

Hong Kong Stock Market



In his March 1999 Budget speech, Hong Kong's Financial Secretary announced a package of reforms to enhance Hong Kong's competitiveness as an international financial center. This included a comprehensive reform of the stock and futures markets. The reforms were designed to increase competitiveness and meet the challenges of an increasingly globalized market.

HKEx

Under the reform, the Stock Exchange of Hong Kong Ltd (SEHK) and the Hong Kong Futures Exchange Ltd (HKFE) were demutualized and on 6 March 2000 merged with the Hong Kong Securities Clearing Company Ltd (HKSSC) to become a single holding company, Hong Kong Exchanges and Clearing Ltd (HKEx). HKEx listed itself on SEHK on 27 June 2000, thus becoming the world's second bourse to go public.

HKEx is thus the holding company of the Stock Exchange of Hong Kong Ltd, the Hong Kong Futures Exchange Ltd and Hong Kong Securities Clearing Company Ltd. It brings together the market organizations which have transformed Hong Kong's financial services industry from a domestic focus to the global player it is today.

SECURITIES MARKET

Reports of securities trading in Hong Kong go back to the middle of the 19th century. The first formal market, the Association of Stockbrokers in Hong Kong, was not set up until 1891. The Association became the Hong Kong Stock Exchange in 1914.

A second exchange, the Hong Kong Stockbrokers' Association was incorporated in 1921. The two exchanges merged under the name of the Hong Kong Stock Exchange in 1947 and re-established the stock market after the Second World War.

Rapid growth of the Hong Kong economy led to the birth of three other exchanges - Far East Exchange in 1969; Kam Ngan Stock Exchange in 1971; and Kowloon Stock Exchange in 1972.

Pressure to strengthen market regulation and to unify the four exchanges led to the incorporation of the Stock Exchange of Hong Kong Ltd in 1980. The four separate exchanges ceased business on 27 March 1986 and the new exchange started trading through a computer-assisted system.

DERIVATIVES MARKET

Set up in 1976, the Hong Kong Futures Exchange Ltd is a derivatives leader in the Asia-Pacific region. It provides efficient and diversified markets for trading futures and options contracts by its more than 130 participant organizations, including many that are affiliated to international financial institutions.

The derivatives market under HKEx operates futures and options markets on a broad range of products, including equity index, stock and interest rate. HKEx and its subsidiaries, HKFE Clearing Corp Ltd and SEHK Options Clearing House Ltd, operate a rigorous risk management system which enables participants and their clients to meet their investment and hedging needs in a liquid and well-regulated market place.

STOCK SETTLEMENT

Hong Kong Securities Clearing Co Ltd (Hong Kong Clearing or HKSCC) was incorporated in 1989. It was recognized as a clearing house under the Securities and Futures (Clearing Houses) Ordinance and was under the supervision of a statutory regulator, the Securities and Futures Commission.

The SEHK provided 50% of the company's HK\$50mn guarantee. The balance was provided in equal shares of 10% by each of the five leading banks:

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- △ *Bank of China*
 - △ *Hang Seng Bank*
 - △ *Standard Chartered Bank*
 - △ *Bank of East Asia*
 - △ *HSBC*
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HKSCC owns and operates the Central Clearing And Settlement System (CCASS), which it created in 1992, and provides clearing and settlement services for all eligible securities listed on the Stock Exchange of Hong Kong (SEHK). The company also offers a nominee service.

It used to be a non-profit independent entity which invested surpluses in its infrastructure and in reducing fees charged to its users. From the introduction of CCASS in 1992 to 1999 stock settlement fees were cut by 80%. Hong Kong Clearing is now a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Ltd (HKEx).

CCASS

CCASS is a computerized book-entry clearing and settlement system for securities listed on the Stock Exchange of Hong Kong (Stock Exchange). It started operating in 1992 and became the central counterparty for all CCASS participants.

The clearing operation is based on the immobilization of share certificates in a central depository. Share settlement is on a continuous net settlement basis by electronic book entry to participants' stock accounts in CCASS. Transactions between CCASS participants are settled on T+2, the second trading day following the transaction.

Before the establishment of CCASS, trades were settled by physically exchanging share certificates for checks. As a result, settlement backlogs and late deliveries were common, especially when market turnover was high.

As an electronic book-entry system, CCASS increases efficiency and competitiveness of Hong Kong's stock market by reducing the time needed to clear and settle securities transactions. CCASS also eliminates the risks associated with the physical transfer of share certificates and checks. Since the establishment of CCASS, the stock market has experienced record-high trading volumes and periods of extreme volatility. Despite these challenges, CCASS has maintained its reputation for security, reliability and efficiency.

Hong Kong Clearing guarantees the settlement of all Stock Exchange trades settled under the Continuous Net Settlement (CNS) system, by becoming the settlement counterparty for both buying and selling brokers. This protects the market as a whole; by reducing the risk that one broker's default could cause a chain-reaction that leads to defaults by other brokers.

All trades executed on the SEHK must be settled through CCASS. Trade data is transferred automatically to CCASS through an interface with the SEHK's automatic order-matching and execution system.

HANG SENG INDEX



The Hang Seng Index HSI International Ltd, a wholly-owned subsidiary of Hang Seng Bank and a sister company of HSI Services Ltd, was founded as a vehicle to form joint index-related ventures or partnership projects with external parties. The FTSE/Hang Seng Indexes are the first such index-related joint project of HSI International Ltd.

Founded in 1984, HSI Services Ltd, a wholly-owned subsidiary of Hang Seng Bank, manages and compiles the Hang Seng family of indices including the Hang Seng Index, Hang Seng Composite Index Series, Hang Seng London Reference Index and Hang Seng Asia Index. First published in 1969, the Hang Seng Index has become the key barometer of the Hong Kong stock market.

Pls go to http://www.amcham.org.hk/hongkong/establishing_office.html to view web edition supplements.

SECURITIES AND FUTURES COMMISSION OF HONG KONG

The Securities and Futures Commission (SFC) is an independent statutory body responsible for administering the laws governing securities and futures markets in Hong Kong, while facilitating and encouraging development of these markets.

The SFC is divided into four operational divisions: Corporate Finance, Intermediaries and Investment Products, Enforcement, and Supervision of Markets. The Commission is supported by the Legal Services Division and Corporate Affairs Division.

The SFC's statutory regulatory objectives as set out in the Securities and Futures Ordinance 2002 are:

- △ *to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;*
- △ *to promote understanding by the public of the operation and functioning of the securities and futures industry;*
- △ *to provide protection for members of the public investing in or holding financial products;*
- △ *to minimize crime and misconduct in the securities and futures industry;*
- △ *to reduce systemic risks in the securities and futures industry; and*
- △ *to assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.*

The package of reforms introduced by the Financial Secretary in March 1999 and referred to above, also included an overhaul of all existing legislation governing the operation of the securities and futures market. As a result, the Securities and Futures Commission Ordinance and nine other securities and futures related ordinances were consolidated into a new Securities and Futures Ordinance, which was passed by LegCo on 13 March 2002 and came into operation on 1 April 2003.

CHINESE IPOs

From 2005 till the first quarter of 2007, Chinese companies wanting to go public have been debuting either in Hong Kong or Singapore. Small and medium-sized enterprises (SMEs) tend to list on the Singapore Stock Exchange, big firms list in Hong Kong: US\$22 billion ICBC IPO in September 2006; US\$9.73 billion Bank of China IPO in May 2006; US\$9.2 billion China Construction Bank in October 2005; and US\$1.9 billion Bank of Communication IPO in June 2005.



ICBC had the biggest IPO ever last year when it raised US\$22 billion during its listing of H-shares*. Most of the large Chinese state-run enterprises have listed on the HKEx, while the smaller manufacturing companies are listing in Singapore. However, since

the Shenzhen and Shanghai stock exchanges were re-opened last year, the securities regulator has been encouraging companies to list on the Mainland exchanges. There is even an unwritten policy of having Chinese companies list on the Mainland rather than in Hong Kong, which has forced HKEx to look further afield for companies to list on the Exchange.

Last year, on the backs of the largest Mainland IPOs the HKEx became the second-largest IPO center behind the London Stock Exchange, knocking the New York Stock Exchange into the third spot. Total market capitalization of the Mainland enterprises on the Exchange was HK\$6.7 trillion (US\$869 billion) as of end-December 2006, which amounted to 50% of Hong Kong's total market capitalization.

Why Hong Kong? There are a number of reasons to consider. It is an international city where 70 of the world's top 100 banks are located; Hong Kong's governance is on par with international standards, forcing Chinese banks to be more transparent and accountable, while the China Securities Regulatory Commission (CSRC) only reformed its securities rules in 2006. And to date, Chinese companies listed in Hong Kong are more transparent than their counterparts on the Mainland.

Yet, some investors are worried. David Webb, Hong Kong's leading shareholder activist, stated in 2006 that "there has been a tendency for rulemakers to lower the bar. Ultimately, that undermines quality and jeopardizes our future as a market." (See website: www.webb-site.com)

**H-share companies are companies incorporated in the People's Republic of China and approved by CSRC for a listing in Hong Kong. Shares in these companies are listed on the Stock Exchange, subscribed for and traded in Hong Kong dollars, or other currencies, and referred to as H-shares. The letter H stands for Hong Kong. Source: Hong Kong Exchange.*

Two amendments were announced in February 2006 and came into effect in May 2006. The expansion and change in composition of the listing committee, which is responsible for all listing matters, helps to make the committee more representative of the marketplace, especially with investors becoming involved, who were previously not represented on the committee.

AMENDMENTS REGARDING THE COMPOSITION OF THE LISTING NOMINATING COMMITTEE

Rule 2A.21 provides that the persons eligible for appointment or re-appointment as members of the Listing Committee shall be nominated by the Listing Nominating Committee comprising the Chief Executive of the Exchange and two members of the Board of Hong Kong Exchanges and Clearing Limited (HKEx) and the Chairman and two Executive Directors of the Securities and Futures Commission.

Amendments to rule 2A.21 provide for a change to the composition of the Listing Nominating Committee such that the HKEx representatives will be three non-executive members of the HKEx Board rather than two members of the HKEx Board and the Chief Executive of the Exchange.

AMENDMENTS REGARDING THE COMPOSITION OF THE LISTING COMMITTEE

The Listing Rules will also be amended to:

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- Δ expand the Listing Committee to comprise at least 28 members (that is, 28 members or such greater number as the Exchange Board from time to time agree) increased from the current membership of 25;*
 - Δ change the composition of the Listing Committee to include at least eight investor representatives, the HKEx Chief Executive and nineteen members who are a suitable balance of listed issuers and market practitioners including lawyers, accountants, corporate finance advisers and brokers; and*
 - Δ in recognition of the fact that Listing Committee members may become more effective as they gain experience on the Listing Committee and consistent with Government best practice, extend the current term for Listing Committee members to six years excluding any period of appointment to fill a casual vacancy. As with the current arrangements (in rule 2A.25), Listing Committee members would not be eligible for re-appointment for at least two years after completing a maximum term save in exceptional circumstances.*
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