The Hong Kong Institute of Directors
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the marketplace is for less interference. Any regulation that restricts the freedom of the market to conduct its business is viewed as anti-competitive.

5. When a crisis erupts, such as what is happening in the US and Europe at the moment, the mood changes dramatically. There are normally two reactions. First, who is to blame? Why was the regulator asleep at the wheel? Why was a particular type of activity or intermediary or segment of the financial market not regulated? You know, it is always easy to give an opinion after the fact. And, suddenly there are a lot of expert opinions on what should have been done or should not have been done. Hindsight gives us 20/20 vision, and no doubt we can draw invaluable lessons. But it requires foresight to make the right judgment call each and every time and this is not possible in the absence of complete information in a rapidly changing market situation.

6. The market participants and politicians also tend to forget that when the party was in full swing, no one heeded calls for caution. Also, they did not want to hear talk of having more regulation. Worse still, regulators are blamed all the same when the very event they were warning the market against actually happens.

7. The second reaction after a crisis, as history shows us is that there is normally a call for more regulation, expanded powers, or sometimes even an overhaul of the regulatory structure after a crisis happens. Examples that come to mind are the introduction of Sarbanes-Oxley in the aftermath of corporate scandals like Enron. Last week's proposals by the US Treasury to improve regulatory coordination and oversight and to modernise the regulatory structure are the most sweeping overhaul since the Depression. Similarly, there were calls in the UK to review the regulatory arrangements following the failure of Northern Rock.

8. To sum up, there are two points I wish to make. First, regulation cannot guarantee zero failures or against crises happening. For financial markets to remain robust and well-functioning, it calls for self-discipline, market discipline and regulatory discipline to be exercised by the different stakeholders in the marketplace. In this respect, corporate directors have a major role to play.

9. Secondly, regulators have to ensure that there is not too much regulation or too little regulation. Regulators have to decide on a regulatory framework that protect public interest and maintain market confidence, while not hindering the ability of a financial market to provide competitive financial products and services. In other words, achieving regulatory balance.

10. I will now return to the topic of my talk today on *Regulation and Global Competition.*

11. In preparing my remarks, I asked myself four questions.
    - First, why is the regulator often accused of being anti-competitive? In this regard, I will examine why there had been calls for less regulation.
    - Second, how do regulators achieve regulatory balance? I will touch on the international experience.
    - Third, what is the approach of the SFC in achieving regulatory balance in Hong Kong?
    - Finally, how does Hong Kong as a whole measure up?

The call for less regulation

12. Now, on my first question: is regulation anti-competitive? I agree that regulation can be stifling, anti-competitive and costly. This can happen where financial innovation is not encouraged or is only allowed with such restrictions that reduce its attraction, or where new market entrants are restricted, or where there are unnecessary or obsolete regulations.

13. What is important to the business community is that regulation does not impede competition and create unnecessary administrative procedures that is both time consuming and costly. For example, New York's regulatory regime is often cited as one of the reasons for its loss of competitiveness as market participants move their business to jurisdictions such as London where regulation is considered to be more efficient. The US Treasury report I mentioned earlier had identified the need to reduce redundancies and gaps in regulation.

14. As I see it, there are four developments in capital markets that had led to calls for less regulation. One was the listing of demutualised stock exchanges that transformed exchanges into for-profit organisations. In pursuit of revenue sources and profit for shareholders, exchanges had asked for a relaxation of trading rules in order to facilitate more transactions, and a shorter time to market to launch new products.

15. To retain star performers, intermediaries had attractive compensation packages that rewarded generously those that brought in the most business. Industry wanted minimal interference in this area, but as we have seen sometimes the incentive structures encouraged excessive risk taking by staff in order to earn huge bonuses.

16. Another area where there was a call for less or no regulation was in respect of hedge funds, as they brought in huge business to prime brokers and helped to create deeper and more liquid markets.

17. Finally, as the number of high net worth clients grew, coupled with a search for higher yield in a low interest rate environment, there were calls for a lighter regulatory regime for this category of investors compared to the regime that was in place for retail investors.

Regulatory balance – the international experience

18. According to various studies, the regulatory environment is one of the critical success factors of international financial centres. Other factors that have been identified for the success of London and New York are the availability of skilled people, product innovation and market liquidity.

19. In fact, an effective regulatory environment is a brand name that stands for quality market and integrity, and where markets can expect the regulators to act and enforce in a consistent, certain and predictable manner.

20. The quality of a market is judged by whether it is efficient, orderly and fair and whether investors are treated fairly. Other factors include the choice of products, the

changes to harmonize the regulation and oversight of broker-dealers and investment advisers offering similar services to retail investors.

26. The report also recommends that the SEC modernises its regulatory structure and adopt a more principles-based approach as is the practice of the CFTC. As I mentioned earlier, the UK's principles-based approached has been viewed by the market to be more flexible and efficient.

The SFC's approach to regulation

27. In Hong Kong, we adopt international standards of securities regulation established the International Organisation of Securities Commissions (IOSCO). In addition, the Securities and Futures Ordinance (SFO) provides for the SFC to promote a competitive securities industry and to be mindful of the need for Hong Kong to remain competitive as an IFC, over and above the normal objectives of securities regulation. To sum up, what this means is that the SFC is entrusted to –

- Regulate and enforce to protect investors and maintain market stability;
- Facilitate market development and innovation so as to maintain a competitive securities industry and Hong Kong's status as an IFC; and
- Educate investors.

28. What the SFC is doing is to look closely at how we discharge our statutory role with a view to cutting back red tape and unnecessary bureaucracy. We deregulate in areas where rules, processes or regulations create structural barriers to efficiency and competition or where they are obsolete or create unintended consequences because of changes in the operating environment.

29. At the same time, we would tighten regulations, or re-regulate, where the regulations are deficient in achieving the desired regulatory outcomes, again because of changes in the operating environment, loopholes or regulatory gaps. Regulation and deregulation are not inconsistent, and in fact are complementary in achieving the regulatory objectives.

30. Investor education is an important complement to regulation, as it helps to empower the investor with basic knowledge of products and their risks, their rights, responsibilities and where to channel complaints of unfair treatment or misconduct. Enlightened investors would be equipped to ask the right questions, make informed decisions and be more alert to scams.

31. In addition to consulting the market on proposed regulatory changes, the SFC also works with the industry on enhancing efficiency. For example, the SFC announced in June last year a set of initiatives to streamline the licensing procedures for overseas fund managers wishing to operate in Hong Kong. Under the streamlined procedures, there are now cases where fund management companies can obtain their licences within four weeks.

How does Hong Kong stack up?

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