Speech at CPA Australia Corporate Governance Forum
"Creating The Biggest Capital Market For IPOs In The World"

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4 October 2007

Good afternoon ladies and gentlemen.

It is a pleasure to be asked to address you today on the role the regulators play in making our market the biggest capital market for IPOs in the World. You may ask why Hong Kong – the core of the answer is China.

If we look at the current pretenders to this throne they look very different. New York achieved its position for the simple reason that it serves the biggest economy in the world. For many years, New York was unquestionably the world's leading financial centre – but this century the crown has slipped a bit. You only have to look at the amount being spent on consultancies in New York all being given the same basic question to answer – "Has New York lost its way?" The answer is never quite so simple but two issues in particular stand out. The first is less to do with New York than the rest of the world – markets have become global and the balance of global economic power is moving east. With the low cost and ease of telecommunications, and the general rise in transparency and regulatory standards – companies generally - and there are always exceptions to this - do not need to cross the globe looking for capital. Capital will come to them – if the market is open, transparent and accessible.

The second issue for New York and one that has attracted lots of comment is regulation - partly Sarbanes-Oxley which is seen as a knee-jerk reaction to Enron but more generally the costly regulatory environment.

The other major global financial centre, London, has been very much in the ascendant for the last 5 years – but interestingly it does not have the economic power base to serve that New York has nor does it have an economy growing at the sort of rates we see in Asia – nor is it part of a major currency block. Again consultants are paid to analyse why - in this case the question becomes – "to what does London owe its success?" Again the highly paid consultants do rounds of interviews, produce a voluminous report and conclude essentially 3 reasons for London's success:

- Critical mass – success breeds success and the fact that there are so many investment bankers, traders, lawyers, accountants, hedge funds etc. – means it's a good place to start if you want to recruit these skills – albeit at a price
- Secondly, the regulatory environment – it is seen to have got the balance right in term of regulatory standards. Not too tough to frighten business away but not too light so as to allow confidence to suffer.
- The third factor is loosely termed, as lifestyle issues – travel, though anyone that has used Heathrow recently might question this, availability of schooling, restaurants, theatre etc.

So the two big global financial centres have quite different stories – let's now come back to Hong Kong.

China's growth in the past few years has made the China story the focus of investors across the world. Let me remind you of some of the key facts about the China story.

- According to the National Bureau of Statistics, China is now the world's fourth largest economy, and is forecast to surpass Germany and Japan to become the second largest economy in the world.
- China has enjoyed economic growth of at around 10% a year for four consecutive years (2003 – 2006).
- In 2006 China's GDP grew by a higher than expected 10.7%, the biggest growth in the economy since 1995.
- Economic growth in China is strong with the surplus in its balance of payments in 2006 having increased 74% from the previous year. Indeed, the surplus has risen from US$40.5 billion in 1997 to US$177.5 billion in 2006.
- Foreign Exchange reserves have also grown rapidly. As at the end of 2006 forex reserves were at US$1 trillion as compared with US$139.9 billion at the end of 1997, and had increased 30% compared with the previous year (2005).

The PRC's capital markets have also undergone rapid changes during the past few years. China's stock market was launched in the early 1990's and since then has undergone rapid development with a significant increase in market size, infrastructure, legal framework and market maturity.

As at the end of July 2007, Shanghai hosted 852 listed companies and it raised US$17 billion directly or indirectly in 2006. The Shanghai Stock Exchange had a market capitalisation of US$2 trillion, making it the 3rd largest market in Asia and the 7th largest in the world. In addition, Shanghai had a market cap-to-GDP ratio of 77% and an average daily turnover of US$11.2 billion for the 12 months ended July 2007.

Whilst not as spectacular the Hong Kong story is also of strong economic growth:

- Hong Kong's GDP has been growing steadily since 1998, and in 2006 grew by 6.8%. Similarly, Hong Kong's balance of payments and foreign exchange reserves have grown steadily and in 2006 were US$20.5 billion and US$133.21 billion respectively.
- As at the end of July 2007, the Hong Kong stock market hosted 1,206 companies, had a market capitalisation of US$2. 2 trillion (the 2nd largest in Asia and the 6th largest in the world), an average daily turnover of US$5.3 billion for the 12 months ended 31 July 2007. It raised US$67 billion directly or indirectly in 2006 (of which US$46 billion was for Mainland enterprises). In addition, the Hang Seng Index was trading at 23,185 or a PE of 18 and that only 2 months ago!

Both Hong Kong and Shanghai are twice the size of the other Asian markets apart from Japan.

- Korea had 1,717 listed companies with a market capitalisation of US$1.1 trillion and an average daily turnover of US$6.3 billion.
- India had 1,274 listed companies with a market capitalisation of US$1.1 trillion and a daily average turnover of US$2 billion.

- Taiwan had 683 listed companies, a market capitalisation of US$0.7 trillion and daily turnover of US$3.4 billion
- Singapore had 732 listed companies with a market capitalisation of US$0.5 trillion and a daily average turnover of US$1.1 billion.

The combined turnover of Hong Kong, Shanghai and Shenzhen exceeds that of Tokyo and is only exceeded by the New York Stock Exchange, Nasdaq and London. As China's economy grows so will its market challenging the standings of these leading markets.

However just as economies are going global so are markets. This brings me to the question of who and what determines which will be the biggest capital market? The simple answer is the market determines which will be the biggest capital market or at least it does where market forces are allowed to act freely. There are many factors that decide the winners. As a regulator it is my role to get only one of these criteria right – the regulatory environment - and as I have outline in the brief summary of the respective positions of New York and London, this is a critical factor to get right.

The regulators in Hong Kong are conscious that the regulatory system has to be right and that standards have to be maintained. Hong Kong already has a strong regulatory environment with detailed rules and requirements based on the English language, the rule of law and tested over many years. Our experience of developing regulatory standards is based on many years of application and refinement, and crucially the input of practitioners. This has created a regulatory environment that provides protections to investors without placing too great a cost burden on the industry – it's all about balance.

But setting rules and standards is not enough – we have to also make sure that the industry operates to these standards. We do this through communicating to the industry what is expected – and believe me, most firms do want to understand the rules and follow them – and through our enforcement actions where we find deliberate breaches of the rules.

In this regard I am pleased to note that the recent CLSA report on Corporate Governance in Asia ranks Hong Kong highest overall and gives us the highest ranking for enforcement. But there is always room for improvement. Indeed one of the regulatory initiatives which I'll touch on later, statutory backing for certain listing requirements, is designed to address a weakness noted in this report.

We are also conscious that over-regulation is just as much of a problem as under-regulation. As I mentioned earlier, some believe that in introducing Sarbanes-Oxley Act of 2002 the USA has swung too far. The Act sought to address real issues and problems that had resulted in large losses to investors but the impression is the cure may be worse than the disease – or at least there must be other ways to deal with these issues.

It has been said that Sarbanes-Oxley has helped to displace business from New York to London, where the Financial Services Authority is said to regulate the financial sector with a lighter touch – that's what I hear from the international players that operate across all time zones. The Alternative Investment Market has seen spectacular growth in listings, almost entirely coincided with the introduction of SOX. Clearly, there needs to be the right balance of regulation. We believe that we have got it about right in Hong Kong, though there is always room for improvement and as the market develops and changes we must be prepared to react.

This brings me to some of the recent regulatory initiatives in Hong Kong.

In its policy conclusions of March 2004, the Government set out various initiatives to improve the regulation of listing. These initiatives were aimed at strengthening Hong Kong's position as a leading international financial centre and at enhancing investor confidence in the Hong Kong market as well as at increasing Hong Kong's competitiveness. In order to address the lack of teeth and the limited sanctions available under the Listing Rules and the insufficient investigation powers of the Exchange, it was decided to introduce statutory obligations for listed issuers to comply with important listing requirements, thereby invoking the statutory investigation powers of the Securities and Futures Commission and the sanctions available under the Securities and Futures Ordinance.

In January 2005 the Government and the SFC separately consulted the public on proposals to give statutory backing to major listing requirements:

- financial reporting and other periodic disclosure (e.g. annual and interim reports) by listed companies;
- disclosure of price sensitive information by listed companies; and
- shareholders' approval for certain notifiable transactions.

In August 2006, the Government and the SFC agreed that these areas would be codified by way of general principles in statute, supported by an SFC code based on the Listing Rules. The SFC published its Consultation Conclusions in February 2007. The Government and the SFC worked on the proposed legislative amendments but were unable to table the amendment bill before the Legislative Council before July 2007. The SFC is now working with the Government on draft legislative provisions for further consultation.

In 2005, a new Code on Corporate Governance Practices came into effect. The Code is based on the UK's code and sets out the principles of good corporate governance, and two levels of recommendations: code provisions and recommended best practices.

Listed companies are expected to comply with or explain departures from the Code provisions. The recommended best practices are for guidance only. In March 2007, the HKEx published a report on the findings from its review of the corporate governance practices disclosed in listed issuers' 2005 annual reports.

The HKEx found a good level of compliance with the Code. Of the 621 listed companies reviewed all met the "comply or explain" requirements in their 2005 annual reports in respect of Code provisions. Large listed companies complied with more code provisions than smaller companies, 89% of all listed companies complied with 41 or more of the 44 Code provisions. The Exchange is conducting a follow up survey to ask listed companies about compliance with recommendations.

In May 2007, the HKEx and the HKIoD issued a joint news release to assist listed issuers and their directors in determining the appropriate level of disclosure when a director resigns.

The Main Board and GEM Listing Rules require listed issuers to announce changes in their directorates and, in the event that a director resigns, to announce the reasons why. In purported compliance with this requirement issuers frequently announce that a director is resigning for "personal reasons". In some cases this reason is given even when the reasons are such that are not commonly understood to be personal. As a result the press release was aimed at assisting issuers in interpreting what are personal reasons.

It seems that since the issue of the press announcement listed issuers are generally following the disclosure guidelines and are providing more meaningful disclosure of the reasons for the resignation of their directors.

In a few cases where the reasons disclosed in the initial announcements were "personal reasons" but after enquiry were found to be outside the scope of personal reasons as set out in the joint press announcement, the list issuers were asked to make further announcements clarifying the position.

In January 2002, the HKEx published a consultation paper entitled "Proposed Amendments to the Listing Rules relating to Corporate Governance Issues". Amongst other things, the HKEx proposed to amend the Main Board Rules to shorten the time allowed for the release of results announcements and reports and to introduce quarterly reporting for the Main Board issuers. After taking into account the views of respondents, the HKEx published its conclusions and decided to defer quarterly reporting whilst stressing that it was good reporting practice and decided not to change the deadlines for half-year and annual reporting.

However, the HKEx said that it would keep the matters under review. Given developments and changes in requirements in other international securities markets the HKEx is now of the view that it's appropriate to reconsider these matters. In August 2007, the HKEx issued a consultation paper on periodic financial reporting. Looking at other markets we note that London is introducing quarterly reporting and the only other market in Asia that does not have quarterly reporting is Bangladesh – not particularly a market we see as a comparator for Hong Kong.

The proposals are:

- to shorten the time allowed for the release of half year results for Main Board issuers from three months to two months;
- to shorten the time for release of annual results announcements and reports from four months to three months for Main Board issuers;
- no change to the reporting deadlines for half year and annual reporting for GEM;
- to introduce quarterly reporting for Main Board issuers;
- to amend the GEM Listing Rules to align the disclosure and publication requirements for GEM issuers' quarterly reporting to be the same as the proposed quarterly requirements for Main Board issuers.

As these initiatives show our regulatory environment continues to develop. We are striving to ensure that we provide the right balance of regulation supported by effective enforcement.

So to come back to the main question – "Creating the Biggest Capital Market for IPOs in the World" – clearly the balance of global economic power is moving east with China dominating in terms of both economic importance and capital market growth.

In a global economy, capital is mobile and will flow to investment opportunities, provided there is reasonable assurance in terms of legal certainty, transparency and accessibility. Hong Kong offers all of those qualities and is well positioned to continue to serve the phenomenal growth of China and south-east Asia.