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Plenary 1

**Impact of the Internet on the Functioning and Regulation of
Markets**

*6. Securities Market Regulation in the Internet Age,
Speech by Dr. Zhou Xiaochuan
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**Securities Market Regulation in the Internet Age
(Speech at the 2001 IOSCO Annual Conference)**

Dr. Zhou, Xiaochuan
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Mr. Chairman, Ladies and Gentlemen

I am delighted to participate in the IOSCO annual conference this year. Stockholm is “one of the most wired cities in the world”. It is of special significance for us to explore here the revolutionary impact of Internet on the securities markets, and the new challenges that we are facing. I would now like to share with you some of my thoughts on the topic.

1. New Developments in Securities Markets in the Internet Age

Major advances in information and communication technology have always deeply influenced the shaping of securities markets. The inventions of telegraph, telephone and Internet marked milestones of securities market development. Internet technology has now become a major driving force to the market evolution, extending enormous impact on market participants and regulators, and changing the patterns of securities issuance, trading, clearing and settlement, and information dissemination.

In recent years, China's communication and information technology developed rapidly. Internet users have reached 30 million, of which, one million access Internet by mobile phone or over broadband. There are more than a quarter million websites in Chinese. According to a recent report of the China Internet Information Center (CNNIC), more than 50% of the people surveyed believed that on-line securities trading has a great potential.

E-finance is fast expanding. Internet trading lowers the costs of entry. More investors enter the market. Diversified and personalized services are provided. Chinese securities firms started brokerage on the net in 1997. Last year, CSRC issued regulations, which established a licensing system for the Internet securities brokerage. At present 33 brokerage firms have been licensed to carry out such services. Within the first quarter this year, over 2.4 million investors, representing 8% of total investors and about 10% of all Chinese Internet subscribers, delivered their orders on the net, constituting 3.6% of total trading volume. More than 20% of new investment account holders are engaging in Internet trading, and the majority of B share investors are active traders on the net.

Internet technology has significantly enhanced information disclosure. Starting last year, companies undertaking IPOs are required to conduct on-line road shows. And currently financial statements, interim announcements and other relevant documentation of the listed companies are obligated to disclose entirely on the websites of the stock exchanges. These financial statements enjoyed 90 million investor visits. 5.7 million of downloads or an average of 5000 downloads for each listed company were made. In an emerging market like China's, Internet is enabling a large number of new investors to leap frog to the new way of information access.

Internet facilitates the breaking down of traditional walls between financial services. “On-line Financial Supermarket” based on a single website has become a new model for financial service providers. Because of the current laws and regulations, China’s financial system, at present, is still of Glass-Steagall type. But market force has already created overlaps among banking, securities and insurance operations. Some of our financial institutions established account linkages among different types of financial services on a single website.

Internet technology would also prove to be a supplementary method for improving corporate governance. On-line dissemination improves communication between listed companies and retail investors. Shareholders can voice their own opinions on corporate governance in a new way. We are now studying the feasibility of proxy votes via the Internet so that investors can conveniently participate in shareholders meetings, and at low costs.

Market structure and trading systems are also in the midst of changes. Alternative trading systems and the rise of virtual exchanges challenge the position of traditional securities exchanges. Many securities exchanges started to consider or have already carried out such plans as mergers, alliances, demutualization and public listings. These activities have speeded up the process of globalization and are reshaping the international capital markets.

2. New challenges confronting securities markets

i. Market information

Along with the broad use of Internet by the securities industry, the number of entities disseminating information has dramatically increased. Together with this have come the problems of data quality, reliability and “information explosion”, which are posing an extremely difficult problem for regulators. We are pleased to see the expansion in the amount of information disclosure, which is conducive to the reduction of information asymmetry. On the other hand, we are mindful of the mounting use of the Internet to fabricate and disseminate misleading information, to provide false advice, defraud investors and manipulate the market.

Due to imbalances in regional development and differing standards in infrastructure and application, investors are experiencing significant differentials in timeliness and convenience of accessing information. This leads to “information divide” and the problem of unequal access to information between Internet and non-Internet users. We are also concerned with the investors’ capacity of “digesting information” as a result of information explosion.

ii. Technology reliability

With the increasing level of Internet application, participants in the markets upgrade and renovate technology of their operation systems. The security, reliability and stability of information and communication technology (ICT) become prominent. The speedy dissemination of information and broad use of new technology may, at the same time, amplify the risks in the markets. The ICT problems of securities firms and the stock exchanges may result in trading losses to investors, hurting investor’s confidence and shaking the markets.

iii. The shift of market structure

With more and more individual investors entering into the market directly, exchanges and

securities firms, all endeavor to change the way they organize themselves in order to meet the needs of investors. After demutualization and public listing of the exchanges, how to handle public interests and their own interests have already drawn public attention. Some securities firms become universal financial groups operating on the global basis. IT firms extend their business into the securities industry. It is still uncertain how these will affect the regulatory institutions .

iv. Law enforcement

Obviously, Internet makes law enforcement more challenging. The complexity of Internet technology greatly increases the difficulty to effectively monitor on-line information. It is reported that the success rate for investigating and handling the fraud cases are relatively low. Enforcement officers need to continuously update their IT knowledge and technical methods. It will take some time for the current legislation to be adapted to the new technology. As an emerging market, we feel similar kind of pressure.

v. Regulatory structure

The Internet economy expedites the process of market globalization. Changes in the market structure unveil vacancies of regulation. While national borders for Capital flows and financial transactions become blurred, their mutual influence becomes clearer. Cross border financial fraud and crime multiplied. Applying laws of home or host country remains controversial. International cooperation on the borderless market and between national regulators have become more important than ever before.

3. New agenda for securities market regulators

i. Internet as a tool for investor education

Confronting the dazzling problems in the Internet age, investor education is of paramount importance. After all, it is investors who are responsible for their investment decisions. Our job is to see to it that the investors are equipped with sufficient knowledge to formulate their own judgment. Internet is an effective tool to strengthen investor education. As I mentioned before, CSRC has already required exchanges, intermediaries and the media to establish reliable and credible educational web pages and programs. We have also designated one of our departments to lead the educational programs. In addition, we are exploring other possible ways and means of investor education comparable to the characteristics of our massive investors in the market.

ii. Enhancing cooperation

Strengthening the inter- and intra-jurisdiction cooperation of regulatory agencies can lead to improved regulatory effectiveness. We have established an inter-agency committee, composed of banking, securities and insurance regulators, to coordinate, *inter alia*, policy concerning IT issues on financial sectors.

Cooperation in enforcement and information exchange between jurisdictions, no doubt, plays an irreplaceable role in the Internet Age. MOU (Memorandum of understanding) among agencies, as an effective institutional arrangement, establishes a firm foundation for combating cross-jurisdiction crimes.

In inter-jurisdiction cooperation, multinational organizations can play a unique role. We appreciate the efforts IOSCO has made in this regard and we encourage IOSCO to further strengthen multilateral cooperation.

iii. Capacity building

The effect of Internet penetration goes beyond our traditional organization capability. We are committed to capacity building, organizational adjustment and upgrading of technical measures. It is more important than ever before to develop regulatory personnel who are specialized in and adapted to new technology. At the same time regulators should maintain high quality technology specialists. We noticed that many securities regulatory agencies have established IT committees to keep up with advances of technology. We, too, have established such a committee to coordinate the related activities among various departments.

iv. Expanding the basis for public participation in decision making, encouraging technology improvement and institutional innovation

There is a spectrum of issues on our agenda. Important of all is that Internet allows broader public participation in the solution of problems and formulation of public policy. CSRC welcomes responses to and recommendations on our IT related policies from the market. Our communication with market participants through CSRC website is encouraging. This is helpful in improving the transparency of the policy making process and enlarging the social base for law enforcement.

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Honorable Chairman, ladies and gentlemen:

In conclusion, I would like to emphasize that regulators should foster an enabling environment for innovation and competition, since these are the inherent driving forces of market development. In the Internet Age, we face daily changes in technologies and see remarkable market innovations. We firmly uphold the time tested regulatory principles, protect the interests of investors, and seek to give it new expressions in this new era.

Thank you.