

**A statement to be presented to the Panel on Financial  
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**Introduction**

1. The financial services sector contributed about 11% to Hong Kong's GDP. If we wish to maintain our role as a leading international financial services centre in the next millennium, we need to ensure that our financial sector can grow and become more competitive within a proper regulatory environment.
2. The incidences of the recent market intervention and the CA Pacific Finance Ltd. affair illustrate well that regulatory loopholes exist which the Government needs to plug.

**Categorization of the Thirty Measures** [Table 1 in background paper]

3. It is understandable that most of the 30 measures announced by the Government deal with short selling, settlement, and disclosure, since these were the core areas of concern during the crisis.

**Is the Government Doing the Right Thing?**

4. The Government is moving in the right direction in making market transactions more transparent and tightening up regulations covering short selling, fraudulent transactions and reporting.
5. The disclosure to the Securities & Futures Commission (SFC) of holders of large open interests is in line with the market surveillance program of the Commodity Futures Trading Commission (CFTC) in the USA. The purpose of the CFTC's surveillance program is to identify an individual or group of traders who may attempt to manipulate the market. However, information about open interests at the broker level to the general public may not add too much benefit to the investors as the

size of the long/short positions is not revealed in such aggregated figures.

### **Why Regulate?**

6. Regulations should not simply be used to plug loopholes. They should enable the financial sector to become more competitive and be able to face the future challenges such as changes in customer needs, the use of information technology in financial services, and in the establishment of other regulations such as the formation of the Mandatory Provident Fund (MPF).
7. Regulators should also recognize that the financial system will undergo drastic changes including much more intense competition, globalization, conglomeration, and the increased use of financial market instruments.

### **The Australian, Canadian, and UK Regulatory Reform** [Table 2 in background paper]

8. The three countries, Australia, Canada, and the UK (hereafter referred to as the ACU) have either overhauled or are in the process of redesigning their financial systems. They all regard these regulatory changes as preparatory steps towards facing the challenges of the next century.
9. ACU countries believe that technology and additional competition will make the conventional lines dividing business more blurred. For example, commercial banks can enter into securities, insurance and fund management house business, while fund management houses may provide depository and payment functions. Regulatory reform in the ACU countries thus divides regulatory responsibilities along functional lines which include (a) monetary policy/stability and payment system, (b) prudential regulation of various financial institutions, and (c) market conduct regulations including authorization and licensing, consumer protection, and company regulation.

10. The outcome of the reform in the ACU countries can be summarized as :
- There is a consensus that the central bank should concentrate on handling monetary policy and should shy away from supervision of financial institutions.
  - Supervision of all financial institutions ranging from conventional depository institutions like banks to non-depository institutions like insurance companies should be put under one roof.
  - Market conduct, consumer protection, and training should also be put under one roof.

### **The Hong Kong Regulatory Structure [Table 3 in background paper]**

11. Hong Kong is still following the traditional approach of institutional-based regulation; that is, regulatory agencies are allocated duties in accordance with the institutional nature of the regulated firms. Thus, depository institutions like banks are assigned to the HKMA, insurance companies and the MPF to the two units under the Financial Services Bureau (FSB), and investment businesses to the SFC. Thus, for any one regulatory function as identified by the ACU countries, there exists, in most cases, more than one responsible regulatory agency. Our system seems to be largely at odds with those of the more advanced economies. It seems it is taken for granted that these institutions never cross their own institutional lines. However, it is not the real world that I know of. For example, banks are moving aggressively into securities business and they are almost given a “de facto” exemption from dealer registration under the existing law [section 60(4) of the Securities Ordinance]. Our future MPF scheme which will control a big portion of our wealth serves as another interesting example. It is easy for the MPF schemes to link to investment and insurance related products and they will then be subject to regulations by at least three parties. A simple financial activity will then be regulated by several unrelated agencies. Not only will it increase the burden on the market but it will also lead to more gray areas which will cause oversights in the regulatory framework.
12. That is why the present system may not enable Hong Kong to deal with large financial conglomerates which operate across various financial

institutions and markets. The proposal to establish a cross-market supervision committee is certainly a positive step. However, turning the FSB into a leader for an action oriented team may not be making the best use of the expertise of our civil servants, who are well trained in coordinating and pushing forward legislation that is essential for the growth of Hong Kong's financial sector.

## **Conclusion**

### **13. I would like to highlight the following facts:**

- **The rest of the world is moving towards a function-based regulatory system.**
- **The international financial markets are becoming more competitive and consumers are demanding a package of financial services covering a variety of products.**
- **Hong Kong, which has been voted one of the world's freest economies, may not be all that free in certain areas (for example, Hong Kong is one of the few places in the world that still maintains an interest rate cartel).**
- **When compared with other systems, Hong Kong's regulatory system seems to be fragmented, less forward looking and less capable of meeting the new challenges.**

**We may have reached the point where evolutionary changes and marginal self-improvements from within the organization may not be enough.**

### **14. I am not proposing that Hong Kong should simply follow the crowd in adopting the substance of other people's reform. At the very least, we may need to learn from other countries' example of initiating an independent inquiry to review the entire financial system and its regulatory environment, in order to ensure our competitiveness in the next millennium.**

**Thank you.**

**Table 1. Categorization of the 30 measures**

<b>Measures\Institutions</b>	<b>SEHK</b>	<b>HKC</b>	<b>HKFE</b>	<b>SFC</b>	<b>HKMA</b>	<b>FSB</b>	<b>Total</b>
<b>Short selling</b>	6			4		2	12
<b>Settlement</b>		3		2		1	6
<b>Disclosure</b>	1		2				3
<b>Cross-market supervision committee</b>	1	1	1	1	1	1	6
<b>Cross-market early warning system</b>			1	1			2
<b>Reporting</b>				1		1	2
<b>Rules on covered warrants</b>	1						1
<b>Capitalization</b>			1				1
<b>Margin</b>			1				1
<b>Trading system</b>			1				1
<b>General coordinating &amp; monitoring role of FSB</b>						1	1
<b>Chief Executive's power</b>						1	1
<b>Total</b>	<b>9</b>	<b>4</b>	<b>7</b>	<b>9</b>	<b>1</b>	<b>7</b>	<b>36</b>

Note:SEHK=Stock Exchange of Hong Kong. HKC=Hong Kong Clearing, HKFE=Hong Kong Futures Exchange, SFC=Securities & Futures Commission, HKMA=Hong Kong Monetary Authority, FSB=Financial Services Bureau. The total sum is bigger than 30 as some of the measures involve the actions of more than one institution.

**Table 2. Regulatory structure in Australia, Canada, and UK**

	<b>Australia</b>	<b>Canada</b>	<b>UK</b>
<b>Monetary policy/stability and payment system</b>	<i>Reserve Bank of Australia</i>	<i>Bank of Canada</i>	<i>Bank of England</i>
<b>Prudential regulation</b>	<i>Australian Prudential Regulation Commission (APRC)</i> <ul style="list-style-type: none"> <li>• deposit taking institutions</li> <li>• life and general insurance</li> <li>• superannuation</li> </ul>	<i>Office of the Superintendent of Financial Institutions (OSFI)</i> <ul style="list-style-type: none"> <li>• banks</li> <li>• trust companies</li> <li>• loan companies</li> <li>• insurance</li> <li>• pension</li> </ul>	<i>Financial Services Authority (FSA)</i> <ul style="list-style-type: none"> <li>• banks</li> <li>• building societies</li> <li>• insurance</li> <li>• friendly societies</li> <li>• investment business</li> </ul>
<b>Market Conduct</b>	<i>Corporations and Financial Services Commission (CFSC)</i> <ul style="list-style-type: none"> <li>• market conduct</li> <li>• consumer protection</li> <li>• company regulation</li> </ul>	<i>OSFI</i> <ul style="list-style-type: none"> <li>• consumer protection</li> <li>• deposit insurance</li> </ul>	<i>FSA</i> <ul style="list-style-type: none"> <li>• authorization</li> <li>• enforcement</li> <li>• consumer relations</li> <li>• training</li> </ul>

**Table 3. Regulatory structure in Hong Kong**

	<b>Hong Kong</b>
<b>Monetary policy/stability/payment system</b>	<i>Hong Kong Monetary Authority (HKMA)</i>
<b>Prudential regulation</b>	<p><i>HKMA</i></p> <ul style="list-style-type: none"> <li>• deposit taking institutions (Licensed Banks, Restricted Licensed Banks, Deposit-taking Companies)</li> </ul> <p><i>Securities &amp; Futures Commission (SFC)</i></p> <ul style="list-style-type: none"> <li>• unit trusts and mutual funds</li> <li>• investment-linked assurance schemes</li> <li>• pooled retirement funds and immigration-linked investment schemes</li> <li>• overseeing the operations of the Stock Exchange of Hong Kong (SEHK), Hong Kong Futures Exchange(HKFE) and the Clearing Houses</li> </ul> <p><i>Financial Services Bureau (FSB)</i></p> <ul style="list-style-type: none"> <li>• insurance (Office of the Commissioner of Insurance)</li> <li>• provident fund (Mandatory Provident Fund Office)</li> </ul>
<b>Market conduct</b>	<p><i>HKMA</i></p> <ul style="list-style-type: none"> <li>• depository institutions</li> </ul> <p><i>SFC</i></p> <ul style="list-style-type: none"> <li>• licensing requirements for securities and commodities dealers, investment advisers, leveraged foreign exchange traders and their representatives.</li> <li>• regulating takeovers and mergers and share buy-backs of public companies</li> <li>• supervising the listing-related activities of the SEHK.</li> <li>• ensuring compliance with Hong Kong’s securities, futures and leveraged foreign exchange trading legislation</li> <li>• investor education</li> </ul> <p><i>FSB</i></p> <ul style="list-style-type: none"> <li>• authorization of insurers (Office of the Commissioner of Insurance)</li> </ul>