

Speech at 5th Pan Asian Regulatory Summit

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Thank you Sanjeev and also thanks to Thomson Reuters for organising this conference and for inviting me to deliver the opening address.

When I last spoke at this event two years ago, I talked about the post-crisis revolution in financial regulation in the US and the EU and its impact on Asian markets. The point I made then was that an attitude in the West that its regulatory and policy preferences must be exported to Asia to contain a threat of regulatory arbitrage was completely misconceived.

This remains my view – in fact I am more certain than ever. Time has shown that many of the post-crisis reforms – although well intentioned – have led to a fragmentation and localisation of financial services, imposing unnecessary costs on firms and economies.

Hong Kong's unique status

But this time around, I want to shift the focus a bit. A huge amount has been said and written about regulation from the perspective of the US and the EU, as well as the juggernaut of reforms decided on by G20 leaders. There isn't really much more to add.

However, not as much has been said about the view from places like Hong Kong, looking out to the rest of the world.

Today I want to talk about the factors that drive our international and mainland China policy priorities in Hong Kong. It shouldn't surprise you that these drivers are very different to those in the West. So I will try to use the Hong Kong experience to talk about the challenges and opportunities we have across three dimensions.

The first is the way in which we interact with global finance outside mainland China. This includes the SFC's new approach to the regulation of large globally active firms with a presence in Hong Kong.

The second dimension illustrates how we work with mainland China on very significant domestic reforms to do with the renminbi story and the gradual opening of the capital account. And in this context I will touch on Shanghai-Hong Kong Stock Connect.

The third and final dimension is about how, finally, Asian regulators are now starting to make themselves heard in London, Washington and Brussels with one voice – which definitely grabs the attention of policymakers in those places.

But let's start back here, in Hong Kong. To understand what we do as a regulator it is essential to appreciate our defining characteristic as an international financial centre. This is that we are a very small place physically, but we play host to a very large, open market serviced by a global, highly developed and sophisticated financial services industry.



Most of the very large firms which are active here are headquartered abroad, but are a key component of Hong Kong's success. It's telling that financial services contribute nearly 16% of Hong Kong's GDP – a much higher share than in Germany and Japan, where they account for less than 5% of national output, and even higher than in the UK, where they contribute nearly 10%.

This means that from a policy perspective the way we regulate must recognise the fact that we are basically an enthusiastic importer of financial services – rather than an exporter like Switzerland – and that we are therefore very heavily entwined with global financial markets and, increasingly, with mainland China's domestic market.

This alone means that our approach to regulation cannot be identical to that in the EU or the US, both of which have large domestic markets and export and import financial services to each other. As a result, they have a complex and often tense transatlantic relationship.

Now what does all this theory imply for global firms operating in Hong Kong?

At a practical level we need to reassess how we regulate larger firms whose activities in Hong Kong can be managed locally, regionally and globally – or a combination of any of these. Getting a grip on the activities of these firms in order to have a good handle on market development and investor protection in Hong Kong is nevertheless a major challenge.

Focus on firms

So we have now turned a lot of attention to the way firms are actually managed. The reality is that the global financial industry is more concentrated than ever. At the same time, large firms are incredibly complex with a wide range of overlapping subsidiaries and business lines operating across many jurisdictions. The largest US banks each have some 2,000 to 3,000 legal entities around the globe, and are often said to be too big and complex to manage.

For an intensely international financial centre like Hong Kong, there is an obvious tension between a traditional, locally focused approach to oversight of our licensed firms, and the reality that business, risk and compliance decisions affecting Hong Kong are often made in multiple international locations.

We have therefore concluded that our regulatory reach must extend, at the very least, to the senior management decisions of foreign-headquartered firms when Hong Kong financial market interests are at stake.

This means that as a supervisor and an enforcement agency, we cannot limit ourselves only to looking at licensed corporations in Hong Kong as standalone legal entities. We have to look more broadly into all operations and management both here and abroad which are relevant to the business of regulated firms in Hong Kong. Our securities laws give a rock solid basis on which to do this. If we do not do so we will only have a blinkered view of activity in our markets, and would not achieve the good outcomes for conduct and investor protection that our laws envisage.

Simply put, our approach, at the softer end, is to be more proactive when it comes to fostering closer communication between industry participants and ourselves. This will



include how local, regional and global operations may affect the conduct of business by a licensed firm here.

We have also made clear that all people who are involved in the management of Hong Kong businesses – wherever they are located – have to take responsibility for implementing proper controls and ensuring appropriate standards of conduct.

We also must be kept informed – in real time – of any issues arising within a globally active group that may harm Hong Kong investors or our markets. This could range from foreign regulatory action to a control failure elsewhere in the world which also needs to be fixed locally. We want to minimise surprises.

We are also communicating loud and clear that when there are serious conduct issues we will be unflinching in pursuing criminal, disciplinary or penal sanctions as well as remedial outcomes against firms and individuals wherever they are – including senior management. I think that our enforcement track record over the last few years certainly demonstrates how we have pursued this line.

Listening to this you would be forgiven for thinking that we may have taken a leaf out of the US or EU playbook, and are pursuing an extraterritorial agenda. That is far from the truth.

And to be honest it would be hard to achieve anyway as we don't have the luxury of being able to export regulation on the back of a big presence of Hong Kong financial firms in the West. This means that we can't credibly threaten a tactical withdrawal from overseas markets if others don't play ball, unlike the US and the EU. And even if we could I don't think this is the right approach.

This is because we are very aware that it is next to impossible to properly supervise different parts of large global firms alone. And despite pursuing an extraterritorial approach in some areas, regulators in the West are also waking up to this reality.

We are therefore working hard to enlarge the scope and depth of formal cooperation with other regulators to better supervise firms which have a global footprint. Specifically, we are pursuing new, bilateral supervisory arrangements with foreign regulators for those firms that are particularly significant for Hong Kong's markets.

These international arrangements will provide for a more 'joined up' approach to supervision, and mean that we will be better able to understand a licensed firm's Hong Kong operations in the wider context of the firm's group-level activities in Asia region or further afield.

Through this we want to achieve enhanced information sharing, closer coordination of inspections and exchanges of inspection findings and supervisory reports.

This all may seem easy to achieve, but I can assure you that it isn't. The simple idea of sharing supervisory information and running joint inspections can run into severe problems to do with data protection, secrecy laws and inadequate legal gateways enabling cooperation to take place.

It also raises difficult issues about whether one regulator is comfortable relying on the work of another. The fact is that, among securities regulators, supervisory cooperation is in a very primitive state. It's far better between the prudential regulators of banks centred in the Basel



Committee. But that's partly because non-bank financial markets are complex and massively heterogeneous.

We at the SFC are nevertheless determined to reverse this situation, starting with the large global firms who are such important contributors in this major international financial centre. To do otherwise ultimately leads to yet more market fragmentation, subsidiarisation, localisation and reduced liquidity, with all the additional, unnecessary cost this implies for firms as well as real economies.

I would therefore ask that firms actively support us in this important project. It can't work well without your close involvement and I believe that it will be as valuable for your risk management programmes as it is for us regulators. It should also minimise unnecessary barriers to cross-border business.

More connectivity and cooperation with mainland China

I now want to turn to the second dimension of our international market: mainland China. Clearly, the overall direction of travel over many years is greater connectivity between the mainland and Hong Kong markets, with Hong Kong acting as a bridge to global investors.

This started with the H share listing of Tsingtao Brewery in the early 1990's, and accelerated after 2011 with renminbi internationalisation and as a result of the profound financial and economic reforms now underway in mainland China. QFII, RQFII and QDII are all now familiar acronyms signifying milestones on the road to further capital account liberalisation. And there is no doubt that Hong Kong will continue to play a pivotal role in this area.

Now, there has been a lot of comment about Shanghai-Hong Kong Stock Connect in recent days. It has been much written about so I don't need to recap on its basic design here.

What I do want to do is to describe what the SFC has done so far, and especially to show that Stock Connect has resulted in unprecedented agreement about cooperation between ourselves, the China Securities Regulatory Commission (CSRC) and the Shanghai Stock Exchange which in many respects outstrips examples elsewhere in the world.

First, I should confirm that the SFC has completed all key regulatory work necessary to enable Stock Connect to start.

This work, of course, includes system and operational changes, as well as new rules, at the Stock Exchange of Hong Kong. But, of far more significance to the SFC, we have now agreed brand new arrangements with the CSRC which ensure that anyone who intends to commit misconduct in either market will know that they are more likely than ever to be caught and punished.

These arrangements include a new enforcement Memorandum of Understanding for Stock Connect. We announced this just over a week ago. It covers alerts made by each of the CSRC and SFC to the other about suspicious trading, commitments about fast responses to information requests made during investigations as well as arrangements for the CSRC and SFC to carry out joint investigations of misconduct. It also covers coordinated enforcement action leading to financial redress for mainland and international investors harmed by misconduct.



We have also concluded new understandings about how the CSRC and SFC will cooperate in relation to investor complaints, investor education and extreme market disruptions.

On top of this we have since agreed on the way in which the SFC, CSRC, Shanghai Stock Exchange and the Shanghai clearing house will work together to ensure there is a rapid flow of information in both directions for effective market surveillance.

Make no mistake – these arrangements are ground breaking; they mark a significantly enhanced level of collaboration between the SFC and the CSRC which matches the level of connectivity between our markets intended to be brought about by Stock Connect. In short, they enable us to stand united to combat anyone intent on harming our markets.

I should also say that we are extremely grateful to the CSRC for the hard work and commitment which enabled us to reach these agreements. We are convinced that Stock Connect will be of benefit to both markets as well as mainland and international investors. Our job is done, and we hope that trading begins in the not too distant future.

Collective Asian voice emerging

The third international dimension I want to touch on is the whole Asian region itself, which spans India in the Northwest to Australia in the Southeast.

Asia accounts for roughly one-third of global GDP which will rise to half of world GDP in 15 years. But because Asia is so diverse, and because there is undoubtedly competition within the region, our collective voice on regulation at the global level has been weak.

When I spoke at this conference last time round I said that Asian jurisdictions have very different domestic priorities and market structures to the West, and for this reason US and EU regulations designed to tackle the financial crisis should not be transplanted into Asia simply to tick an international checklist. I also said that we must set local priorities to make best use of scarce legislative and regulatory resources.

This is not to say that Asia should ignore the global reform agenda. There is no doubt that Asia has a big incentive to ensure that regulation involves a race to the top, and not to the bottom. International investors expect nothing less, and to pursue regulatory arbitrage is naïve and self-defeating. But at the same time we must make sure we have the right rules for Asia.

In this spirit, securities regulators in Asia are now finally getting their act together to speak with one voice.

The SFC is a big part of an effort to ensure that Asia is heard loud and clear by other countries.

Through the IOSCO Asia-Pacific Regional Committee, we are now communicating far more clearly about diversity in the Asian regulatory landscape; the reasons behind Asian jurisdictions' different approaches to market development and regulation; and the need to have a balanced and informed debate about how Asia should deal with attempts to export rules to us from the US and the EU.

Our collective efforts have yielded good results. In 2013, we engaged with the European authorities about the right criteria for the recognition of Asia Pacific clearing houses under



European law. We eventually succeeded in this effort by this summer. Had we not done so the result could have been a withdrawal of European banks from local securities markets. A concerted approach made all the difference.

We have since written collectively to the US Commodity Futures Trading Commission regarding the impact of its rules about derivatives exchanges on Asia Pacific markets. These rules led to a number of non-US trading platforms finding it hard to determine which clients might qualify as US persons, and some stopped dealing with them altogether. This is not good for Asian liquidity – implying fewer hedging opportunities and more cost. We are again hopeful that our collective efforts will make a difference.

This is a small beginning, but definitely signifies a new confidence that speaking with one Asian voice can be extremely powerful.

So I hope that this gives you some idea of how we view things from Hong Kong. I realise that any attempt to review the way in which we interact with global and China financial markets is bound to be superficial and incomplete. But I hope I have given you an idea of the SFC's take on this complex but vital subject.

Thank you.