31st Annual Conference of
The International Organization of Securities Commissions (IOSCO)

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Hong Kong

Opening Ceremony

The Hon. Rafael S.Y. Hui, GBS, JP

Acting Chief Executive
Hong Kong Special Administrative Region

Executive Committee Chairman Ms Diplock, Technical Committee Chairman Mr Prada, Emerging Markets Committee Chairman Dr Cansizlar, Secretary General Mr Richard, SFC Chairman Mr Wheatley, Honourable delegates, distinguished guests, ladies and gentlemen,

Good afternoon, I would like to warmly welcome all of you to this Conference including those of you from abroad, to Hong Kong - Asia's world city.

Six months ago, Hong Kong successfully hosted the 6th Ministerial Conference of the World Trade Organization. Today, I am pleased to raise the curtain on yet another world-class event. Hong Kong is deeply honoured to be the host of the 31st Annual Conference of the International Organization of Securities Commissions.

IOSCO has been instrumental in raising the standards of securities regulation around the globe. As a member, the Hong Kong Securities and Futures Commission, the SFC, actively participates in IOSCO's work. Our SFC is represented on all five Standing Committees of the Technical Committee, working closely with its overseas counterparts in tackling the world's most pressing regulatory issues. The Hong Kong Special Administrative Region Government is proud that the SFC was elected Chairman of the Presidents' Committee for 2006 and the host jurisdiction for this conference.

We are meeting at a time when it seems that the world economy has never been better. GDP worldwide grew by around 5% in real terms in both 2004 and 2005, and is expected to grow at a similar pace this year.

In line with the robust growth in the real economy, the financial markets have also done very well in the past few years. Global financial assets, as estimated by McKinsey, amounted to 136 trillion US dollars, which is one and a half times their size a decade ago. Reflecting in part robust global demand, the Commodity Research Bureau Index has doubled in five years. During April to early May this year, just before the recent pullback in share prices, the global equity market, as measured by the MSCI World Index, rose to its highest level since the bursting of the tech bubble in March 2000.

In Hong Kong, our stock market has been very buoyant this year. Daily turnover in the Hong Kong stock market is at a historical high, averaging more than 30 billion Hong Kong dollars per day, some 70% above that of the previous year, and 3 times that of the year of SARS in 2003. The Hong Kong Stock Exchange has helped raise about 21 billion US dollars last year through IPOs, mainly for Mainland companies. As a result, Hong Kong attained the No. 1 position in terms of IPO fund raising in Asia and 3rd in the world last year. In terms of total equity fund raised in 2005, Hong Kong ranked 5th in the world and 1st in Asia. The Bank of China, which made its debut on the Stock Exchange of Hong Kong last week, is one of the world's biggest IPOs in recent years.

Even though all the cylinders of world growth seem to be firing at full speed, financial markets reaching new highs and corporate balance sheets at one of the strongest levels across the globe, there is no room for complacency for the regulators, investors and market participants. I say this for a number of reasons.

First, until very recently, the world is going through a phase of exceptionally low interest rates for seemingly hard-to-understand reasons, once dubbed "conundrum" by Alan Greenspan. It wasn't too long ago that the official overnight rates set by central banks were zero in Japan, 1% in the US and 2% in the euro area. Some reckon that these levels were the lowest in the past decades. As a result, there was, and still is, ample liquidity scouring the world in search of higher yields, particularly in emerging-market assets. A significant portion of these fund flows has come to Asia, the fastest-growing region. Even taking into account of the fact that the fundamentals of many emerging market economies have improved significantly since the Asian Financial Crisis, there are clear signs as reflected in bond yields and credit spreads that risks have not been adequately priced by investors due to this exceptionally high level of liquidity. Once the low interest rate cycle ends, as it now seems to be the case, the unwinding of global imbalances may cause a major reduction in liquidity and a sharp reversal of flows into the emerging markets. This will certainly pose risks to the financial markets and investors.

The second reason relates to the high volume and great complexity of new financial instruments for risk transfer, notably the financial and credit derivative products. These instruments are supposed to reduce the overall risk of the financial markets or participants through the diversification of risks to a broader group of investors. However, inadequate trade processing infrastructure and risk management may actually magnify rather than reduce risks. As these products are mostly traded over-the-counter, the trading activities are basically very opaque, posing challenges for regulators on measuring or capturing the financial system's effective exposures. Even for individual firms engaged in these trading activities, measuring and aggregating credit exposures to counterparties require sophisticated techniques.

The third reason is the growing prominence of hedge funds and other largely unregulated entities in our financial system today. Highly leveraged institutions did pose a challenge to systemic risk in Asia during 1997-1998, but hedge funds have evolved a lot since then to become an important market component adding liquidity, dispersing risks and increasing diversity in market participants. But I am not sure whether there is sufficient transparency in transactions involving hedge funds to allow regulators to understand and manage the risks involved in the exposure of commercial and investment banks to these firms. Almost a decade after the Asian crisis and with hedge fund assets having grown to about 1.5 trillion US dollars, securities regulators are still debating whether or not, and if so, how hedge funds should be regulated. This Annual Conference would provide a good platform to exchange views on these issues.

Ladies and gentlemen, the correction in commodity prices and global equities, particularly emerging market equities, since mid-May has served as a useful reminder to us that the liquidity which has swarmed markets in the past few years could make an exit just as fast. Between 11 May and 22 May, virtually all major equities markets were off at least 4% with some emerging markets particularly hard hit, having fallen by 15% to 25%. Should well-anchored long-term inflation expectations be disrupted, the markets may be braced for a period of increased volatility.

Asia is no stranger to volatile and destabilizing capital flows. The recent correction has evoked doomsayers' fear of a return of the Asian financial crisis or the 1987 global stock market meltdown. I wish to point out however that we have learnt our lessons well from the

Asian crisis. Since 1998, Asian economies have added a total of more than 1.7 trillion US dollars in reserves, run huge current account surpluses, cleaned up the banking sectors and strengthened banking and securities regulatory regimes. In Asia, we now have a corporate sector which is much less leveraged and a financial sector much more resilient than before to cope with sudden shocks or exit of capital flows that were so disruptive to Asia's financial systemic stability during 1997-1998.

In addition, we spare no efforts in strengthening international cooperation. In the case of Hong Kong, the SFC has signed 36 bilateral or multilateral cooperation arrangements with regulatory bodies worldwide. Over the years, our SFC has been working closely with overseas regulators, exchanging information and rendering assistance over enforcement and licensing-related matters. The SFC will continue its efforts in this regard, and certainly, maintain an active role in the work of IOSCO.

Notwithstanding these accomplishments, this is a time for greater vigilance on the part of regulators and market participants. Financial institutions should be vigilant in managing their risks. Securities regulators should be vigilant of possible systemic implications on market liquidity and price volatility arising from the unwinding of large positions taken by hedge funds and other institutional investors, particularly in the more concentrated segments of the market. To improve the quality of information for risk assessment, there is, I believe, a need for better access to data, especially those relating to financial derivatives and to hedge fund activities, more stress testing to ensure the resilience of the market players, and increased regulatory cooperation across jurisdictions. It is essential that the regulators, financial institutions and other market participants are well equipped to anticipate and, more important, withstand shocks arising from sudden reversal in market conditions. In this connection, I am confident that IOSCO, in collaboration with other international bodies, will continue its work and effort in reducing market vulnerabilities and enhancing resilience of the financial system.

Ladies and gentlemen, in these two days you will be sharing ideas and insights on a range of important issues that impinge on the future development of the financial services industry. I wish you all a fruitful conference. For delegates who are visitors to this exciting city, I encourage you to take time out of your busy schedule to experience Hong Kong's many attractions.

Thank you.

Ends/Wednesday, June 7, 2006