host of other regulatory reform projects affecting less significant areas of securities regulation.

34. In relation to futures regulation, the major reforms completed or underway and reform proposals include:

- a far-reaching review of the regulation of exchange traded futures which proposes moving from one set of prescriptive rules for all futures products to a more flexible system of “performance-based” standards based on the susceptibility of the product to manipulation and the participation of retail customers in the market for that product and
- the already mentioned proposals for the possible regulation of the OTC derivatives market.

35. In addition, the CFTC is facing a host of issues related to the increased international integration of markets, the proliferation of futures exchanges and the fragmentation of futures markets.

36. Interestingly, the US has not seriously entertained proposals to reduce the number of separate regulatory bodies as it seems to be believed that the existence of several different regulators has helped prevent gaps in the regulatory system from emerging.



## **Singapore**

### ***Existing regulation***

37. The Monetary Authority of Singapore (MAS) is an integrated financial supervisor, overseeing the banking, securities, futures and insurance industries since 1984.

38. The existing law, however, is a patchwork of different laws and regulations. The major laws and regulations include the MAS Act, the Securities Industry Act, the Take-over Regulations, the Futures Trading Act, the Unit Trusts Regulations and the Guidelines for Property Funds (Established As Companies) in Singapore.

### ***Markets and intermediaries***

39. The Singapore Exchange (SGX), via its subsidiary Singapore Exchange Securities Trading Limited (SGX-ST), is the major Singaporean stock exchange. The Singapore stock exchange is the 13<sup>th</sup> largest in the world in terms of market capitalisation with a market capitalisation of just over US\$254 billion and is the 3<sup>rd</sup> largest in Asia outside Japan, after the Australian and Hong Kong exchanges. As at end-March 2000, there were 426 listed companies of which approximately 45 originate from overseas.

40. As at end-March 2000, SGX-ST had 31 members and 46 non-members. The MAS licences member and non-member companies as dealers. As at end-March 2000, SGX-ST had more than 3,700 individuals licensed as dealer's representatives. As at end-March 2000, there were a total of 154 licensed investment advisers. Banks in Singapore can conduct securities business as exempt dealers under the Securities Industry Act.

41. The trading of derivatives products is carried out on the Singapore Exchange through its subsidiary, Singapore Exchange Derivatives Trading Limited (SGX-DT). The Singaporean futures exchange, is the 12<sup>th</sup> largest in the world in terms of turnover and the 2<sup>nd</sup> largest in Asia outside of Japan.

42. As at end-March 2000, the futures exchange had 30 corporate-clearing members, 17 corporate non-clearing members and 15 commercial associate members. All the 30 corporate clearing members are licensed by the MAS whereas only 11 non-clearing members and 4 commercial associate members are licensed.

43. Information on the origin of regulated securities and futures intermediaries was not available at the time of writing.

### ***Effects of globalisation: threats, opportunities and regulatory response***

44. Globalisation has effected Singapore in much the same way it has affected other small jurisdictions with internationally open financial systems.

45. Technology and the internet have opened up vast new opportunities as well as created potential risks. The internet aside, competition in the financial industry has increased and become more global. There is also unprecedented convergence in financial services, restructuring and consolidation among financial players. New hybrid financial products are emerging with characteristics that cut across traditional business lines.

46. Singapore's relative openness, economic competitiveness and reputation for clean governance place it well to prosper from globalisation. However, Singapore faces problems from the small size of its financial markets, particularly in terms of market liquidity, and also from its location in South East Asia, which was the part of Asia worst affected by the Asian crisis. Although Singapore weathered the crisis relatively well, its economic integration with neighbouring countries and its proximity to increasingly unstable Indonesia have raised some doubts about the immediate future prospects for the Singaporean economy.

47. Singapore has been quick to respond. The Chairman of the MAS has warned Asian countries that they must accept globalisation as a reality and should embrace, rather than fight against it. He said that the best way to embrace globalisation is to increase competitiveness. In order to do that, Singapore has embarked on an aggressive agenda.

48. The MAS, is now seeking to further harmonise and integrate its regulation and supervisory practices (please see below regarding proposed regulatory reform).

49. On 1 December 1999, the SGX was officially launched as a demutualised, integrated securities and derivatives exchange (merging the Stock Exchange of Singapore and the Singapore International Monetary Exchange). The demutualised SGX remains the frontline regulator while the MAS ensures that the SGX fulfils that role properly.

50. Securities brokerage commissions will be fully liberalised by January 2001.

51. In response to growing online securities trading, in February 2000, a Guidance Note was issued relating to the public offering of securities through

the internet. The MAS has also developed general principles on the licensing of securities activities on the internet.

52. In future, the MAS aims at further liberalising the financial system, moving towards a system of risk-based supervision, and seeking greater harmonisation of regulations and supervisory practices across different sectors of the financial markets.

### ***Proposed regulatory reform***

53. The existing Securities Industry Act and the Futures Trading Act will be streamlined into a single piece of legislation, which will be introduced next year (proposed Act).

54. The MAS is also reviewing the feasibility of having consolidating legislation governing the provision of personal investment and financial advice.

55. Under the proposed Act, Singapore will move towards a licensing scheme flexible enough to allow intermediaries to undertake broadly similar classes of financial activity under a single licence but will not presently pursue a strictly single licence regime.

56. The MAS is revising its existing capital framework for securities firms, so as to move toward a risk-based approach not dissimilar to that in banking. Similarly, the MAS is adopting risk-based supervisory frameworks for securities which place the principal responsibility for risk management on the financial institutions themselves.

57. The MAS will soon issue a consultative document on corporate governance, recommending enhanced standards for all listed companies.

58. The MAS is also reviewing the scope of its present insider trading laws and will soon issue a consultation paper to the public to seek comments. Liability may be extended to third parties other than corporate insiders themselves and the first person receiving the price-sensitive information from corporate insiders. It is proposed that those who have inside information should not trade on it, whether or not they are connected with the relevant company. The laws relating to directors, officers and others connected with a company will also be tightened with knowledge of inside information being presumed.

## Japan

### *Existing regulation*

59. Like many other jurisdictions, securities and futures regulation in Japan is in a state of transition.

60. For years, Japan's financial markets regulation has remained largely unaltered from its post Pacific War origins during the American occupation. The major change has been the creation in July 1992 of the Securities and Exchange Surveillance Commission (SESC). The SESC's major role is to be a market watchdog, responsible for market surveillance, inspection, investigation and enforcement.

61. However, owing to the stagnant state of the Japanese economy following the late 1980s early 1990s asset price deflation and the international crisis of confidence in the Japanese economic model, there has been a flurry of regulatory activity. In response, a series of financial system reforms (the so-called "Japanese Big Bang") were started in November 1996, under three principles of "free, fair and global". The aim of the proposals was to rebuild the Japanese financial markets so that they rivalled the US and UK markets.

62. As the first step, the Foreign Exchange Law was revised to totally liberalise cross-border currency transactions. Then, in December 1998, the Financial System Reform Law was enacted. That Law consolidated the Banking Law, the Securities and Exchange Law and the Insurance Business Law. It also made several reforms, including:

- fully liberalising dealings in securities derivatives
- ending restrictions on the range of activities that can be carried out by banks' securities subsidiaries and encouraging banks, securities companies and insurance companies to operate in each others sectors
- changing the licensing system of securities companies to a registration system
- liberalising brokerage commissions
- allowing off-exchange securities trading and introducing electronic trading systems
- improving the disclosure system
- tightening insider dealing laws.

63. In November 1999, the Tokyo Stock Exchange established a new market for promising start-ups, named “Mothers” (the Market of High Growth and Emerging Stocks).

64. On 1 July 2000, the Financial Services Agency was established as an integrated regulator. The Financial Services Agency is independent of the Ministry of Finance and is responsible for all aspects of financial regulation, supervision and inspection in respect of all kinds of financial services, such as banking, securities and insurance. However, the SESC remains responsible for market surveillance, intermediary inspections, investigations and enforcement.

### *Markets and intermediaries*

65. The leading Japanese stock exchange, the Tokyo Stock Exchange (TSE), is the 3<sup>rd</sup> largest in the world in terms of market capitalisation with a total market capitalisation of over US\$3,776 billion. This consists of 1,935 listed entities of which 43 originate overseas. Market turnover is very high by world standards. The TSE is the 3<sup>rd</sup> least concentrated stock market in the world.

66. Japanese futures markets are significant by world standards. The Japanese equity futures and bond futures markets have the 3<sup>rd</sup> highest turnover in the world and the money market futures markets have the 4<sup>th</sup> highest turnover in the world. Japan’s OTC derivatives markets are also sizeable with the foreign exchange OTC derivatives markets and the OTC interest rate derivatives markets the 3<sup>rd</sup> and 4<sup>th</sup> largest in the world by turnover respectively.

67. Information on the number and origin of regulated securities and futures intermediaries was not available at the time of writing.

### *Effects of globalisation: threats, opportunities and regulatory response*

68. Globalisation is generally regarded to have treated Japan’s financial markets unkindly. Although Japan’s financial markets remain very significant by world standards, they remain largely domestically focused. Japan is certainly the largest financial market in Asia, but Hong Kong remains the centre for international business in Asia outside Japan. It is widely held view in the (largely Western eyes) of the international financial community that, although Japan’s economic and financial model served it well in the post Pacific War period up until the late 1980s, the period since then has exposed the flaws in the Japanese regulatory system. These flaws are seen to be threefold.

69. First, it is believed that Japan has excessively heavy regulation with too many matters that are business decisions elsewhere being dictated by

government fiat. Secondly, it is believed that there exists too close a relationship between regulators and industry which compromises the effective administration of that regulation. Finally, the Japanese regulatory system created high barriers to international participation in Japanese financial markets.

70. Since the mid 1990s, the Japanese securities and futures markets have been confronting major changes, triggered by liberalisation and globalisation, rapid technological progress, the failure of Japan's financial system and the bursting of its bubble economy. These all contributed to Tokyo's decline as an international financial centre.

### ***Proposed regulatory reform***

71. The Financial Services Agency is entrusted with the mission of reviving Japan's prospects as an international financial market on par with London and New York. To this end, the Financial Services Agency will see through a series of reforms which are scheduled to be completed by the end of March 2002. The Financial Services Agency also aims to develop a state-of-the-art financial infrastructure as well as proper regulations for the markets. The Financial Services Agency is aiming to make the activities of financial institutions and its own regulatory activities more transparent and intends to make rules to that end. It also intends to strengthen its co-operation with foreign regulators. At the time of writing, further details on these proposed reforms were not available.

72. In addition, the Financial System Council is now studying demutualising and corporatising the stock and financial futures exchanges.

## **Australia**

### ***Existing regulation***

73. The present securities and futures regulation in Australian is a product of 7 years of ongoing reform. Securities and futures markets and intermediaries are regulated under the Corporations Law, a single law governing corporations, securities and futures. The law is the product of the creation of a single national law which replaced a system of uniform state based laws in 1991. That law has since been significantly amended since 1993, with reforms mainly concentrating on company law. But since 1998, the reform agenda has extended to securities and futures regulation.

74. Australia's securities and futures regulation is administered by two bodies: the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA). Both bodies were created

in 1998 to harmonise regulation which was previously split between three industry focused regulators: one for securities and futures, one for banking and one for insurance and superannuation (equivalent to the MPF). The APRA was created to harmonise prudential regulation across the three industries. The ASIC was built from the securities and futures regulator to take over the task of regulating the markets for all financial products and the fitness and continuing conduct of intermediaries offering those products. It therefore took over the role of the insurance and superannuation regulator.

### *Markets and intermediaries*

75. The Australian Stock Exchange (ASX) is the largest market for listed equity securities in Australia. It is home to 1260 listed entities, with a total market capitalisation of US\$413 billion, making it the 12<sup>th</sup> largest market in the world and either the 1<sup>st</sup> or 2<sup>nd</sup> largest in Asia outside Japan.<sup>4</sup> Of these entities, approximately 70 are overseas corporations. Annual turnover on the ASX is approximately US\$125 billion.

76. The Sydney Futures Exchange (SFE) is the major futures market in Australia, although the ASX trades some share warrant and share option futures products. The SFE trades a wide range of commodity, currency, and financial futures products. Australia equity futures contracts are the 14<sup>th</sup> most actively traded in the world and interest rate futures contracts the 5<sup>th</sup> most actively traded in the world. The SFE operates one of the largest futures markets in Asia. Australian OTC futures markets are also quite sizeable and liquid for the relative size of the country.

77. The Australian funds management industry has grown rapidly in recent years, mainly owing to burgeoning superannuation funds, and there is now US\$350 billion worth of funds under management.

78. There are approximately 4,000 licensed securities intermediaries and 95 licensed futures brokers. At the time of writing, information was unavailable on the number of licensed futures advisers and the number of the regulated intermediaries which, or the ultimate controller of which, originated from overseas. Of the 10 largest merchant banks operating in Australia, 9 originate from overseas. The ASIC regulates the securities dealing businesses of banks that are licensed, but not those that are exempted.

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4 The Hong Kong and Australian stock markets are almost the same size and their relative global rankings depend to a large degree on US\$/A\$ exchange rate fluctuations.

## ***Effects of globalisation: threats, opportunities and regulatory response***

79. Australia's securities and futures markets are largely domestically focused. A large and competitive mining industry and the privatisation and listing of many state owned enterprises and listing of telecommunications and financial services companies has, to a degree, broadened the nature of Australia's markets. There is a large degree of foreign investment in Australia's markets and a high degree of participation by foreign intermediaries. Given this Australia's remote geographic location and high taxes, Australia's markets are particularly vulnerable to the threats of globalisation. Balanced against this, is a belief by some in Australia that, with globalisation, the disadvantages of Australia's remote location will be reduced.

80. The threats of globalisation, together with a long held reputation for complex regulation and burdensome taxation, has led to fears in government and industry that, if Australia does not substantially reform the regulation of its securities and futures markets, business will migrate elsewhere. Balanced against this is the belief in Australia that Australian markets are among the best regulated and most sophisticated in Asia, despite their size. There is a perception in Australia that, if the regulatory burden is lightened, Australia can compete with Hong Kong and Singapore as an Asian financial centre owing to the perceived strength and sophistication of its regulatory system and markets. These two countervailing views have in large part propelled Australia's long sustained drive to reform corporate, securities and futures regulation. Australia faces a very serious threat that, if it does not reform, securities and futures activity will move to the UK or US. To avoid this outcome, Australia accelerated its reform program in 1996.

### ***Proposed regulatory reform***

81. Australia's reform program has trod a measured path for the last 7 years. The reforms originally were intended to redress deficiencies in investor protection stemming from some 20 years of inactivity in law reform and what was acknowledged to be overly complex law. However, the reforms increasingly acquired a mark of being intended to address the challenges of globalisation, an angle which has become more prominent since 1997 and the publication of the findings of a major reform inquiry, the Wallis Report.

82. To date, Australia's major reforms have included:

- the creation of two functional regulators, the ASIC and APRA, from three industry focused regulators in 1998
- the demutualisation of the Australian Stock Exchange (ASX) and the listing of its shares on its own market in 1996 and 1997. The



ASX retains its function of regulating listed securities, except its own, a task which the ASIC performs. There was a proposal from the Sydney Futures Exchange (SFE) to merge with the ASX, but the Australian competition law regulator barred this.

- a major reform of the regulation of collective investments to abandon the unit trust model of regulation and to simplify, modernise and strengthen investor protection while easing the burden on funds managers. The reform became effective in 1998.
- major proposals to reform many aspects of Australia's securities and futures regulation were released in 1997 and draft legislation released in 1998 (the Corporate Law Economic Reform Bill (CLERP Bill or Act)). These proposals included:
  - + reform of the regulation of takeovers, with Australia's detailed, court and regulator administered statutory takeover laws moving somewhat closer to a more flexible regulator and specialist tribunal administered system although it remained in statutory form
  - + simplifying prospectus disclosure requirements for small companies and facilitating electronic prospectuses and their distribution on the internet and
  - + facilitating the adoption of international accounting standards.

The CLERP Bill was passed in late 1999 and the CLERP Act took effect in March 2000.

- A further package of major reform proposals followed including:
  - + the creation of a single licensing regime for securities, futures, insurance and foreign exchange intermediaries (the proposal is similar to that proposed in Part V of the S&F Bill).
  - + standards of business conduct for licensed intermediaries which vary depending on whether or not they deal with retail investors
  - + harmonised regulation for all financial products, including securities, futures, other derivatives, foreign exchange, superannuation, insurance and deposit products. This would include harmonised disclosure requirements for all products other than securities, interests in collective investment schemes and debentures which were already subject to the prospectus requirements newly reformed in the CLERP Act.

- + a new regime for the licensing of all operators of clearing and settlement facilities as, presently, futures clearing houses need to be licensed, but not securities clearing facilities
- + what will be regulated as a “market” will change to focus on “multilateral” markets, where there are a number of buyers and sellers rather than just a single seller selling to many buyers – this will lead to some activity presently regulated as a market being regulated as an intermediary
- + a new regime for foreign regulated markets seeking to operate in Australia

These reforms were all embodied in the Financial Services Reform Bill (FSRB) released for comment in early 2000. It was also proposed that the Bill harmonise the separate market misconduct provisions for securities and futures which are presently slightly different. However, no draft legislation on this last subject has been produced.

83. In late November 2000, it was announced that the FSRB was indefinitely postponed. This was owing to a court case which had called into question the Australian federal government’s ability to comprehensively legislate for uniform national corporate, securities and futures laws and the inability of state and federal governments to agree on a new constitutional basis for legislation. As a result, the immediate future prospects for regulatory reform in Australia are poor.

## **Conclusions**

84. While globalisation is an overused term and a nebulous concept, it has by default become a useful term to refer to the accelerating integration of the world economy owing to technological progress erasing the significance of borders and distance and legal reform lowering the barriers to commerce between nations. Globalisation poses threats and opportunities for the financial markets of every jurisdiction, including the US, which must strive to keep its leading position. Even the UK, which is the second most significant international financial centre in the world, fears losing its status. However, the threats are the greatest to jurisdictions with relatively small but international open financial markets such as Hong Kong, Singapore and Australia. These markets, but Hong Kong and Singapore in particular, lack large domestic economies to insulate their financial markets from increasing competition among jurisdictions and the threat of losing business to elsewhere.

85. All the jurisdictions surveyed in this paper are reforming their securities and futures regulation to maintain their competitiveness. However,

the competition in Asia is especially fierce. Hong Kong has traditionally been favoured as Asia's ex-Japan financial market owing to its openness to international business, low taxation and light regulation. However, as Australia and Singapore deregulate, the competition is intensifying. Further, with the Mainland opening up with its accession to the WTO, Hong Kong can no longer take for granted the business it attracts as the "gateway" to the Mainland.

86. Japan is a stark lesson for jurisdictions which ignore the need for continuous regulatory reform. However, Japan can rely on its large domestic markets for some comfort. Hong Kong does not have that luxury.

87. Securities and futures regulation in Hong Kong, while good, is far from perfect. There are many areas in need of consolidation, harmonisation and even improvement. Reforms such as those imposed in the S&F Bill and the Banking (Amendment) Bill 2000 are not only good for Hong Kong investors and intermediaries but are imperative for Hong Kong to maintain its position as the favoured financial centre not only for the Mainland, but also for the rest of Asia outside of Japan.

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