



## **Regulator's Role in Today's Fund Management Business**

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### **Opening**

I'd like to thank the Hong Kong Investment Funds Association for inviting me here to speak today. I didn't know at the time I accepted this opportunity that it would follow such a tumultuous weekend; or that we would be at the heart of the most significant financial crisis that I and any of you have ever seen. And I am sure many of you will have spent the weekend watching nervously for the reports from the US as to whether the so-called Paulson Plan would get approval or not. We've also been watching very nervously to Europe, where -19.3 spent 3771 0 Our jobathact s



## **Profile of the fund management business**

### *Globalisation of market participants and investors*

We have seen tremendous growth in the number of cross-border investment managers as well as cross-border marketing of funds in recent years. Out of the 2,200 retail funds authorised in Hong Kong, 76% are domiciled in European countries such as Luxembourg, Ireland and the UK. In addition, 86% of the fund management groups managing SFC-authorised funds are multinational financial groups based in overseas jurisdictions.

The clientele of the fund management business is also highly international in nature. According to our Fund Management Activities Survey which is conducted on an annual basis, overseas investors have consistently accounted for over 60% of the assets managed by licensed corporations, registered institutions and private banks in Hong Kong. Such percentage made new high in 2007, surging to an unprecedented new high of 68% in 2007.

Hong Kong is undoubtedly an international fund management centre. From a regulatory



## **International response to the subprime crisis**

Since the emergence of the subprime crisis, the International Organization of Securities Commission (IOSCO) has undertaken various initiatives to examine and review the issues surrounding the subprime crisis. As a member of the IOSCO Technical Committee, I would like to share with you some of the findings and recommendations made by IOSCO in relation to the subprime market turmoil.

Back in November 2007, a task force was established by the IOSCO Technical Committee to study the subprime market turmoil that began to emerge earlier that year. The task force was asked to study the subprime issue, its impact to the financial capital markets, and to make recommendations to better protect the investing public from the spill over effects resulting from activity in the subprime market. In addition to the study of the subprime crisis, the Technical Committee also continued its work on the issue of credit rating agencies and analyzed the role played by credit rating agencies in the structure finance markets and the subprime market turmoil.

The task force's findings on the subprime market were published in May 2008. Having studied the developments of the subprime market and the response of regulators worldwide, the task force recommended the IOSCO to conduct further review with respect to these topics:

- Issuer transparency and due diligence by investment managers when investing into these structured products;
- Firm risk management and prudent supervision; and
- Valuation and accounting issues

In its recent meeting in mid-September, amidst the unfolding of some major market events,



understand the investments that they are making on behalf of their clients. This includes conducting thorough analysis on the characteristics of the products and assessing their risk profiles and their impact on the overall investment portfolio. The risks involved should be adequately and properly captured in the risk management systems, which incorporate vigorous stress testing.

Apart from being internally equipped with a comprehensive and updated risk management system to monitor the investment activities and manage the risks of their investments, managers should also devote resources on the external front to avoid misunderstanding of their products by investors. In this regard, managers have to provide clear, proper disclosure of the nature and risk profiles of the products in simple language, to facilitate investors make an informed investment decision.

Apparently, investment products are “sold to” and not “bought by” investors. Therefore it is of paramount importance that selling agents of the products fully understand the investment features and risk profiles of the products. They also have a duty to take into consideration of the investment objectives and unique circumstances of the investors when promoting investment products. At the same time, given the complexity of the products, managers have a duty to clearly communicate and clarify the intricacies of their financial products to their distributors and their sales agents to equip them with the knowledge and expertise to assess the suitability of the products vis-à-vis the specific circumstances of their clients, and to explain the products to them.

### **SFC's role in the Hong Kong fund market**

As a regulator, the SFC does not only face the challenges posed by the global market events, Apparently, in  
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Securing the conviction of an individual for insider dealing; the first since insider dealing was made a criminal offence under the Securities and Futures Ordinance (SFO);

Prosecuting and taking disciplinary action against individuals for conducting “marking the close” activities;

Obtaining a court injunction to stop an unlicensed firm from carrying on futures dealing business; and

Investigating suspected boiler room activities.

Amidst this unprecedented global financial crisis, we will dedicate our efforts to ensure that market operations are conducted smoothly and in an orderly fashion. We will also continue to vigorously monitor market activities and take decisive actions against those who commit misconduct in the market.

We also need to continue to work alongside industry players like yourselves who are at the forefront of market development and serve as a useful source of information for policymakers like the SFC. It is important that we listen to your views, monitor trends, and assess the effectiveness of principles and regulation on a continual basis.

## **Conclusion**

Now you will know that the government has asked us to do a three-month review of our structured products market. They have asked us to do this on the back of what has become a significant issue in Hong Kong, where individuals feel they were sold products that they did not understand; that they were sold products that they had thought were alternatives to bank deposits. These products are complex products. In today’s very difficult market, those



the Hong Kong Monetary Authority are looking closely at whether there has been misconduct and mis-selling in our licensed institutions and regulated banks.

At the same time, we have been asking all of you, and we've realised that we've put quite a burden on you and so thank you for providing us the information, for more information about the sorts of products that you manage, the exposure of those products, the underlying characteristics of those products and how those products might operate in very difficult market conditions. Whilst we are analysing that, we need to make sure that we have understood those products which may impose more risks to individuals in a global meltdown and those risks which impose less. It is not our job to tar all financial products with the brush of certain toxic waste – certain structured products have created confusion and complexity in the market. So, we will work very closely with you and we need your input to make sure that we do not throw the baby out with the bath water, and stifle what is a healthy and good industry for Hong Kong.

Thank you all very much.