

## Keynote speech at AIMA Policy and Regulatory Forum

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8 March 2012

### Introduction

Thank you for inviting me here.

We have just heard from a panel of distinguished speakers sharing their insights into policy and regulatory issues in the alternative investment space. Quite rightly, much of your discussion today will focus on the “what” and “how” questions, dissecting the rules and regulations that are being put in place, and contemplating compliance solutions. These are no doubt important questions, not least because many of the new rules will have a major impact on the way you do business, and your bottom line.

Since we do not often have such a large gathering of regulators and hedge fund professionals all in one room, I thought it would be useful for me to take a step back from the more technical issues, and use this occasion to share with you the regulators’ thinking, and explore how the hedge fund industry could work more closely with the regulators. It has always been my belief that a frank, open dialogue between the regulator and the regulated would help the industry develop in a healthy manner, and provide reference points for us as we write rules to regulate the industry and the market. Many of you here today have picked Hong Kong as your base. You therefore have a stake, as much as we do, in maintaining the Hong Kong market’s integrity, depth and vibrancy.

In the last three years we have seen a strong inflow of firms, among them hedge funds and other alternative managers, eager to tap the opportunities that open up as mainland China continues to liberalise the use of its currency and allow liquidity to leave its border. To capture those opportunities, our market must offer not just choice and talent but also proper investor and systemic protection. I will also share with you my thoughts on why some of the recent reform developments will help in these areas.

### The current hedge fund regulatory regime

First, let’s clarify the facts. While across the global markets there has been a slew of new legislation and rules since the 2008 financial crisis aimed at bringing hedge fund managers under the oversight of regulators, we in Hong Kong have always regulated hedge fund managers who operate in our market. Whether you manage assets for institutional clients or you offer your products to the public, without exception you are required to be licensed with, and supervised by, the SFC.

Our rules and regulations are clear, transparent and consistently applied. We do not wish your compliance costs to be higher than they need to be. Our statutory functions are to protect investors and maintain market integrity. As you will have seen from the proceedings






that those in charge of risk monitoring could not see the whole picture. In hindsight, we now know that there was one crucial regulatory blind spot – AIG. The insurer accumulated huge potential liabilities that went unnoticed and in the end it had to be bailed out by the US



*(i) Central clearing of standardized OTC derivative contracts*

As you know, the G20/FSB has made firm commitments on central clearing and reporting of OTC derivatives. The idea behind this is the desire to avert another AIG-



consultation paper in June this year. I hope that the industry will actively participate in the deliberation process, to ensure that our proposals are effective and practical.

### **Hedge fund transparency**

The hedge fund industry has a strong track record of responding to changing market conditions, including regulatory demands. There is, however, one particular area that I would urge you to do more, and that is transparency.

I understand that many of you have reservations over publicity. After all, hedge fund products are sold to a limited circle of investors. The hedge fund is not systemically important. However, we are seeing a gradual expansion of the hedge funds' investor base, from the super rich and endowments to pension funds and funds of funds. Whether you like it or not, the high profile successes, or failures of hedge funds and their star managers reported in the media have forever changed the way the public looks at this sector. The days of quietly trading and making money in your garage away from the prying eye of the public are gone. They went, if not before then certainly when the public learned of fraud scandals like Madoff, and insider dealing sentences like the 11-year prison term handed down to Galleon's Raj Rajaratnam. Some hedge fund managers tell me that greater transparency could reveal their trading strategies or proprietary technologies, or could expose them to populist or political backlash. But these issues are not confined to hedge funds. Players from other financial and non-financial industries face, and successfully manage, such challenges.

More communication fosters trust. Investors who hand over their money would understandably want to know more about how it is used and safeguarded, and that their hedge fund managers are completely upfront with them.

And it is not just investors. We would like you to be actively engaged with regulators as well. The regulatory landscape of the financial industry is undergoing seismic shifts. The ultimate goals of the reforms are clear and have been agreed by world leaders. But how we get there is still being mapped out. We hope to find the most practical solution, one that would deliver results with the least disruption to the industry. To that end, we need your ideas. AIMA has been willing to engage with us in our policy deliberations and reform proposals. For this we are very appreciative. We would like each of you to know that our doors are always open and that we would benefit from the opportunity of hearing your views whether on the global economy, market trends, or our regulatory proposals.

### **Opportunities for hedge funds managers in Hong Kong**

I have been talking quite a bit about regulation and how the industry should respond to it. Before I wrap up, I would like to spend a few minutes to look ahead at the opportunities that are available to the industry in Hong Kong.

While current investments in mainland China represents just over one-tenth of the hedge fund assets managed in Hong Kong, I trust that many of you who are based here have in mind opportunities arising from the liberalisation of the RMB and gradual opening of the Mainland's capital market.

Hong Kong is of course best placed to capture these opportunities. I need not repeat here the well rehearsed arguments in Hong Kong's favour – like the rule of law, pool of talents, world class infrastructure, etc. Let me, instead, explain it in real commercial terms. Hong



Kong is the Mainland's offshore international market that could access the rest of the world for the Mainland while the Mainland is not ready to do so itself. The Mainland therefore has a strategic interest in Hong Kong's continued development as an international financial