<u>Response to follow-up questions raised by the LegCo Financial Affairs Panel</u>

The Administration/Securities and Futures Commission ("SFC") are requested:

(a) To provide information on the measures taken to facilitate market development and introduction of new financial products in Hong Kong; and how the efficiency of the existing regime compared with that of overseas jurisdictions such as Singapore.

The SFC encourages financial product innovation of the securities and futures markets. We provide the required assistance and support to facilitate the launch of various investment instruments and products.

In the past few years, we

- authorized the Link REIT, the first REIT in Hong Kong and the largest privatised REIT in Asia, as well as the first REIT with pure exposure to mainland properties (namely the GZI REIT). The REIT Code was revised in June 2005 to allow overseas investments by REITs and the gearing limit for borrowing of REITs is raised to 45% of total assets. We have also recently authorised the first hotel REIT in Hong Kong.
- the Hedge Funds Guidelines issued in 2002 were revised in 2005 to facilitate offering of retail hedge funds in Hong Kong. As at December 2006, there were 14 SFC-authorized retail hedge funds with an aggregate asset size of USD1.66 billion.
- authorized the first bond index tracking Exchange Traded Funds (ETFs) in Asia under the Asian Bond Fund (ABF) 2 project in 2005. The first ETF in Hong Kong tracking the performance of the China A-share market and the Indian stock market were authorized in November 2004 and October 2006 respectively.
- authorized the first open-ended China A-share fund in June 2006 that substantially invests directly in "A" Shares through its QFII quota.
- approved HKExs launch of Callable Bull/Bear Contracts;
- proposed enhancements to the securities offering prospectus regime;
- reviewed the investor compensation levy collection mechanism, resulting in levy exemption since December 2005;
- proposed reducing the transaction levies by 20% to 0.004%. The reduction has become effective since December 2006.

Currently, we are working with HKEx to introduce more new products such as new ETFs, Hang Seng China H-Financials Index futures and options. Meanwhile, we are also considering the recommendations made under the Economic Summit's Action Agenda for the financial services sector, and have already started work on implementing some of these. For example, we are already working on implementing statutory backing for certain listing rule requirements; expanding the list of listed company jurisdictions; reviewing the position limits regime and adjusting the position limits for some futures and options contracts; encouraging electronic communications and monitoring the global development of XBRL. Many of these initiatives will eventually require legislative amendments.

We have not conducted any survey to compare our regulatory regime generally with other overseas countries. However, according to the latest World Competitiveness Yearbook (2006) of International Institute for Management Development (IMD), Hong Kong was ranked 2nd in overall competitiveness, following the US. In regulatory areas, the legal and regulatory framework of Hong Kong was regarded as the best in encouraging the competitiveness of enterprises. Hong Kong was ranked the best in regulation intensity (which means regulation does not restrain the ability of companies to compete).

More recently, in March 2007, the City of London published a report on the competitiveness of 46 financial centres worldwide. The report confirms that London and New York are the two leading global financial centres, and puts Hong Kong and Singapore in third and fourth place respectively. The report notes that Hong Kong performs well in all key areas, especially regulation – which was rated by respondents to its survey as a major component in considering the competitiveness of a market. The report also notes that Hong Kong is a real contender to become a genuinely global financial centre. It is worth noting also that in an earlier 2005 study – also by the City of London – there was no clear leader among the Asian centres. The 2007 study however clarifies that Hong Kong is ahead of other Asian cities. (For members information, the 2007 study ranks the top 10 financial centres as follows: London, New York, Hong Kong, Singapore, Zurich, Frankfurt, Sydney, Chicago, Tokyo, Geneva.)

Financial markets are constantly changing. Continuous innovation and new product development are important ways in which the financial services industry generates benefits for consumers and markets. It is important that regulation can respond rapidly to the pace of change in markets and so allow them to continue to develop for the benefit of their users. The Financial Services Authority in the United Kingdom, for example, is moving towards a more “principles-based” regulatory regime, i.e. to place greater reliance on principles and high level rules, and less reliance on prescriptive rules. The SFC will keep in view of the developments on regulation in this direction.

We also take this opportunity to note that we very much welcome the FA Panel’s interests in our market development efforts. As members will no doubt agree, market development is not simply about introducing new products but also extends generally to any initiatives that can help enhance the quality of our markets. Hence, for example, initiatives that improve the liquidity and efficiency of our market or quality of our market infrastructure or the effectiveness of our regulatory regime, are all equally important. The SFC therefore keeps such matters under regular review. To the extent that any future initiatives may require legislative amendments, we look forward to receiving members’ support to realise them.

(b) To consider devising and including key performance indicators (“KPIs”) in the future Budgets of SFC to enable better assessment of its cost effectiveness.

The SFC will devise KPIs where appropriate to help assess its cost effectiveness.